Updates
November 02, 2017

Ninth Circuit Trims PSLRA Safe Harbor's Protection for Forward-Looking Statements

A recent decision of the U.S. Court of Appeals for the Ninth Circuit, *In re Quality Systems, Inc. Securities Litigation*, 865 F.3d 1130 (9th Cir. 2017), cut back on the protections afforded by the safe-harbor provision of the Private Securities Litigation Reform Act of 1995 (the PSLRA) for public companies whose forward-looking statements are alleged to be false or misleading.

The PSLRA's safe harbor, 15 U.S.C. § 78u-5(c), is a codification of the common-law "bespeaks caution" doctrine. Subject to certain statutory exceptions—including for statements made in connection with an initial public offering or a tender offer—the safe harbor precludes civil liability based on forward-looking statements that turn out to be "wrong" in two instances. First, the safe harbor protects a statement if it is identified as forward-looking and is either immaterial or accompanied by "meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." Second, in the absence of meaningful cautionary language, the safe harbor still protects against liability if the maker lacked actual knowledge that the statement was false or misleading.

Pre-*Quality Systems* Application of PSLRA Safe Harbor to "Mixed Statements"

"Mixed" statements containing both forward-looking and non-forward-looking components present the most difficult safe-harbor questions. In a "mixed" statement situation, arguably the inclusion of a forward-looking component makes the entire statement forward-looking. The Ninth Circuit sanctioned this approach in *Police Retirement System of St. Louis v. Intuitive Surgical, Inc.*, 759 F.3d 1051 (9th Cir. 2014), holding that certain "mixed" statements, when examined as a whole, were forward-looking and therefore protected by the safe harbor. Other appellate courts have not gone this far, concluding that the safe harbor protects only the forward-looking portion of the mixed statement, leaving the speaker potentially liable for inaccuracies in the non-forward-looking portion. *See, e.g., In re Vivendi, S.A., Sec. Litig.*, 838 F.3d 223, 246-49 (2d Cir. 2016); *Spitzberg v. Hous. Am. Energy Corp.*, 758 F.3d 676, 691-92 (5th Cir. 2014); *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 705 (7th Cir. 2008).

Quality Systems Creates New Test for "Mixed Statements"

In *Quality Systems*, the Ninth Circuit essentially did an about-face, asserting that its decision in *Intuitive Surgical* had not addressed "the status of mixed statements under the PSLRA." 865 F.3d at 1141. After holding that an allegedly false statement concerning the defendant company's "robust" pipeline was neither forward-looking—despite its inclusion in the same sentence as projections of revenue and earnings growth—nor inactionable as puffery, the court tacitly rejected the approaches taken in *Intuitive Surgical* and in the decisions of its sister circuits.

Focusing on the cautionary language requirement of the safe harbor's first prong, the court held that a materially false, non-forward-looking portion of a mixed statement almost always precludes application of the safe harbor to the forward-looking portion of the statement because "cautionary language must be understood in the light of the [accompanying] non-forward-looking statement." *Id.* at 1146. In this situation, "virtually no cautionary language short of an outright admission that the non-forward-looking statements were materially false or misleading would have been adequate" to constitute the type of "meaningful" cautionary language required to

qualify for safe-harbor protection. *Id.* at 1148. In other words, in order for the safe harbor to protect the speaker from liability for the forward-looking portion of a mixed statement, the speaker would have to admit that it had violated the securities laws with respect to the non-forward-looking portion of the statement.

Having effectively gutted the protection provided by the safe harbor's first prong whenever a mixed statement includes an allegedly false non-forward-looking component, the court proceeded to do the same with the second prong based on a similar analysis: "[Defendants'] forward-looking statements were premised on . . . non-forward-looking statements [that they knew to be untrue]. It necessarily follows that they also had actual knowledge that their forward-looking statements were false or misleading." *Id.* at 1149.

The *Quality Systems* defendants filed a petition for rehearing *en banc*, primarily arguing that by establishing a new prerequisite for application of the safe harbor, not found in the language of the PSLRA, the court had largely eviscerated the protections afforded by the safe harbor, in contravention of Congress's intent to enhance market efficiency by encouraging greater disclosure of forward-looking information. The Ninth Circuit denied the petition.

Argument Not Considered by Ninth Circuit

Surprisingly, neither the defendants nor the amici who supported the defendants' petition for rehearing *en banc* argued that the allegedly false non-forward-looking statement in *Quality Systems*—that the company's product pipeline is robust—should itself be considered forward-looking, and therefore protected by the safe harbor, as "a statement of the assumptions underlying or relating to" the company's revenue and earnings projections. 15 U.S.C. § 78u-5(i)(1)(A), (D). Nor is there any indication in the decisions of either the Ninth Circuit or the district court, 60 F. Supp. 3d 1095 (C.D. Cal. 2014), that this argument was presented at any time before the petition for rehearing *en banc*.

This approach, if accepted, would turn the entire "mixed statement" into a forward-looking statement subject to the safe harbor's protection. Indeed, the Ninth Circuit had appeared to endorse this approach in *Intuitive Surgical* . 759 F.3d at 1059.

Implications of *Quality Systems* Decision

The Ninth Circuit may not have the last word. The *Quality Systems* decision appears to be an outlier, in conflict with decisions of other federal circuit courts of appeals and with the Ninth Circuit's own decision in *Intuitive Surgical*. Given this discord, as well as the apparent conflict between the Ninth Circuit's decision and the statutory language of the safe harbor, it would not be surprising if the defendants seek direction from the U.S. Supreme Court regarding the proper application of the PSLRA's safe harbor to mixed statements. Under the circumstances, the Supreme Court might find this case worthy of review.

But until then . . . . Unless and until the Supreme Court reverses *Quality Systems*, public companies seeking safe-harbor protections subject to the Ninth Circuit's interpretation would be well-advised to separate their forward-looking statements from any non-forward-looking, historical statements. At the very least, public companies should guard against including statements about projections or plans in the same sentence as historical information, and should not assume that optimistic descriptors like "robust" will be considered so vague as to be nonactionable puffery.

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