


2016

## A Cautionary Look at a Cautionary Doctrine

Andrew W. Fine

Follow this and additional works at: <http://brooklynworks.brooklaw.edu/bjcfcl>

 Part of the [Banking and Finance Law Commons](#), [Business Organizations Law Commons](#), [Commercial Law Commons](#), [Common Law Commons](#), [Consumer Protection Law Commons](#), [Judges Commons](#), [Jurisprudence Commons](#), [Legal History Commons](#), [Litigation Commons](#), and the [Securities Law Commons](#)

---

### Recommended Citation

Andrew W. Fine, *A Cautionary Look at a Cautionary Doctrine*, 10 Brook. J. Corp. Fin. & Com. L. ().

Available at: <http://brooklynworks.brooklaw.edu/bjcfcl/vol10/iss2/8>

This Note is brought to you for free and open access by BrooklynWorks. It has been accepted for inclusion in Brooklyn Journal of Corporate, Financial & Commercial Law by an authorized administrator of BrooklynWorks. For more information, please contact [matilda.garrido@brooklaw.edu](mailto:matilda.garrido@brooklaw.edu).

# A CAUTIONARY LOOK AT A CAUTIONARY DOCTRINE

*“Good corporate governance is a system in which those who manage a company – that is, officers and directors – are effectively held accountable for their decisions and performance. But accountability is impossible without transparency.”<sup>1</sup>*

## ABSTRACT

*Optimism is an indispensable element of effective salesmanship. It is therefore quite natural for the directors of public companies to want to optimistically tout the potential long-term benefits of investing in their companies. After all, directors of public companies must be empowered to attract the attention and money of American investors. But what happens if these long-term projections fail to come true? Who is to blame for long-term projections that are simply unrealistic? A doctrine called the “bespeaks caution” doctrine has emerged in order to govern these inquiries, and holds that these optimistic forward-looking statements are legally immunized provided that they are sufficiently tempered with “meaningful” cautionary language in accompanying stock offering documentation. Such cautionary language must operate to put investors on notice that their investment is merely speculative, and that returns on investment are not guaranteed. Through this doctrine, public companies are protected against lawsuits brought by disappointed investors scrounging for settlement handouts when their investments fail to yield return.*

*The structure of this doctrine, of course, begs the question: what constitutes “meaningful” cautionary language? In recent years, circuit courts have been split on this issue, and remain divided about whether stock-issuing companies are required to truly believe their optimistic forward-looking statement before they may be protected from shareholder lawsuits in the event that such statements fail to materialize. In other words, it is currently unclear under the law whether these forward-looking statements must be made in good faith in order to merit legal protection. This Note argues that the bespeaks caution doctrine should and must require that optimistic forward-looking statements be made in good faith in order to merit protection under the law. This Note proceeds by analyzing the current state of the bespeaks caution doctrine across various circuit courts, and continues by critiquing certain judicial decisions which applied the doctrine. It then proposes amendments to the doctrine, which aim to preserve the transparency and integrity of U.S. capital markets.*

---

1. Securities and Exchange Commission Chairman Mary L. Shapiro, Press Release, U.S. Sec. & Exch. Comm’n, SEC Approves Enhanced Disclosure About Risk, Compensation and Corporate Governance (Dec. 16, 2009), <https://www.sec.gov/news/press/2009/2009-268.htm>.

## INTRODUCTION

Optimism is an indispensable element of effective salesmanship. To attract purchasers to a product, a seller might optimistically tout a product's current and long-term advantages. Sellers of stock may feel similarly compelled to advertise the potential long-term benefits of investing in their company. In fact, such practice has become the norm; stock sellers routinely advertise their stock through optimistic projections, or "forward-looking statements," contained within offering documentation.<sup>2</sup> These forward-looking statements are understood to be a type of "soft information," which generally includes "opinions, predictions, analyses, and other subjective evaluations" of a company.<sup>3</sup>

Historically, the Securities and Exchange Commission (SEC) prohibited issuing companies—companies that sell stock to the public—from including forward-looking statements in SEC filings or annual shareholder reports.<sup>4</sup> This prohibition was relaxed, however, in 1977 when the SEC Advisory Committee on Corporate Disclosure (Advisory Committee) codified Rule 175 of the Securities Act of 1933 (Securities Act) in order to encourage more open communication between investors and issuing companies.<sup>5</sup> Rule 175 facilitated this communication by permitting the inclusion of forward-looking statements in SEC filings, but also by offering legal immunity to forward-looking statements that were made in good faith and upon a reasonable basis.<sup>6</sup> This meant that investors could not sue issuing companies when their optimistic forward-looking statements failed to come true provided that the statement was made in good faith. Congress later supplemented and ultimately overshadowed Rule 175 by enacting similar provisions in the Private Securities Litigation Reform Act of 1995 (PSLRA),<sup>7</sup> which amended both the Securities Act and the

---

2. See Erin M. Hardtke, *What's Wrong With the Safe Harbor for Forward Looking Statements? A Call to the Securities and Exchange Commission to Reconsider Codification of the Bespeaks Caution Doctrine*, 81 MARQ. L. REV. 133, 138–39 (1997) (citing *In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850 (N.D. Cal. 1993)); *Rubinstein v. Collins*, 20 F.3d 160 (5th Cir. 1994) (noting that offering documentation includes materials disclosed in connection with initial public offerings, secondary offerings, private placements, and any statement attached thereto); Ann M. Olazábal, *False Forward-Looking Statements and the PSLRA's Safe Harbor*, 86 IND. L.J. 595, 595 (2011).

3. Suzanne J. Romajas, Note, *The Duty to Disclose Forward-Looking Information: A Look at the Future of MD&A*, 61 FORDHAM L. REV. 245, 245 n.5 (1993).

4. *Id.* at 252.

5. See Hardtke, *supra* note 2, at 136; Anand Das, *A License to Lie: The Private Securities Litigation Reform Act's Safe Harbor for Forward-Looking Statements Does Not Protect False or Misleading Statements When Made with Meaningful Cautionary Language*, 60 CATH. U. L. REV. 1083, 1091 (2011); see also Commodity and Securities Exchanges, 17 C.F.R. § 230.175 (2011).

6. See Romajas, *supra* note 3, at 252; Hardtke, *supra* note 2; Commodity and Securities Exchanges, 17 C.F.R. § 230.15 (2014).

7. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995); 15 U.S.C. § 78u-4 (2012).

Securities Exchange Act of 1934 (Exchange Act).<sup>8</sup> The PSLRA's "safe harbor" provision similarly grants conditional legal immunity to forward-looking statements when such statements are sufficiently tempered by "meaningful cautionary language."<sup>9</sup> PSLRA, however, abandoned the strict and unconditional good faith condition of Rule 175.

While these codifications demonstrate that the SEC now tolerates forward-looking statements in issuing documentation, the PSLRA's lack of legislative guidance on the safe harbor's conditions has required courts to independently develop and refine the safe harbor's conditions.<sup>10</sup> Courts have done so by developing their own doctrine governing whether forward-looking statements are to be granted legal immunity in light of cautionary disclosures. This doctrine actually predated the PSLRA's safe harbor. Interestingly enough, the Conference Committee that promulgated the PSLRA expressly recognized the established nature of the doctrine, and even went as far as to "use[] it as a basis in its drafting of the legislation."<sup>11</sup> This doctrine—which has become known as the "bespeaks caution" doctrine (the doctrine)—evolved from a footnote, contained in an Eighth Circuit Court of Appeals decision, *Polin v. Conductron Corporation*.<sup>12</sup> Over time, the doctrine evolved into the prevailing judicial standard for assessing whether an issuing company's forward-looking statements merit legal immunity against claims of fraud or misrepresentation.<sup>13</sup> Circuit courts have routinely applied the doctrine to a wide range of forward-looking statements, including "statements made in offering documents for initial public offerings, secondary offerings, private placements, limited partnerships, as well as statements made in documents attached to offering materials."<sup>14</sup>

---

8. Jordan D. Hershman & Inez H. Friedman, *A Truly Safe Harbor for Forward-Looking Statements: Bespeaking Caution and "Meaningful Cautionary Language"*, in SECURITIES LITIGATION: PLANNING AND STRATEGIES 773, 775 (A.L.I.-A.B.A. Course of Study No. SC73, 1998).

9. *Id.*

10. Hardtke, *supra* note 2 (noting that the codification of SEC Rule 175 "never had a profound effect").

11. *Id.* at 154 (citing H.R. Conf. Rep. No. 104-369, at 46, *reprinted in* 1996 U.S.C.C.A.N. 730, 745).

12. *Id.*; *see also* *Polin v. Conductron Corp.*, 552 F.2d 797, 806 n.28 (8th Cir. 1977) (noting that an Annual Report "besp[oke] caution in outlook and f[ell] far short of the assurances required for a finding of falsity and fraud").

13. Das, *supra* note 5, at 1091.

14. Hardtke, *supra* note 2, at 138–39 (citing *In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850 (N.D. Cal. 1993)); *see also* *Rubinstein v. Collins*, 20 F.3d 160 (5th Cir. 1994); *Saltzberg v. TM Sterling/Austin Assocs.*, 45 F.3d 399 (11th Cir. 1995); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875 (1st Cir. 1991); *Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 949 F.2d 243 (8th Cir. 1991).

While the doctrine is broadly applied,<sup>15</sup> its conditions are rather difficult to reconcile with existing legislation; in fact, many judicial applications of the doctrine are largely incompatible with the original criteria for forward-looking statements under Rule 175.<sup>16</sup> For example, where Rule 175 once required that a forward-looking statement be made in good faith to merit protection,<sup>17</sup> the doctrine now stands devoid of any explicit good faith requirement in several circuits, including the Third, Sixth, Eighth, and Eleventh.<sup>18</sup> In these circuits, “allegations of fraud [are dismissed] where adequate disclaimers have been used . . . even if [the forward-looking statement is] known to be false when made.”<sup>19</sup> The doctrine’s judicial application is consistent only in the general requirement that forward-looking statements be accompanied by “meaningful cautionary language” in order to merit legal protection.<sup>20</sup> Unfortunately, issuing companies have gleefully exploited the ambiguity of this lenient “meaningful cautionary language” standard. Unless the judiciary addresses the issues arising from this standard, the integrity of the national securities industry is at risk of erosion.<sup>21</sup> Thus, the circuit courts must adopt a stricter standard incorporating both a good faith requirement and heightened specificity standards.<sup>22</sup>

This Note proposes a new and unambiguous standard through which forward-looking statements should be analyzed under the doctrine. This Note’s proposal is entirely reconcilable with the Supreme Court’s recent decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, which addressed the broader issue of whether an issuing company is liable for an opinion statement when facts surrounding that opinion undermined the opinion’s validity.<sup>23</sup>

---

15. Ann M. 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, 9–10 (2000) (noting that the bespeaks caution doctrine had been expressly “adopted by ten of the thirteen federal Circuit Courts of Appeal” by the year 2000, and that there exists “no bright line rule . . . as to what will constitute meaningful cautionary language in a particular case”); Hardtke, *supra* note 2, at 22.

16. See generally 4 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 12.9 (2014).

17. *Id.*

18. See Jennifer O’Hare, *Good Faith and the Bespeaks Caution Doctrine: It’s Not Just a State of Mind*, 58 U. PITT. L. REV. 619, 629 (1997); *In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850 (N.D. Cal. 1993).

19. Morris DeFeo Jr., Amanda Paracuellos & Kelly Howard, *When a Company’s Forward-looking Statements Find No Safe Harbor: Bespeaks Caution Doctrine Provides Alternative Protection*, CROWELL & MORING LLP (2006) [https://www.crowell.com/documents/DOCASSO\\_CFKTYPE\\_ARTICLES\\_404.pdf](https://www.crowell.com/documents/DOCASSO_CFKTYPE_ARTICLES_404.pdf) at 3.

20. Hershman & Friedman, *supra* note 8, at 775–76.

21. Das, *supra* note 5, at 1108.

22. HAZEN, *supra* note 16.

23. See *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015).

Part I of this Note explores the history of the bespeaks caution doctrine and considers its underlying justifications and statutory foundations. Part II examines the degree of specificity that reasonable investors should expect from an issuing company's cautionary disclosures. Part III investigates the appropriateness of integrating a good faith requirement into the doctrine by analyzing the consequences of *In re Espeed Inc. Securities Litigation*, a Southern District of New York decision that immunized a forward-looking statement despite the existence of facts that undermined the statement's validity.<sup>24</sup> Part IV analyzes the Supreme Court's recent *Omnicare* decision with respect to opinion liability, which appears to endorse a good faith requirement for the doctrine insofar as a forward-looking statement is considered a statement of "opinion."<sup>25</sup> Part V investigates the effects that factual context has had upon the doctrine's judicial application. Part VI proposes a new framework for providing sufficient cautionary language under the doctrine. This Note concludes that the proposed framework would best suit the underlying aims of the doctrine by reinstating a good faith condition.

## I. THE ORIGIN OF THE BESPEAKS CAUTION DOCTRINE

The 1929 stock market crash was a national disaster. However, it forced a pivotal lesson upon the nation: the securities industry must be policed by something stricter than laissez-faire regulation.<sup>26</sup> The severity of the crash reminded the nation of the profound importance of financial integrity and corporate transparency.<sup>27</sup> It also compelled Congress to draft reactive legislation for purposes of "foster[ing] fair play and insur[ing] [the future] integrity of the markets."<sup>28</sup> The resulting legislation was the Securities Act and the Exchange Act.<sup>29</sup> Both Acts contained anti-fraud provisions, such as Rule 10b-5,<sup>30</sup> engineered to ensure the accuracy and reliability of the information disclosed by issuing companies to the public.<sup>31</sup> The legislation was designed to secure a new era of corporate transparency—or so Congress had hoped.<sup>32</sup>

Prior to the 1970's, the SEC prohibited issuing companies from including forward-looking statements on their SEC filings, believing that

---

24. See generally *In re Espeed, Inc. Sec. Litig.*, 457 F.Supp.2d. 266 (S.D.N.Y. 2006).

25. See *id.*

26. See Das, *supra* note 5, at 1083–84.

27. *Id.* at 1084 (noting that "Federal regulation of the securities markets was a response to the 1929 stock market crash and the following Great Depression – a time when defrauding investors was highly prevalent.").

28. Elaine A. Welle, *Freedom of Contract and the Securities Laws: Opting Out of the Securities Regulation by Private Agreement*, 56 WASH. & LEE L. REV. 519, 535 (1999).

29. *Id.*

30. Commodity and Securities Exchanges, 17 C.F.R. § 240.10(b)-5 (2015).

31. Das, *supra* note 5, at 1084.

32. *Id.* at 1083–84.

such speculative information was “inherently unreliable” and subsequently threatening to market integrity and predictability.<sup>33</sup> In 1977, however, the Advisory Committee convinced the SEC to amend its disclosure policy in favor of more open communication between issuing companies and investors.<sup>34</sup> The result was the passage of Rule 175 of the Securities Act, which both endorsed and conditionally protected forward-looking statements contained in SEC filings that were reasonably supported and made in good faith.<sup>35</sup> The Advisory Committee emphasized the importance of these conditions, characterizing them as essential in ensuring that forward-looking statements were “reliable and truthful.”<sup>36</sup>

Subsequent legislation soon overshadowed Rule 175.<sup>37</sup> On December 22, 1995, Congress overrode President Clinton’s presidential veto to pass the PSLRA.<sup>38</sup> The passage of the PSLRA was controversial for its “safe harbor” provision, which like Rule 175, grants conditional legal immunity to optimistic forward-looking statements. Unlike Rule 175, however, the PSLRA’s safe harbor can grant immunity to forward-looking statements even when they are *not* made in good faith.<sup>39</sup> This is because the PSLRA’s safe harbor shields forward-looking statements in two circumstances: (1) when forward-looking statements are accompanied by meaningful cautionary disclaimers; *or* (2) when “the plaintiff fails to prove the statements were known to be false when made.”<sup>40</sup> This disjunctive “*or*” distinguishes the PSLRA from Rule 175. Rule 175 required forward-looking statements to be accompanied by meaningful cautionary language *and* made in good faith in order to merit protection. The PSLRA’s safe harbor only requires the satisfaction of one of those conditions.<sup>41</sup>

Thus, good faith considerations are irrelevant under the PSLRA if defendants can demonstrate that their optimistic forward-looking statements have been sufficiently tempered by accompanying meaningful cautionary language. Senators Paul S. Sarbanes (D-MD) and Barbara L. Boxer (D-CA) opposed the PSLRA’s safe harbor for this very reason. They warned Congress prior to the PSLRA’s passage that a safe harbor provision without an unconditional good faith requirement “would essentially immunize

---

33. Hardtke, *supra* note 2, at 136 (citing Safe Harbor Release, [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85, 436, at 85, 779); *see also* Romajas, *supra* note 3, at 252.

34. Hardtke, *supra* note 2, at 136.

35. Romajas, *supra* note 3, at 252.

36. STAFF OF H. COMM. ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION, 95TH CONG., THE 1977 ADVISORY COMMITTEE REPORT 346 (Comm. Print 1977).

37. *See* Hershman & Friedman, *supra* note 8, at 775.

38. *Id.*

39. *Id.*

40. DeFeo Jr. et al., *supra* note 19 (citing Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995)).

41. Hershman & Friedman, *supra* note 8, at 775.

fraudulent [forward-looking statements] from civil liability.”<sup>42</sup> Indeed, since the passage of the PSLRA, issuing companies have rushed to take advantage of this new and forgiving safe harbor.<sup>43</sup> Honesty was now optional.

It is important to bear in mind that Congress passed the PSLRA as an amendment to legislation that was ultimately intended to promote corporate transparency and ensure market integrity in the wake of the Great Depression.<sup>44</sup> The Statement of Managers accompanying the PSLRA declared that the PSLRA was enacted for similar reasons: to “protect investors and maintain [national] confidence in our capital markets.”<sup>45</sup> The safe harbor provision admittedly succeeds in protecting issuing companies against groundless misrepresentation suits by allowing early dismissal of frivolous claims.<sup>46</sup> However, statutory protection against frivolous lawsuits has imposed an egregious cost on investors: issuing companies may now deliberately misrepresent their prospects to the public, knowing that their misstatements are protected under the PSLRA by the mere inclusion of certain cautionary disclosures in offering documents.<sup>47</sup> In light of this consequence, the PSLRA’s statutory safe harbor for forward-looking statements actually undermines its purported purpose of protecting and informing investors.<sup>48</sup>

Misleading forward-looking statements in SEC filings can maliciously manipulate unsophisticated investors.<sup>49</sup> This is one of the reasons why the SEC traditionally prohibited forward-looking statements in the first place; it feared that forward-looking statements could “clothe . . . [accompanying] information with an unduly high aura of credibility.”<sup>50</sup> Cautionary disclosures in offering documentation thus serve the essential function of cautioning investors against unduly relying on forward-looking statements.<sup>51</sup> Under the first prong of the PSLRA’s safe harbor, cautionary disclosures must be “meaningful,” meaning that they must identify specific factors that could foreseeably influence the realization of the forward-

---

42. Das, *supra* note 5, at 1095; *see also* 141 CONG. REC. 19037-19060 (Dec. 21, 1995) (statement of Sen. Boxer) (expressing concerns that the safe harbor was a “license to lie,” and “even if [a] knowingly false statement is made, the defendant escapes liability if ‘meaningful cautionary statement[s] are added to the forward-looking statement’”).

43. Hershman & Friedman, *supra* note 8, at 775.

44. *Id.*

45. *Id.* at 775 n.1 (citing H.R. REP. NO. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 733).

46. Olazábal, *supra* note 2, at 2.

47. *See generally* HAZEN, *supra* note 16.

48. Welle, *supra* note 28, at 535 (noting that “[t]he securities laws are intended to foster fair play and insure the integrity of the markets”).

49. *Id.*

50. Romajas, *supra* note 3, at 249 (citing Carl W. Schneider, *Nits, Grits, and Soft Information in SEC Filings*, 121 U. PA. L. REV. 254, 258 (1972)) (noting the effect that formal review of SEC filings appears to have on investor reliance).

51. *See* Hardtke, *supra* note 2, at 140.



looking statement.<sup>52</sup> Phrasing cautionary language too generally will not suffice to warrant safe harbor protection under the PSLRA; disclosures must be specific and precise.<sup>53</sup> While these requirements sound conceptually promising, both the SEC as well as the corporations “rush[ing] to avail themselves” of the safe harbor have demonstrated very different understandings of this “meaningful” condition.<sup>54</sup> A year after the PSLRA’s passage in 1995, then-SEC Commissioner Wallman observed that “most of the [post-PSLRA] safe harbor language reviewed by the SEC staff is too boilerplate to qualify as ‘meaningful cautionary language’ under the [PSLRA].”<sup>55</sup> One year later, Former SEC Enforcement Director William McLucas stated at a securities seminar that the “meaningless, overly general or boilerplate”<sup>56</sup> cautionary disclosures that were being issued under the PSLRA “defeat[] the very purpose of the statute.”<sup>57</sup> He proceeded to warn that practice of relying on generalized risk disclosures “needs to be stopped in its infancy.”<sup>58</sup>

Alas, this practice was not stopped. Many corporations “continue to operate on the assumption that the largely boilerplate cautionary warnings that routinely accompany their written [forward-looking statements] . . . entitle them to [safe harbor protection].”<sup>59</sup> The validity of those assumptions depends entirely upon whether courts consider a corporation’s cautionary disclosures to be “meaningful.” Judicial analysis of this question has been dictated not only by statute, but also by common law developed outside the reach of the SEC.<sup>60</sup> That common law development resulted in the bespeaks caution doctrine, which has gradually become a “popular tool used by the courts when granting a motion to dismiss or a motion for summary judgment” in cases brought against issuing companies for alleged misrepresentation or fraud.<sup>61</sup>

The bespeaks caution doctrine acquired its name from a footnote in *Polin v. Conductron Corporation*, an Eighth Circuit case decided in 1977 concerning allegedly fraudulently misleading statements made in a proxy statement and annual reports.<sup>62</sup> The footnote stated that the allegedly misleading terms at issue “employed bespeak caution in outlook and [thus]

---

52. Hershman & Friedman, *supra* note 8, at 778.

53. *See id.* at 775–76.

54. *See id.*

55. *Id.*

56. *Id.* (citing the remarks of former SEC Enforcement Director McLucas at the PLI Securities Seminar on November 2, 1996).

57. *Id.*

58. “Those defrauding can hide the real reason that their fraudulent prediction will not come true and they cannot be sued.” 141 CONG. REC. S19037 (daily ed. Dec. 21, 1995) (statement of Sen. Boxer).

59. Hershman & Friedman, *supra* note 8, at 776.

60. *See Das*, *supra* note 5, at 1091.

61. Hardtke, *supra* note 2, at 137–138.

62. *See Polin v. Conductron Corp.*, 552 F.2d 797, 806 (8th Cir. 1977).

fall far short of the assurances required for a finding of falsity and fraud.”<sup>63</sup> After *Polin* was decided, the Second Circuit expanded upon this footnote through its decision in *Goldman v. Belden*,<sup>64</sup> which ruled against a corporation whose directors and officers knew of certain risks facing the company, but declined to disclose them to investors in the company’s offering documentation.<sup>65</sup> In its opinion, the Second Circuit reasoned, “there was no note of caution in the defendants’ statements and the defendants knew caution was warranted.”<sup>66</sup> *Goldman* thus, “fashioned a rule requiring that [earnest] cautionary language accompany forward-looking statements” in order for those statements to be protectable.<sup>67</sup> Given these origins, it appears that the bespeaks caution doctrine is primarily motivated by an interest in genuine corporate transparency.<sup>68</sup>

The modern bespeaks caution doctrine and the PSLRA’s safe harbor provision are so strikingly similar that commentators believe that the PSLRA “codified” the doctrine.<sup>69</sup> Indeed, the PSLRA’s safe harbor was itself “modeled” after the doctrine.<sup>70</sup> However, despite the doctrine’s “codification,” courts continue to apply and analyze the common law doctrine rather than the statutory safe harbor.<sup>71</sup> This is because the PSLRA lacks clear legislative guidance on the parameters and application of the safe harbor, which has inspired, and indeed required, the continued judicial development of a malleable doctrine.<sup>72</sup> The doctrine has consequently evolved into the prevailing standard for determining whether a forward-looking statement is immunized from claims of fraud or misrepresentation through accompanying cautionary language.<sup>73</sup> Its acceptance within the judicial community is overwhelming; circuit courts have applied the doctrine to statements made in connection with both private and public placements of stock.<sup>74</sup> Its widespread application in the courts is not surprising; Congress explicitly acknowledged in passing the PSLRA that

---

63. *Id.*

64. See generally *Goldman v. Belden*, 754 F.2d 1059 (2d Cir. 1985).

65. See *Das*, *supra* note 5, at 1091.

66. See *Goldman*, 754 F.2d 1068.

67. *Das*, *supra* note 5, at 1092.

68. *Hardtke*, *supra* note 2, at 136.

69. See *HAZEN*, *supra* note 16, §12.9.

70. *DeFeo Jr. et al.*, *supra* note 19.

71. *Id.*

72. *Hardtke*, *supra* note 2, at 136.

73. *Olazábal*, *supra* note 2, at 12–13 (noting that “courts have regularly continued to base their decisions, at least in part, on the ‘bespeaks caution’ doctrine, even in cases to which the [Reform] Act applies”).

74. See, e.g., *In re Worlds of Wonder Sec. Litig.*, 814 F. Supp. 850 (N.D. Cal. 1993); *Rubinstein v. Collins*, 20 F.3d 160 (5th Cir. 1994); *Saltzberg v. TM Sterling/Austin Assocs.*, 45 F.3d 399 (11th Cir. 1995); *Romani v. Shearson Lehman Hutton*, 929 F.2d 875 (1st Cir. 1991); *Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 949 F.2d 243 (8th Cir. 1991).

the safe harbor was not intended to replace the doctrine or to foreclose the judicial development thereof.<sup>75</sup>

Though the bespeaks caution doctrine and the PSLRA's safe harbor confer the same type of protection against liability, the doctrine is "much broader in its application than is the [PSLRA's] safe harbor." Courts have liberally applied the doctrine to a much wider set of transactions and statements than is allowed under the PSLRA.<sup>76</sup> It is perhaps for this reason that the doctrine appears to have overshadowed the PSLRA's safe harbor provision in federal courts.<sup>77</sup> Indeed, courts regularly base their decisions on the doctrine, "even in cases to which the [PSLRA] applies."<sup>78</sup> While the "relationship between the bespeaks caution and the safe harbor is, in short, not entirely clear," the doctrine's increased scope and applicability likely contributes to its comparative popularity amongst courts over the past several decades.<sup>79</sup>

While the exact relationship between the PSLRA and the bespeaks caution doctrine is ambiguous, they are both motivated by the same underlying policy goals and, thus, can be reconciled accordingly.<sup>80</sup> For instance, the PSLRA and the doctrine were both intended to afford issuing companies an early dismissal mechanism for frivolous lawsuits.<sup>81</sup> These frivolous suits were typically class action lawsuits brought by investors that suffered losses stemming from an unanticipated drop in stock value.<sup>82</sup> Investors hoping to recover from such loss would allege that they made investments in reliance on a prospectus, which was, in hindsight, misleading and untrue.<sup>83</sup> Despite the meritless nature of many of these suits, the claims regularly siphoned off substantial settlement figures from issuing companies prior to the passage of the PSLRA.<sup>84</sup> The doctrine is similarly intended to provide issuing companies with a "means of dismissing [these] frivolous lawsuits early in the litigation process."<sup>85</sup>

The PSLRA and the doctrine are also both intended to encourage open communication between corporations and the public by allowing issuing

---

75. H.R. REP. NO. 104-369, at 31 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 733.

76. Olazábal, *supra* note 2, at 12.

77. Jonathan L. Booze, *A Comparative Analysis of the Application of the Bespeaks Caution Doctrine to Forward-Looking Statements*, 47 U. KAN. L. REV. 495, 496 (1999); *see also* Hershman & Friedman, *supra* note 8, at 779–80 (noting that the bespeaks caution doctrine "has been adopted by at least ten appellate courts," and that courts "will look to cases employing the bespeaks caution doctrine for guidance" in understanding the parameters for the PSLRA).

78. Olazábal, *supra* note 2, at 13.

79. *See* Hershman & Friedman, *supra* note 8, at 780 n.12; *Shaw v. Dig. Equip. Corp.*, 82 F.3d 1194, 1213 n.23 (1st Cir. 1996); Olazábal, *supra* note 2, at 12.

80. Olazábal, *supra* note 2, at 11 (noting that the "'bespeaks caution' doctrine and the statutory safe harbor are similar in their underlying purpose").

81. *Id.*

82. *Id.* at 2.

83. *Id.*

84. *Id.*

85. O'Hare, *supra* note 18, at 654.

companies to accentuate their investment pitches with forward-looking statements.<sup>86</sup> Both Congress and the courts have sought to encourage issuing companies to disclose more, rather than less, information to interested investors to the benefit of both parties.<sup>87</sup> Affording corporations conditional protection for their forward-looking statements and optimistic salesmanship encourages such disclosure.<sup>88</sup>

Ultimately, however, these justifications relate to an amendment to a more generalized and fundamental legislative agenda: the “restor[ation] of the integrity of the securities litigation system.”<sup>89</sup> This restoration is achieved, in part, through the PSLRA’s discouragement of frivolous lawsuits and the simultaneous encouragement of thorough and candid corporate disclosure.<sup>90</sup> Indeed, issuing companies should be encouraged to communicate their hopeful predictions to interested investors.<sup>91</sup> After all, issuing companies “[cannot] be required to take a gloomy, fearful or defeatist view of the future.”<sup>92</sup> On the other hand, investors should expect thorough and transparent disclosure in an issuing company’s prospectus, as well as a sales pitch that is devoid of fraud and misrepresentation.<sup>93</sup> Thus, restoring integrity to securities litigation requires courts to delicately balance these conflicting principles.

Interests in corporate transparency necessarily place limits on the scope of the doctrine’s protection. For a forward-looking statement to earn protection through cautionary disclaimers under the first prong of the doctrine, circuit courts agree that those disclaimers must be both substantive and narrowly tailored to the alleged forward-looking statements in order to render disclosures meaningful.<sup>94</sup> Courts have heeded the warnings of the SEC and have subsequently rejected generalized, boilerplate disclosures under the doctrine.<sup>95</sup> Courts also agree that the cautionary disclaimer must relate clearly and unambiguously to the forward-looking statement and

---

86. *Id.*; see Olazábal, *supra* note 2, at 3.

87. Olazábal, *supra* note 2, at 3.

88. O’Hare, *supra* note 18, at 654.

89. Olazábal, *supra* note 2, at 3.

90. See *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129–30 (2d Cir. 1994) (finding that “[p]eople in charge of an enterprise are not required to take a gloomy, fearful, or defeatist view of the future”); *Rombach v. Chang*, 355 F.3d 164, 174 (2d Cir. 2004) (noting that “[u]p to a point, companies must be permitted to operate with a hopeful outlook”); Olazábal, *supra* note 2, at 3.

91. HAZEN, *supra* note 16.

92. *Rombach*, 355 F.3d at 174.

93. See *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3d Cir. 1993) (noting that a “vague or blanket (boilerplate) disclaimer which merely warns the reader that the investment risks will ordinarily be inadequate to prevent misinformation”); *Rombach*, 355 F.3d at 174.

94. Hershman & Friedman, *supra* note 8, at 781.

95. See *Warshaw v. Xoma Corp.*, 74 F.3d 955, 959 (9th Cir. 1996); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1415 (9th Cir. 1994) (noting that the bespeaks caution doctrine “helps to minimize the chance that a plaintiff with a largely groundless claim will bring a suit and conduct extensive discovery in the hopes of obtaining an increased settlement”) (citing *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991)).

must conspicuously accompany that forward-looking statement.<sup>96</sup> Finally, the cautionary disclaimer must be extensive enough to put a “reasonable investor” on notice that the forward-looking statement is a mere speculation.<sup>97</sup>

While courts universally recognize these particular conditions, there is overt disagreement as to the extent of specificity required in these cautionary disclosures. In the absence of Congressional guidance, circuit courts have adopted inconsistent and incompatible standards for what constitutes “meaningful cautionary language” under the doctrine.<sup>98</sup> Thus, language “held inadequate by one court might well survive before [another].”<sup>99</sup> Some of the more lenient judicial interpretations are arguably irreconcilable with the PSLRA’s underlying purposes.<sup>100</sup> They have been said to grant issuing corporations a “license to lie” with respect to forward-looking statements.<sup>101</sup>

## II. MAKING “MEANINGFUL” DISCLOSURES MEANINGFUL AGAIN

It is well established that the bespeaks caution doctrine only immunizes forward-looking statements. The doctrine neither protects nor addresses disclosures relating to an issuing company’s current financial or managerial state. There is thus no express requirement under the doctrine that the issuing company disclose its present financial condition along with its forward-looking statement.<sup>102</sup> This is curious, since the likelihood of an issuing company’s future success is inevitably tied, to some material degree, to the issuing company’s present condition.<sup>103</sup> Certain courts, such as the Third Circuit, have taken notice of this anomaly, finding that “a reasonable investor would be very interested in knowing, not merely that future economic developments might cause further loss, but that *current* reserves were known to be insufficient under current economic conditions.”<sup>104</sup> Current information about a company would be particularly

---

96. *In re Worlds of Wonder*, 35 F.3d at 1414; *see also* Hershman & Friedman, *supra* note 8, at 781.

97. *See* Halperin v. eBanker USA.com, Inc., 295 F.3d 352, 357 (2d Cir. 2002) (noting that “alleged misrepresentations in a stock offering are immaterial as a matter of law [if] it cannot be said that any reasonable investor could consider them important in light of adequate cautionary language set forth in the same offering”); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (labeling an omitted fact “material” when “there is a substantial likelihood that a reasonable [investor] would consider it important in deciding how to act”).

98. *See* Hershman & Friedman, *supra* note 8, at 778–780.

99. *Id.* at 2.

100. *Id.* at 9 (citing *SEC Feels Companies Dodging Disclosure Law*, BOSTON GLOBE, December 6, 1996).

101. *See generally* Das, *supra* note 5.

102. *See* Hershman & Friedman, *supra* note 8, at 778.

103. *See In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709 (3d Cir. 1996).

104. *Id.* (emphasis added).

important to an investor when a company faces known and immediate threats to its stock's future value.<sup>105</sup> The Fifth Circuit aptly noted that offering documents, which merely warn of potential future financial difficulties when such problems already affect the issuing company, is nothing short of "deceit."<sup>106</sup>

Yet, issuing companies continue to omit present financial concerns from their SEC filings.<sup>107</sup> Brian Lane, the SEC's former Director of Corporate Finance, cited an SEC study in 1996 which discovered that fewer than "10 percent of the 150 corporate filings reviewed present risks specifically enough to comply with the letter and the spirit" of the PSLRA.<sup>108</sup> Despite the discouraging results of its study, the SEC is relatively powerless to enforce its own standard. William McLucas, the SEC's former Enforcement Director, explained in 1996 "the legal basis for SEC enforcement actions against a corporation for making inadequate cautionary statements would appear tenuous at best."<sup>109</sup> As a result, the burden to identify and reject overly generalized risk disclosures falls upon the courts, placing the judiciary in the best position to promulgate stricter conditions for the doctrine's protection.<sup>110</sup>

The sufficiency of cautionary language must be analyzed from the standpoint of a reasonable investor.<sup>111</sup> The bespeaks caution doctrine has been characterized as "shorthand for the well-established principle that a statement or omission must be considered in context."<sup>112</sup> The sufficiency of that context is often measured according to whether a "reasonable investor" would attach importance to an alleged misstatement or omission.<sup>113</sup> The First, Second, Third, and Eighth Circuits have all expressly or implicitly adopted this "reasonable investor" test, which naturally imposes a strict

---

105. *Id.*; see also *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004) (finding that the "touchstone" of the materiality inquiry under the bespeaks caution doctrine is "not whether isolated statements within a document were true, but whether defendants' misrepresentations or omissions, considered together and in context, would affect the total mix of information and thereby mislead a reasonable investor regarding the nature of the securities offered"); *In re Prudential SEC. Inc. Ltd. P'ships Litig.*, 930 F.Supp. 68, 72 (S.D.N.Y. 1996) ("[c]autionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired").

106. *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994).

107. *Hershman & Friedman*, *supra* note 8, at 775-77.

108. *Id.* at 775-76 n.3.

109. *Id.* at 776 n.4.

110. See *In re Worlds of Wonder*, 35 F.3d 1407, 1414-15 (9th Cir. 1994).

111. *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 709 (3d Cir. 1993).

112. *Id.* at 364.

113. *Id.*; see also *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709 (3d Cir. 1996); *Shaw v. Dig. Equip. Corp.*, 82 F.3d 1194, 1220 (1st Cir. 1996) (noting that "no reasonable investor (nor the market) could have attached importance" to a forward-looking statement given the adequacy of accompanying cautionary language); *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1129-30 (2d Cir. 1994) (noting that corporate optimism may be respected subject to what "current data indicates"); *Halperin v. eBanker USA.com, Inc.*, 295 F.3d 352, 357 (2d Cir. 2002); *Rombach v. Chang*, 355 F.3d 164, 164 (2d Cir. 2004); *In re ESPEED, Inc. Sec. Litig.*, 457 F.Supp. 2d 266 (S.D.N.Y. 2006).

standard of specificity upon a disclosure.<sup>114</sup> This is because a reasonable investor possesses at least a rudimentary awareness of general market conditions.<sup>115</sup> Given this awareness, reasonable investors are generally privy to the risks universally affecting a certain industry or region, rendering disclosures of such risks unnecessary and unhelpful additions to a prospectus.<sup>116</sup> This reality has been judicially recognized; an issuing company is currently under no duty to “disclose a risk ‘the market clearly underst[ands].’”<sup>117</sup> Consequently, an issuing company cannot have made “meaningful” cautionary disclosures if the disclosures, as a whole, would be uninteresting and uninfluential to a reasonably savvy investor.<sup>118</sup>

It follows, then, that “meaningful” cautionary disclosure should contemplate specific risks, which transcend those that a reasonable investor would already know or understand.<sup>119</sup> The Supreme Court mandates the disclosure of a “material” fact when there exists a “substantial likelihood that the disclosure of an omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available.”<sup>120</sup> An issuing company must accordingly disclose any risk that is likely to influence, though not necessarily determine, an investor’s decision to buy or sell securities.<sup>121</sup> While widely known market risks indeed help to compose the “total mix” of information surrounding an investor’s decision, such information is useful only as a backdrop for more specific information about a company that the population of reasonable investors might not already know. This reasonable investor standard, therefore, puts the burden on the company to disclose *any* known concern that is reasonably likely to be considered influential to a reasonable investor’s investment decision.

### III. GOOD FAITH DISCLOSURE

Courts have warned that an overbroad application of the bespeaks caution doctrine “would encourage management [of an issuing company] to conceal deliberate misrepresentations beneath the mantle of broad cautionary language.”<sup>122</sup> Despite these warnings, courts have broadly

---

114. *Trump*, 7 F.3d at 364; see also *Westinghouse*, 90 F.3d at 709.

115. See *Trump*, 7 F.3d at 372 (citing *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991)).

116. See generally *id.*

117. See *In re Worlds of Wonder*, 35 F.3d 1407, 1417 (9th Cir. 1994).

118. *Id.*

119. *Westinghouse*, 90 F.3d at 709 (noting that an entity’s “current economic conditions” would be important to a reasonable investor, and thus merits inclusion with the issuer’s cautionary disclosures).

120. *TSC Indus., Inc. v. Northway Inc.*, 426 U.S. 438, 449 (1976).

121. *In re Espeed, Inc.*, 457 F. Supp. 2d 266, 279 (citing *TSC Indus.*, 426 U.S. at 449).

122. See *In re Worlds of Wonder Sec. Litig.*, 814 F.Supp. 850, 858 (N.D. Cal. 1993) (quoting *In re Trump*, 793 F. Supp. 543, 553 (D.N.J. 1992)); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407 (9th Cir. 1994).

applied this doctrine in ways that have invited, and even encouraged, this very outcome. This Part explores and critiques the leniency with which the doctrine has been applied with respect to the element of good faith.

In 2006, the Southern District of New York adopted a dangerously lenient standard for cautionary disclosures under the doctrine in *In re ESpeed Inc. Securities Litigation*.<sup>123</sup> In this case, defendant ESpeed Corporation (ESpeed) offered electronic trading services to clients and was the “market leader in electronic bond trading.”<sup>124</sup> ESpeed released a prospectus to investors accompanying its initial public offering.<sup>125</sup> Plaintiffs argued that this prospectus was materially misleading on the basis that the corporation intentionally omitted the company’s financial and managerial difficulties from its disclosures.<sup>126</sup> As a result of these deliberate omissions, plaintiffs contended that the defendant’s forward-looking statements did not deserve protection under the doctrine, and were actionably misleading.<sup>127</sup>

The plaintiffs’ primary contentions were that ESpeed’s prospectus failed to disclose that its clients vocally detested ESpeed’s trading platform, and that ESpeed’s clients eagerly awaited the first opportunity to switch trading systems.<sup>128</sup> An ESpeed executive had testified “reports [revealed] that customer reaction was uniformly negative from the beginning,” and that ESpeed’s customers “viewed [its trading platform] as a nearly useless system that was merely a subterfuge for raising commissions.”<sup>129</sup> Though these reports were communicated to ESpeed’s board of directors, they were never revealed to the public.<sup>130</sup> ESpeed officials instead lied to investors, declaring that ESpeed’s clients were quite satisfied with their service.<sup>131</sup> ESpeed’s Chairman and CEO went as far as to publicly announce “traders will wonder how they ever lived without [ESpeed’s services].”<sup>132</sup> Evidence demonstrated, however, that the opposite was true; ESpeed customers “were often coerced into using [ESpeed’s services] through the threat of disadvantageous [trade] executions” and by the absence of a viable alternative platform at the time.<sup>133</sup>

In a shocking decision, the district court found that, despite ESpeed’s deliberate and flagrant misrepresentation of its clients’ satisfaction, the cautionary language accompanying its forward-looking statements was sufficient under the doctrine to render those statements legally

---

123. *In re ESpeed*, 457 F.Supp. 2d at 267.

124. *Id.* at 269.

125. *Id.* at 270.

126. *Id.* at 271.

127. *See generally id.*

128. *Id.* at 274–75.

129. *Id.* at 273.

130. *Id.* at 273–74.

131. *See id.* at 272.

132. *Id.* at 272.

133. *Id.* at 273, 285.



immunized.<sup>134</sup> The “meaningful” cautionary language that managed to shield ESpeed from liability read: “we cannot assure you that we will successfully implement new technologies.”<sup>135</sup> The most illuminative cautionary statement in this case revealed only that: “no single [new] product has yet reached traction.”<sup>136</sup> These statements hardly conveyed the reality that ESpeed’s clients were overwhelmingly and openly dissatisfied with ESpeed’s trading platform, and had been since its release, or that ESpeed’s client base was eager to switch service providers.<sup>137</sup> Yet, the court found that ESpeed’s forward-looking statements were sufficiently “tempered” with caution, despite the fact that the defendant’s cautionary statements could have applied to a wide range of trading service providers.<sup>138</sup> More importantly, a reasonable investor in this case would have been blind to the fact that ESpeed was already disliked by its customers—the very demographic financing its operations and stabilizing its stock value.<sup>139</sup>

ESpeed’s cautionary language did not offer investors a realistic or company-specific perspective of the issuing company’s true market value.<sup>140</sup> Based on ESpeed’s disclosures, any decline in ESpeed’s stock value would likely be attributed to circumstances entirely unrelated to the real reasons for ESpeed’s decline—customer dissatisfaction. The holding in *In re ESpeed* embodies the very fear articulated by Senator Boxer in opposition to the passage of the PSLRA: “those defrauding can hide behind the real reason that their fraudulent prediction will not come true and they cannot be sued.”<sup>141</sup> The wording of the PSLRA, reinforced by precedent such as *In re ESpeed*, effectually licenses “fraudulent predictions and estimates.”<sup>142</sup> Unfortunately, the Southern District of New York is not alone among courts in disregarding good faith considerations. The Third and Eighth Circuits have similarly “refused to consider allegations of fraud where adequate disclaimers have been used, reasoning that if a statement has been rendered immaterial by cautionary language, it remains immaterial,” irrespective of manipulative intent.<sup>143</sup>

Fortunately, this disregard for good faith considerations under the doctrine has not been judicially uniform. The *In re ESpeed* holding stands in stark contrast to that of *Provenz v. Miller*, a Ninth Circuit case holding

---

134. *Id.* at 297.

135. *Id.*

136. *Id.* at 287.

137. *Id.* at 273.

138. *See generally id.*

139. *Id.* at 286.

140. ARNOLD S. JACOBS, 5C DISCLOSURE AND REMEDIES UNDER THE SECURITIES LAWS § 12:93 (2014).

141. 141 CONG. REC. S19037-S19060 (daily ed. Dec. 21, 1995) (statement of Sen. Boxer).

142. *See id.* (“Fraudulent failure predictions and estimates would be permitted under this bill if those defrauding attach ‘some’ possible reasons why the prediction might not come true.”).

143. DeFeo Jr. et al., *supra* note 19.

that cautionary language must disclose all known and material risks threatening the realization of a forward-looking statement (*Provenz* standard).<sup>144</sup> The *Provenz* standard eliminates the dangerous possibility that issuing companies can conceal their real concerns behind a veil of more general ones, since it requires the issuing company disclose *all* known and material risks.<sup>145</sup> The Fifth and Sixth Circuits have since endorsed the *Provenz* standard.<sup>146</sup> This circuit split illustrates the disparate judicial interpretations of the bespeak caution doctrine.

In 1989, the Ninth Circuit, in *In re Apple Computer, Inc.*, articulated a workable standard governing the sufficiency of cautionary disclosures under the doctrine.<sup>147</sup> Under this standard, “the [forward-looking] statement must be genuinely believed [by the preparers of issuing documentation, in order to merit doctrinal protection,] . . . there must be a reasonable statement for that belief, and the speaker must have no awareness of any undisclosed facts tending to seriously undermine the accuracy of the [forward-looking statement].”<sup>148</sup> If this standard for cautionary specificity had been applied to the facts of *In re ESpeed*, the scant cautionary language offered by ESpeed’s prospectus, coupled with the deliberate omission of serious risks known to the issuer, would likely have resulted in a finding for the plaintiffs. This outcome would stand in appropriate compliance with the urgings of the SEC: *In re Apple Computer’s* standard condemns “meaningless, overly general, or boilerplate safe harbor language,” acknowledging that such disclosures “defeat[] the [very] purpose of the [safe harbor]”<sup>149</sup>—the encouragement of accurate, thorough, and useful corporate disclosure.<sup>150</sup> The Ninth Circuit’s ruling from *In re Apple Computer* offers a durable and clear standard for cautionary disclosures under the doctrine that resurrects the original good faith requirement of Rule 175.<sup>151</sup>

---

144. See generally *Provenz v. Miller*, 95 F.3d 1376 (9th Cir. 1996).

145. See 141 CONG. REC. S19037-S19060 (Dec. 21, 1995) (statement of Sen. Boxer); *Provenz*, 95 F.3d at 1376.

146. See generally *Rubinstein v. Collins*, 20 F.3d 160, 168 (5th Cir. 1994); *Mayer v. Mylod*, 988 F.2d 635 (6th Cir. 1993); *In re Worlds of Wonder*, 35 F.3d 1407, 1407 (9th Cir. 1994).

147. *In re Apple Computer Sec. Litig.*, 886 F.2d 1109 (9th Cir. 1989).

148. *Id.* at 1113.

149. Hershman & Friedman, *supra* note 8, at 776 (citation omitted).

150. Olazábal, *supra* note 2, at 3 (“Ultimately, the Reform Act [which essentially codified the bespeaks caution doctrine] aims to restore the integrity of the securities litigation system, promoting efficient creation of capital while meeting investors’ demand for accurate and abundant disclosure of useful corporate information.”).

151. See *id.*; see also Commodity and Securities Exchanges, 17 C.F.R. § 230.175 (2011).

#### IV. THE SUPREME COURT WEIGHS IN: OMNICARE, INC. V. LABORERS DISTRICT COUNCIL CONSTRUCTION INDUSTRY PENSION FUND

On March 24, 2015, Justice Kagan delivered a Supreme Court decision that finally answered the question of when and how issuing companies will be liable for statements of opinion made in offering documents.<sup>152</sup> *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund* was a securities fraud class action lawsuit arising from the registration statement of the petitioner, Omnicare, Inc., filed in connection with a public offering of stock.<sup>153</sup> Specifically, the plaintiffs alleged that certain statements<sup>154</sup> prefaced with the words “we believe” were materially misleading based on facts that were not disclosed, regardless of the fact that the challenged statements were phrased as statements of “opinion.”<sup>155</sup>

Though the opinion in *Omnicare* did not explicitly mention forward-looking statements or the doctrine itself, it is possible (if not likely) that a forward-looking statement could be categorized as a statement of “opinion” as the Court defined it in *Omnicare*.<sup>156</sup> In *Omnicare*, the Court explained that a statement of opinion is defined as “‘a belief[,] a view’ or a ‘sentiment which the mind forms of persons or things.’”<sup>157</sup> The Court further explained that the inclusion of prefacing phrases, such as “I believe” or “I think,” could readily transform factual statements into statements of opinion.<sup>158</sup> Though opinions do not convey certainty in the same manner as facts, the Court nevertheless determined that there is “some room” for opinion liability under section 11 of the Securities Act.<sup>159</sup> This is because every opinion necessarily affirms one fact: “that the speaker actually holds the stated belief.”<sup>160</sup> Thus, an opinion may be false, and hence legally actionable, if it “falsely describe[s]” the speaker’s state of mind.<sup>161</sup> The Court concluded that a “sincere statement of pure opinion is not an untrue statement of material fact,” whereas a communicated opinion that is not

---

152. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015).

153. *Id.* at 1323.

154. The statements were: “[w]e believe that our contract arrangements with other healthcare providers, our pharmaceutical supplies and our pharmacy practices are in compliance with applicable federal and state laws,” and “[w]e believe that our contracts with pharmaceutical manufacturers are legally and economically valid arrangements that bring value to the healthcare system and the patients that we serve.” *Id.*

155. *Id.* at 1324–25.

156. *See id.*

157. *Id.* at 1325 (citing WEBSTER’S NEW INTERNATIONAL DICTIONARY 782 (1927)).

158. *Id.* at 1326.

159. *Id.*

160. *Id.* (citing KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS §109, 755 (5th ed. 1984)).

161. *Id.*

genuinely believed by an issuing company is a legal misrepresentation that may be actionable by law.<sup>162</sup>

This principle can be easily extended to forward-looking statements. A forward-looking statement, such as the statement “this company is projected to double its net earnings by the next fiscal year,” could be considered an opinion because the realization of the statement is not certain. Moreover, such a statement can be altered to more closely resemble an *Omnicare* opinion through the inclusion of the prefacing phrases “we believe” or “we think.”<sup>163</sup> Under the *Omnicare* standard, the forward-looking statement “we believe that this company will double its net earnings by the next fiscal year” is factual insofar as it tells investors that the issuers genuinely believe that their company is projected to double its net earnings.<sup>164</sup> In other words, the forward-looking statement could be considered actionably false under *Omnicare* if the drafters of the registration statement either genuinely disbelieved the stated opinion or failed to communicate material facts that would “conflict with what a reasonable investor would take from the [opinion] statement itself.”<sup>165</sup>

The *Omnicare* standard for opinion liability is not irreconcilable with the bespeaks caution doctrine. To the extent that a forward-looking statement can be considered a statement of opinion, both standards require issuers to temper those statements with disclosure of material risks that do, or reasonably could, undermine the realization of a forward-looking statement. Though not every court has required that a forward-looking statement be rendered in good faith in order to enjoy protection under the doctrine, courts that choose to equate forward-looking statements with statements of “opinion” will now, pursuant to *Omnicare*, likely impose a good faith requirement on the issuer before protection can be extended. The likely imposition of this requirement, however, does not undermine the integrity of the doctrine.

## V. THE UNCERTAINTY OF CIRCUMSTANCE

The Fifth Circuit famously observed that the “bespeaks caution doctrine reflects the unremarkable proposition that statements must be analyzed in context.”<sup>166</sup> While cautionary disclosures should be thorough, the degree of specificity reasonably required of a disclosure under the doctrine is naturally dependent on context. For example, disclosure of present financial or operational difficulties is impossible if an issuing company has not yet

---

162. *Id.* at 1327.

163. *Id.* at 1328.

164. *See id.*

165. *Id.* at 1329.

166. *Rubinstein v. Collins*, 20 F.3d 160, 167 (5th Cir. 1994); *see also In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 369 (3d Cir. 1993) (noting that “a court must appraise a misrepresentation or omission in the complete context in which the author conveys it”).

begun operating, or in the unlikely scenario that the company simply has no such difficulties to report. In such cases, an issuing company may be forced to include cautionary disclosures that are more “formulaic,” provided that “they provide[] a [reasonably] sobering picture” of an company’s prospects.<sup>167</sup> Thus, the adequacy of cautionary specificity is a “relative concept,”<sup>168</sup> depending entirely upon the “context in which the [issuer’s] speaker communicated it.”<sup>169</sup> It is imperative, however, that “some” cautionary disclosure should not immunize a forward-looking statement when that disclosure does not tell the full story; the doctrine cannot allow issuers to “hide behind the real reason that their fraudulent prediction will not come true.”<sup>170</sup> In sum, courts must analyze claims invoking the doctrine on a case-by-case basis.<sup>171</sup>

*In Re Donald J. Trump Casino Securities Litigation* illustrates the need for case-by-case analyses of claims invoking the doctrine.<sup>172</sup> This 1993 Third Circuit case involved a massive casino complex based in Atlantic City called the Trump Taj Mahal. The casino complex was still under construction when Taj Mahal, Inc. released its prospectus to investors.<sup>173</sup> Taj Mahal consequently had no operational history to incorporate into its prospectus. Taj Mahal thus composed rather “formulaic”<sup>174</sup> risk factors, including, but not limited to: anticipated levels of competition, historical trends in casino operation, diminished expectations of profit during certain seasons, the unprecedented size and scale of the Taj Mahal enterprise in Atlantic City, and the generalized risks associated with “the establishment of a new business enterprise.”<sup>175</sup> While Taj Mahal’s disclosures were pertinent, they could have applied to *any* massive casino start-up in Atlantic City.<sup>176</sup>

Investors brought suit upon learning that the Trump defendants were planning to file bankruptcy proceedings.<sup>177</sup> Specifically, plaintiffs alleged that the defendants’ prospectus contained misrepresentations and material omissions in violation of the Securities Act, which fraudulently inspired

---

167. *Rombach v. Chang*, 355 F.3d 164, 176 (2d Cir. 2004).

168. *Trump*, 7 F.3d at 369.

169. *Id.* at 371; *see also Rubinstein*, 20 F.3d at 167.

170. 141 CONG. REC. S19037-S19060 (Dec. 21, 1995) (statement of Sen. Boxer) (“Fraudulent failure predictions and estimates would be permitted under this bill if those defrauding attach ‘some’ possible reasons why the prediction might not come true. Those defrauding can hide behind the real reason that their fraudulent prediction will not come true and they cannot be sued.”).

171. *Id.*

172. *See generally Trump*, 7 F.3d at 357.

173. *Id.* at 370.

174. *Rombach v. Chang*, 355 F.3d 164, 176 (2d Cir. 2004).

175. *Trump*, 7 F.3d at 370.

176. *Id.* at 370.

177. *Id.* at 365.

investors to purchase bonds.<sup>178</sup> The plaintiffs' "strongest attack" targeted the defendant's statement that "[t]he Partnership believes that funds generated from the operation of the Taj Mahal will be sufficient to cover all of its debt service (interest and principal)."<sup>179</sup> According to the plaintiffs, undisclosed facts existed which undermined the reasonableness of that statement.<sup>180</sup> Defendants argued, among other things, that the "abundance of cautionary statements" in their prospectus discouraged any undue reliance on their forward-looking statements, "render[ing] the plaintiffs' claims nonactionable as a matter of law."<sup>181</sup>

The Third Circuit determined that the defendants' cautionary disclosures were sufficient, because the "Taj Mahal [had] not [yet] been completed [at the time the prospectus was released] and, accordingly, [had] no operating history [to disclose]."<sup>182</sup> Had there been operating history to incorporate into Taj Mahal's disclosures, the Third Circuit would have been justified in expecting Taj Mahal's disclosures to integrate concerns stemming directly and specifically from those past or present operational, financial, or managerial difficulties.<sup>183</sup> In fact, three years after *Trump* was decided, the Third Circuit demanded just that in *In re Westinghouse Securities Litigation*.<sup>184</sup> The defendant in *Westinghouse* was denied protection under the bespeaks caution doctrine because it failed to contextualize its prospectus with information concerning the company's "current reserves" and "current economic conditions;" in other words, the defendants in *Westinghouse* had operating history from which to report present financial conditions.<sup>185</sup> The juxtaposition of the *Trump* and *Westinghouse* cases reveals the importance of context in cases invoking the doctrine, since context dictates the level of cautionary detail necessary to properly ground forward-looking statements.<sup>186</sup>

Unfortunately, the circumstantial nature of judicial analysis under the doctrine invites inconsistent rulings and standards, within circuits and even within cases.<sup>187</sup> The Ninth Circuit, for example, in *In re Worlds of Wonder Securities Litigation*, articulated a standard for cautionary disclosure in a

---

178. *Id.*

179. *Id.*

180. *Id.*

181. *Id.* at 366.

182. *Id.* at 370.

183. See *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709 (3d Cir. 1996) (noting that "a reasonable investor would be very interested in knowing, not merely that economic developments might cause further loss, but that current reserves were known to be insufficient under current economic conditions," and, as a result, an issuing entity should tailor its prospectus to its current reserves and current economic conditions).

184. See generally *id.*

185. *Id.*

186. See generally *Trump*, 7 F.3d at 357; *Westinghouse*, 90 F.3d at 696; see *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1414 (9th Cir. 1994).

187. See generally *Worlds of Wonder*, 35 F.3d 1407.

decision and then implicitly contradicted that standard in the holding of that same case.<sup>188</sup> This 1994 decision reasoned that immaterial omissions of fact from a prospectus are not actionable “absent allegations that [the issuing company] withheld financial data or other existing facts from which forecasts are typically derived.”<sup>189</sup> This statement not only implies that forward-looking statements should naturally relate to *existing* facts and data, an observation noted by several other circuits,<sup>190</sup> but that the knowing omission of an existing fact endangering a forward-looking statement would expose that statement to misrepresentation claims.

After emphasizing the importance of incorporating an issuing company’s current concerns into its prospectus, the Ninth Circuit in *Worlds of Wonder* ultimately excused the defendants for knowingly concealing “crippling [internal] deficiencies,” including forced employee cutbacks, product price reductions, and the utilization of junk bonds.<sup>191</sup> The challenged disclosure read: “there can be no assurances that [the defendant] can successfully implement these [internal control] enhancements or that these enhancements will keep pace with the [company’s] growth.”<sup>192</sup> Another disclaimer stated, “there can be no assurances that [Worlds of Wonder’s] existing internal controls *would continue to be adequate* given the rapid pace at which the company was growing.”<sup>193</sup> The plaintiffs argued that based on these disclosures, a reasonable investor could not have known that the defendant was *currently* experiencing significant problems with its system of internal controls.<sup>194</sup> The Ninth Circuit disagreed, finding that the disclaimer sufficiently discouraged reliance on those controls.<sup>195</sup> The court also stated that the defendants made no indication that the existing controls were in fact adequate, a finding contradicted by the evidence.

The *Worlds of Wonder* decision is internally inconsistent. The defendant’s prospectus in *Worlds of Wonder* invidiously disguised the fact that the defendant suffered from severe internal deficiencies at the time it released the prospectus, and even deceptively characterized its internal

---

188. *Id.*

189. *Id.* at 1420.

190. *See* Shields v. Citytrust Bancorp Inc., 25 F.3d 1124, 1129–30 (2d Cir. 1994) (noting that corporate optimism may be subject to what “current data indicates”); *Westinghouse*, 90 F.3d at 709 (noting that “a reasonable investor would be very interested in knowing, not merely that economic developments might cause further loss, but that current reserves were known to be insufficient under current economic conditions”).

191. *See* *Worlds of Wonder*, 35 F.3d at 1420.

192. *Id.*

193. *Id.* at 1417 (emphasis added).

194. *Id.* (“Plaintiffs contend that, in fact, WOW’s internal controls at the time of the offering had ‘crippling deficiencies’ and that ‘no reasonable investor reading the Prospectus would have concluded that there were *any* existing problems with the controls.”).

195. *Id.*

controls as “adequate.”<sup>196</sup> The court refused to entertain the argument that a reasonable investor would likely consider existing internal deficiencies important in their investment decisions, and that the issuer’s omission of these facts from the prospectus was therefore “material” under the Supreme Court’s standard in *TSC Industrial, Inc v. Northway, Inc.*, which defined materiality under the Exchange Act.<sup>197</sup> Additionally, the Ninth Circuit’s holding plainly contradicts its own acknowledgement that “withholding [from a prospectus] . . . existing facts from which forecasts are typically derived” renders a prospectus actionable under the law.<sup>198</sup> It would be difficult to imagine an optimistic forward-looking statement entirely unaffected by the presence of serious internal deficiencies. The defendant’s actions also fall within the Fifth Circuit’s characterization of “deceit,” the oft-quoted standard, articulated in *Huddleston v. Herman & MacLean*, reads: “to caution that it is only possible for the unfavorable events to happen when they have already occurred is deceit.”<sup>199</sup> In *Worlds of Wonder*, the issuing company did just that; it conveyed the *possibility* that its internal controls would cease to be “adequate,” when credible evidence indicated that those controls were actually “crippling[ly] deficient” at the time its prospectus was released to investors.<sup>200</sup>

The *Worlds of Wonder* decision marks the Ninth Circuit’s abandonment of its own standard for the doctrine developed in *In re Apple Computer*, which was decided five years earlier.<sup>201</sup> In *Apple Computer*, the Ninth Circuit articulated clear conditions for protection under the doctrine. One such condition was that the speaker “[have no knowledge] of any undisclosed facts tending to seriously undermine the accuracy of the statement.”<sup>202</sup> The Ninth Circuit stated that disproving this “implied factual assertion . . . [subsequently renders] a [forward-looking statement] or statement of belief . . . actionable” under the law.<sup>203</sup> The court all but ignored this condition in *Worlds of Wonder*, even though it was undisputed that the defendants knew of material internal deficiencies at the time their prospectus was released, and it was also clear that those deficiencies were omitted from the defendant’s prospectus.<sup>204</sup> Under its own standard promulgated in *Apple Computer*, the Ninth Circuit should have decided *Worlds of Wonder* differently, in favor of the plaintiffs. However, because

---

196. *Id.* at 1417 (The Prospectus stated that “there can be no assurances that WOW’s existing internal controls would continue to be adequate.”).

197. *See In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 369 (3d Cir. 1993) (citing *TSC Indus., Inc. v. Northway Inc.*, 426 U.S. 438, 449 (1976)).

198. *See Worlds of Wonder*, 35 F.3d at 1417.

199. *See Huddleston v. Herman & MacLean*, 640 F.2d 534, 544 (5th Cir. 1981); *Rubinstein v. Collins*, 20 F.3d 160, 171 (5th Cir. 1994).

200. *Worlds of Wonder*, 35 F.3d at 1417.

201. *See generally id.*; *see also In re Apple Comput. Sec. Litig.*, 886 F.2d 1109 (9th Cir. 1989).

202. *In re Apple*, 886 F.2d at 1113.

203. *Id.* (citing *Marx v. Comput. Sci. Corp.*, 507 F.3d 485, 490 (9th Cir. 1974)).

204. *See Worlds of Wonder*, 35 F.3d at 1417.



the judiciary has not yet enumerated specific and universal conditions for protection under the doctrine, the doctrinal protection is often awarded unpredictably and inconsistently between and within jurisdictions.<sup>205</sup> Its conditions remain unclear.<sup>206</sup>

The conditions for the doctrine's protection were further confused by the Second Circuit's 2010 decision in *Iowa Public Employees' Retirement v. MF Global*.<sup>207</sup> There, plaintiffs alleged that the defendant, MF Global, wrongfully excluded from its prospectus the fact that its risk management protocols and procedures did not apply to MF Global employees.<sup>208</sup> Rather than engage in an analysis of materiality, the Second Circuit simply declared that, because the allegation concerned an omission of present fact, the doctrine did not apply.<sup>209</sup> This is because present facts are "ascertainable" to investors and therefore need not be included in an offering letter or prospectus.<sup>210</sup> This Second Circuit ruling constitutes yet another departure from the decisions of other circuits with respect to the importance of disclosing present facts.<sup>211</sup> It also undermines Congressional intent, because the Legislature drafted the PSLRA hoping to "encourage securities issuers to disclose more information to the investing public."<sup>212</sup> Instead, the *MF Global* decision appears to endorse the disclosure of less information.<sup>213</sup>

More simply, the *MF Global* ruling does not make logical sense in relation to recent decisions. The Second Circuit did not substantiate its expectation that investors independently "ascertain" a company's internal risk management protocols and procedures as they pertain to a company's employees.<sup>214</sup> Such protocols were not made public, and it remains unclear how the Second Circuit expected investors to ascertain internal corporate information, or to realize that such information should be ascertained in the first place.<sup>215</sup> Furthermore, the Second Circuit seemed to forget that the doctrine puts the burden on issuing *companies*, not their investors, to

---

205. See generally DeFeo Jr. et al, *supra* note 19.

206. *Id.*

207. See generally *Iowa Pub. Emps. Ret. v. MF Global*, 620 F.3d 137 (2d Cir. 2010).

208. *Id.* at 142.

209. *Id.*

210. *Id.*

211. See *In re Apple Comput. Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989); *Shields v. Citytrust Bancorp Inc.*, 25 F.3d 1124, 1129–30 (2d Cir. 1994) (noting that optimism in a corporation may be dependent on what "current [and public] data indicates"); *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709 (3d Cir. 1996) (noting that "a reasonable investor would be very interested in knowing, not merely that economic developments might cause further loss, but that current reserves were known to be insufficient under current economic conditions").

212. Olazábal, *supra* note 2, at 3 (citing H.R. REP. NO. 104-369, at 32 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 733).

213. See generally *MF Global*, 620 F.3d at 137.

214. See *id.*

215. See *id.*

determine what information merits inclusion in an SEC filing.<sup>216</sup> The doctrine's protection is indeed conditioned on the adequacy of a company's choice and use of cautionary language; there is no indication that Congress intended to place any investigative burden on investors.<sup>217</sup> The Second Circuit's troubling ruling in *MF Global* illustrates the inconsistency with which circuit courts have applied and understood the doctrine. The doctrine is in need of a clear, universal articulation offering concrete conditions for its protection.

## VI. THE PROPOSED DOCTRINE

Though courts have consistently scrutinized cautionary language under the doctrine on a highly contextualized, case-by-case basis, the preceding Part has demonstrated that courts have failed to agree on a consistent standard under which to interpret such language.<sup>218</sup> This confusion calls for a new, clear standard that, for the sake of consistency, clarity, and predictability specifically delineates conditions for doctrinal protection. The doctrine should be interpreted as follows:

Forward-looking statements made in a stock offering are immaterial as a matter of law if they are accompanied by meaningful and specific cautionary language, and provided that the following conditions are satisfied:

1. The forward-looking statement's realization is honestly regarded as realistic by the issuing company;
2. The cautionary language closely and conspicuously accompanies the forward-looking statement;
3. The cautionary disclosures incorporate facts and concerns from an issuing company's operating history (including the issuing company's present and material financial, operational, and managerial difficulties), provided that the company has been in business for longer than six months; and
4. The cautionary language reasonably and specifically addresses *all* foreseeable risks and/or present concerns that:
  - i. are known or should be known to the issuer as obstacles to the forward-looking statement's realization; and

---

216. See generally *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 369 (3d Cir. 1993).

217. Olazábal, *supra* note 2, at 3 (noting that Congress intended the PSLRA, which provides a statutory basis for the bespeaks caution doctrine, to "encourage securities issuers to disclose more information to the investing public").

218. See generally Hershman & Friedman, *supra* note 8.

- ii. would foreseeably influence a reasonable investor's decision of whether or not to invest.

While this standard is admittedly strict by revitalizing the good faith requirement of Rule 175 of the Securities Act and incorporating the reasonable investor standard promulgated by the Third Circuit in *Trump*,<sup>219</sup> it is also accommodating in certain circumstances. For example, under the third condition of the standard, issuing companies with operating histories spanning fewer than six months are excused from integrating into a cautionary disclosure facts stemming directly from a nonexistent or extremely limited operating history. This concession was inspired by the juxtaposition of the Third Circuit's holdings in *Trump* and *Westinghouse*.<sup>220</sup> In *Trump*, the Third Circuit held that the Taj Mahal's reliance on relatively formulaic risk disclosures was excusable in the absence of any operating history.<sup>221</sup> In *Westinghouse*, the Third Circuit held that the existence of an operating history raises the standard for cautionary specificity, requiring the additional disclosure of an issuer's current reserves and economic conditions.<sup>222</sup> Because the adequacy of cautionary disclosures is circumstantial, the amended doctrine's proposed third condition is conditional in recognition of the fact that "no bright line rule can ever be stated as to what will constitute meaningful cautionary language in a particular case."<sup>223</sup> Therefore, under the proposal, issuers with lengthy operating histories are held to a higher standard than are issuers without such history.

The fourth condition incorporates the standard of materiality, defined by the Supreme Court in *TSC Industrial*<sup>224</sup> and famously applied to analyze the doctrine by the Third Circuit in *Trump*.<sup>225</sup> Because the materiality standard measures information based on expected import to a reasonable investor,<sup>226</sup> this standard actually alleviates an issuer's burden of disclosure. The Supreme Court has held that under the materiality standard, a false or incomplete statement is not materially misleading if that statement "is otherwise insignificant" to an investor's decision to invest.<sup>227</sup> Furthermore, the materiality standard excuses issuers from disclosing *all* known or

---

219. See *Trump*, 7 F.3d at 369.

220. See generally *id.*; *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 709–10 (3d Cir. 1996).

221. See *Trump*, 7 F.3d at 369.

222. See *Westinghouse*, 90 F.3d at 709–10 (noting that "a reasonable investor would be very interested in knowing, not merely that economic developments might cause further loss, but that current reserves were known to be insufficient under current economic conditions," and, as a result, an issuing entity should tailor its prospectus to its current reserves and current economic conditions).

223. Olazábal, *supra* note 2, at 22.

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

225. See *Trump*, 7 F.3d at 369; O'Hare, *supra* note 18, at 649 (noting that *Trump* is the "leading case subscribing to the materiality version" of the bespeaks caution doctrine).

226. *TSC Indus.*, 426 U.S. at 499.

227. *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

foreseeable risks. Only facts likely to be considered significant by a reasonable investor require disclosure.<sup>228</sup> The Congressional Conference Report addressing the PSLRA's safe harbor provision confirms that "failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor."<sup>229</sup> It is only when that factor is foreseeably important to a reasonable investor that this Note's proposed standard requires disclosure of that factor.

This Note's proposed introduction of a good faith requirement is not without opposition. Commentators have argued that such imposition would "raise factual issues [related to a misrepresentation claim] which would be difficult to resolve upon a pre-trial motion."<sup>230</sup> Indeed, requiring courts to ensure that an issuer did not knowingly conceal material risks before granting the issuer protection under the doctrine would require a careful examination of case-specific facts. This analysis could not likely be accomplished in the pre-trial stage.<sup>231</sup> To require such examination, it is argued, undermines and even defeats the doctrine's intended endorsement of judicial dismissal of frivolous lawsuits at an early stage of litigation.<sup>232</sup>

The benefits of the good faith requirement, however, outweigh its cost. The universal acceptance of this solidified amended doctrine would significantly reduce that cost by undercutting the potency of suits brought merely for the purpose of gaining a settlement payment. This is because a solidified doctrine with clear conditions would enable issuing companies to carefully draft cautionary language accompanying a forward-looking statement in a manner that clearly and predictably invokes the proposed doctrine's protection. Predictably securing this immunization would largely eliminate an issuer's incentive to settle a frivolous claim, since such a claim could not ultimately succeed in court. While litigation may be an inherently unpleasant and costly procedure for issuing companies, many states allow such issuers to shift their legal costs to the complainant in the event that the action is unsuccessful.<sup>233</sup> This can be accomplished through a security for expenses bond, the application of which has been endorsed by the Supreme Court as valid in any state that allows them.<sup>234</sup> Such bonds are instrumental in preventing frivolous lawsuits.<sup>235</sup> The solidification of the doctrine, coupled with the availability of security for expenses bonds, allows issuing companies to proceed confidently to trial without accruing burdensome legal fees in the process.

---

228. Olazábal, *supra* note 2, at 22.

229. *Id.* (citation omitted).

230. O'Hare, *supra* note 18, at 655.

231. *Id.* at 654-55.

232. *Id.*; *see also* Olazábal, *supra* note 2, at 3-4.

233. *See* *Cohen v. Beneficial Indus. Corp.*, 337 U.S. 541, 557 (1949).

234. *Id.*

235. *Id.*

Additionally, while the elimination of frivolous lawsuits at a pre-trial phase is a worthy interest, that interest cannot trump the PSLRA's ultimate goal of "restor[ing] the integrity of the securities litigation system."<sup>236</sup> After all, the PSLRA amends legislation that was drafted in direct response to the stock market crash of 1929 with the legislative intent of "foster[ing] fair play" in the securities market.<sup>237</sup> Out of respect for this underlying legislative intent, the doctrine should and must incorporate a requirement of good faith.<sup>238</sup> The PSLRA's safe harbor was originally codified in Rule 175, which was carefully drafted by the SEC to extend protection only to issuers making forward-looking statements in good faith.<sup>239</sup> Legislators vigorously contested the removal of the good faith requirement from the PSLRA's safe harbor, fearing that a manipulative issuing company could escape liability under the safe harbor, "even if [a] knowingly false statement is made."<sup>240</sup> This, legislators forecasted, would render the amended safe harbor under the PSLRA an effectual "license to lie."<sup>241</sup> The legislative history of Rule 175, the Securities Act, the Exchange Act, and the PSLRA reveals that this legislation was intended to promote honesty, not to protect lies.<sup>242</sup>

Furthermore, cautionary language accompanying a forward-looking statement cannot be reasonably considered "meaningful" by a reasonable investor if the statement is significantly undermined by an undisclosed fact or circumstance.<sup>243</sup> No reasonable investor would ascribe meaningful import to a forward-looking statement made without "sound factual or historical basis."<sup>244</sup> Disclosing "some" reasons why a prediction might not come true while excluding the "real reason that their fraudulent prediction will not come true" would *not* convey a "meaningful" disclosure in the eyes of a reasonable investor, since that disclosure is incomplete at best, and likely manipulative.<sup>245</sup> To fraudulently issue a forward-looking statement without "sound factual or historical basis" would entail the omission of a fact that would potentially be "important" to an investor relying upon the

---

236. Olazábal, *supra* note 2, at 3.

237. Das, *supra* note 5, at 1083–84 (citing Elaine A. Welle, *Freedom of Contract and the Securities Laws: Opting Out of the Securities Regulation by Private Agreement*, 56 WASH. & LEE L. REV. 519, 535 (1999)).

238. *Id.* at 1085 (citing *In re Stone & Webster, Inc.*, Sec. Litig., 414 F.3d 187, 211–12 (1st Cir. 2005)).

239. *See id.* at 1090; Commodity and Securities Exchanges, 17 C.F.R. § 230.175 (2014).

240. Das, *supra* note 5, at 1095 (citing 141 CONG. REC. 38, 201 (1995)).

241. *Id.*

242. *See generally id.*; HAZEN, *supra* note 16.

243. *See In re Nash Finch Co. Sec. Litig.*, 502 F. Supp. 2d 861, 873 (D. Minn. 2007) ("Cautionary language cannot 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.").

244. *See O'Hare, supra* note 18, at 632 (citing *Isquith v. Middle South Util., Inc.*, 847 F.2d 186, 204 (5th Cir. 1988)).

245. 141 CONG. REC. S19037-S19060 (Dec. 21, 1995) (statement of Sen. Boxer).

truth and authenticity of a SEC filing.<sup>246</sup> Therefore, the good faith requirement is a natural corollary to materiality.<sup>247</sup> If the misrepresented or omitted fact would be significant to a reasonable investor, then it would follow that the prospectus would be incomplete or misleading by virtue of such misrepresentation or omission; the forward-looking statement in such a case would be insufficient under both the materiality standard *and* the good faith standard.<sup>248</sup> Therefore, the inclusion of the good faith condition in the amended doctrinal standard complements, and indeed invites, the inclusion of the materiality condition.

Moreover, to the extent that forward-looking statements are uncertain statements of opinion, the Supreme Court's *Omnicare* decision appears to *compel* the imposition of a good faith requirement upon this doctrinal analysis.<sup>249</sup> Since forward-looking statements can generally be prefaced with "we believe" or "we think," there is a strong likelihood that optimistic forward-looking statements will fall in the category of a factually uncertain "opinion" as understood and defined by the *Omnicare* Court.<sup>250</sup> As such, forward-looking statements must be rendered in good faith in order for them to be protectable by law, lest those statements falsely imply that the issuer actually believes them.

## CONCLUSION

It is time that the judiciary rescind an issuing company's "license to lie."<sup>251</sup> Since 1996, the SEC has expressed concern that the bespeaks caution doctrine's protection has been applied too liberally by courts, allowing corporations to make outlandish forward-looking statements protected through the issuance of "meaningless" disclosures.<sup>252</sup> This consequence contradicts the underlying aims of the doctrine's codification in Rule 175. The purpose of Rule 175 was to restore integrity to the securities litigation system.<sup>253</sup> Judicial interpretations with respect to the doctrine, however, continue to diverge, reflecting a need for doctrinal consensus with respect to its aims and parameters.<sup>254</sup> This consensus must incorporate strict conditions, including a good faith requirement, so that the doctrine may be finally and universally reconciled with legislative intent.

---

246. See O'Hare, *supra* note 18, at 632; *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 372 (3rd Cir. 1993).

247. See O'Hare, *supra* note 18, at 632.

248. See *Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988).

249. See *generally* *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015).

250. See *id.* at 1326, 1331.

251. See *generally* Das, *supra* note 5.

252. Hershman & Friedman, *supra* note 8, at 775.

253. See Olazábal, *supra* note 2, at 11.

254. See *id.*; Hershman & Friedman, *supra* note 8, at 780 ("The standards for, and applications of, the bespeaks caution doctrine vary from circuit to circuit: language held inadequate by one court might well survive before another court.").

After all, it could not have been Congress's intention to allow savvy, publicly traded companies to issue false or misleading statements to investors on the basis that those false or misleading statements are somehow excused by unrelated cautionary language.<sup>255</sup>

It is for these reasons that this Note's proposed doctrinal amendments are advanced. Their universal application would reconcile the doctrine with the intent of both Congress and the SEC. Their strict conditions require an appropriate level of integrity from issuing companies, while continuing to reward honest and transparent companies with protection against liability for unrealized forward-looking statements made in good faith. The conditions effectually reject the effectiveness of generalized, boilerplate disclosures and instead demand disclosures that are both specific to the company and informative to investors. Accordingly, the proposed qualifications should dictate the conditional protection of the doctrine.

*Andrew W. Fine*\*

---

255. Das, *supra* note 5, at 1108.

\* B.A., Dickinson College, 2013; J.D. Candidate, Brooklyn Law School, 2016. I would like to sincerely thank every member of the 2015-2016 *Brooklyn Journal of Corporate, Financial & Commercial Law* for their selfless assistance in preparing this Note for publication. Special thanks to Ned L. Schultheis and Dylan L. Ruffi for their guidance and leadership throughout this Note-writing process. Finally, I want to thank all my friends and family, for without them, I would not be where I am today.