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

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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

I. INTRODUCTION

Each year, approximately 300 lawsuits are filed under the federal securities laws and almost ninety-three percent settle out of court at an average cost of $8.6 million. The cost of those suits to corporate America totals over $2.5 billion per year.¹ Many of these lawsuits are filed by "professional" plaintiffs and take the form of class-action "strike" suits. These suits simply allege federal securities law violations and are intended to induce the defendant to settle out of court rather than incur the enormous cost of litigation.² Despite the federal securities laws' underlying goal of encouraging securities issuers to disclose information to the investing public,³ issuers have been justifiably reluctant to make certain kinds of disclosures due to the threat of frivolous litigation.⁴

Particularly vulnerable to fraud allegations under the securities laws are disclosures of predictive, forward-looking, or "soft" information.⁵ If the predictions do not materialize, all parties involved in the making of the predictive statement may be susceptible to claims under the catch-all antifraud provisions of the securities laws: Section 10(b)⁶ of the Secu-

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4. Donald C. Langevoort, Disclosures that "Bespeak Caution," 49 BUS. LAW. 481, 499 (1994) ("The tendency for investors to bring lawsuits when events turn out far less optimistically than expected naturally dampens the incentive of promoters to include the projections.").
5. "Soft" information includes "statements of subjective analysis or extrapolation, such as opinions, motives, and intentions, or forward-looking statements, such as projections, estimates, and forecasts." In re Craftmatic Sec. Litig., 890 F.2d 628, 642 (3d Cir. 1989).
rieties and Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated thereunder. By nature, forward-looking statements inherently have some degree of unreliability, and to allow disappointed investors to sue each time such statements do not materialize would burden issuers and the courts, as well as place unreasonable expectations on those involved in the drafting of disclosure documents. Because forward-looking information typically is useful to potential investors in evaluating a company's economic prospects, steps needed to be taken to protect issuers from strike suits and to encourage the disclosure of valuable forward-looking information.

Recent history has revealed that the courts have decreased their tolerance for strike suits brought under Rule 10b-5 by plaintiff-investors claiming that they were misled by forward-looking statements that did not materialize. Federal courts, in all but one circuit, have adopted a version of the bespeaks caution doctrine as a tool to dispose of such suits. The doctrine allows the courts to grant a defendant's motion to dismiss or motion for summary judgment if the forward-looking statements at issue were accompanied by adequate cautionary language which either rendered the statements immaterial as a matter of law, or were of such a nature that an investor's reliance on the forward-looking

7. Id. § 78a et. seq..
8. Rule 10b-5 creates a private cause of action based on material misstatements or omissions. It provides:
   It shall be unlawful for any person, directly or indirectly ... to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading ... in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (1996). A plaintiff must not only plead an omission or misstatement, but also reasonable reliance and scienter. See Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).
9. See In re Healthcare Compare Sec. Litig., 75 F.3d 276, 281 (7th Cir. 1996) (quoting Azarie v. Mullane, 2 F.3d 1456, 1468 (7th Cir. 1993)) (noting that projections are inevitably inaccurate because things almost never go exactly as planned).
11. See Grossman v. Novell, Inc., 120 F.3d 1112, 1121 (10th Cir. 1997); Harden v. Raffensperger Hughes & Co., 65 F.3d 1392, 1404-06 (7th Cir. 1995); Saltzberg v. TM Sterling/Austin Assocs., 45 F.3d 399, 400 (11th Cir. 1995); In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1414 (9th Cir. 1994); Rubinstein v. Collins, 20 F.3d 160, 167 (5th Cir. 1994); In re Donald J. Trump Casino Sec., 7 F.3d 357, 364 (3d Cir. 1993); Sinay v. Lamson & Sessions Co., 948 F.2d 1037, 1040 (6th Cir. 1991); cf. Mayer v. Mylod, 988 F.2d 635, 639 (6th Cir. 1993); I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., 936 F.2d 759, 763 (2d Cir. 1991); Romani v. Shearson Lehman Hutton, 929 F.2d 875, 879 (1st Cir. 1991); Polin v. Conductron Corp., 552 F.2d 797, 806 n.28 (8th Cir. 1977).
statements would not be considered reasonable. The judiciary has shown its eagerness to further develop the doctrine; however, recent developments in Congress may have thrown a wrench into the judiciary’s efforts.

Congress, like the judiciary, has shown that it is concerned about frivolous securities lawsuits that have a “muzzling effect” on corporate management.\(^\text{12}\) The Private Securities Litigation Reform Act of 1995 (\textquotedblright Reform Act\textquotedblright), built from a proposal by two senators,\(^\text{14}\) traveled down a \textquotedblright[long and [w]inding [r]oad\textquotedblright\(^\text{15}\) before reaching its final form. On December 22, 1995, as part of “the most momentous event in the history of securities litigation since the adoption of the Securities Acts in 1933 and 1934,”\(^\text{16}\) and over President Clinton’s first veto,\(^\text{17}\) the Reform Act became law. One of the most hotly debated provisions of the Reform Act was the new safe harbor for forward-looking statements.\(^\text{18}\) This provision sought to encourage issuers to voluntarily disclose information by providing them with protection from litigation if the standards of the safe harbor were met.\(^\text{19}\) While the safe harbor’s roots are in the judicially-created bespeaks caution doctrine,\(^\text{20}\) the Conference Committee made clear that it did “not intend for the safe harbor provisions to replace the judicial ‘bespeaks caution’ doctrine or to foreclose further development of that doctrine by the courts.”\(^\text{21}\)

Although Congress promulgated the safe harbor as part of its efforts to thwart vexatious litigation,\(^\text{22}\) it may have in effect invited litigation on other grounds,\(^\text{23}\) particularly litigation to test the interpretation of the

\begin{itemize}
\item Avery, supra note 14.
\item HAROLD S. BLOOMENTHAL, \textit{PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995: SPECIAL UPDATE} § 1.01 (Clark, Boardman Callaghan 1996).
\item See text accompanying infra notes 85-88.
\end{itemize}
legislation's ambiguous language. In addition, Congress may have muddied the waters the judiciary was in the process of exploring. This Comment asserts that the new safe harbor, while a congressional milestone and a welcome provision for issuers, needs to be further clarified in light of the bespeaks caution doctrine in order to provide a uniform standard that is useful to both issuers and investors.

This Comment first discusses the development of the judicially-created bespeaks caution doctrine and its current status in the courts. Part III then discusses the protections provided by the Congressionally-created safe harbor for forward-looking statements. Part IV compares the judicial doctrine with the legislative safe harbor. Finally, Part V suggests that the Securities and Exchange Commission ("SEC") should consider changes that would minimize the safe harbor's ambiguity and codify the bespeaks caution doctrine to give the courts a single uniform mechanism to dispose of non-meritorious suits brought by disappointed investors who claim they were misled by forward-looking information that did not materialize.

II. THE JUDICIALLY-CREATED BESPEAKS CAUTION DOCTRINE

A. The Need for Protection

Before 1978, the SEC did not allow issuers to include projections in documents filed with the SEC due to a fear that unsophisticated investors would rely on information that was "inherently unreliable." After evaluating the SEC's disclosure policies in existence in the 1970s, the Advisory Committee on Corporate Disclosure urged the SEC to take action to encourage issuers to disclose forward-looking information.25

The terms "meaningful," "important," and "accompany" have received the most criticism for their ambiguity. See, e.g., Avery, supra note 14, at 337; Carl W. Schneider & Jay A. Dubow, Forward-Looking Information—Navigating in the Safe Harbor, 51 BUS. LAW. 1071, 1089-95 (1996).

Safe Harbor Release, [1994-95 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,436, at 85,779. The Advisory Committee announced this general recommendation on November 3, 1977, along with specific recommendations of how the SEC should accomplish this goal. See Id. ¶ 85, 780-81. The Committee recommended that a safe harbor be adopted that would provide protection to forward-looking statements made with a reasonable basis and in good faith. Id. This recommendation was aimed toward all issuer statements, not solely those that were included in SEC filings. Id. Furthermore, the Committee opined that this safe harbor be available to all registrants and that cautionary language be required to be included with the projections as to clearly indicate the nature of the projection and warn investors not to rely heavily on those projections. Id. The Committee suggested that these disclosures be
Almost two years later, the SEC heeded parts of the Advisory Committee's recommendations and adopted Rule 175.27 Unfortunately, this rule never had a profound effect.28

The development of the bespeaks caution doctrine came as a result of a perceived lack of guidance from the SEC regarding disclosure of assumptions and risk factors in the context of forward-looking statements and a firm's liability for such disclosure.29 In response to this perceived lack of guidance, and to protect issues from frivolous lawsuits,30 the courts developed a doctrine based on the application of two basic concepts of securities law: materiality and reliance.31 As a general matter, the doctrine "provides a mechanism by which a court can rule as a matter of law ... that defendants' forward-looking representations contained enough cautionary language or risk disclosure to protect the defendant against claims of securities fraud."32

Although the phrase "bespeaks caution" first appeared in a footnote of a 1977 Eighth Circuit Court of Appeals decision, Polin v. Conductron Corp.,33 the doctrine was not firmly established until almost ten years later by the Second Circuit in Luce v. Edelstein.34 It was not until five

27. 17 C.F.R. § 230.175 (1996). Rule 175 protects forward-looking statements which are material and turn out to be untrue or misleading. See Id. In order to be protected, the statements must have been made with a reasonable basis and disclosed in good faith.
30. See Rubinstein v. Collins, 20 F.3d 160, 167 (5th Cir. 1994) ("The 'bespeaks caution' doctrine ... reflects a relatively recent ... evolution in securities law driven by the increase in and the unique nature of fraud actions based on predictive statements." (footnotes omitted)); In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1415 (9th Cir. 1994), cert. denied, 116 S. Ct. 277 (1995) ("In our view, 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.'" (quoting Romani v. Shearson Lehman Hutton, 929 F.2d 875, 878 (1st Cir. 1991))).
34. 802 F.2d 49 (2nd Cir. 1986). In Luce, the doctrine was used to affirm the dismissal of claims brought under Section 10(b) and Rule 10b-5 of the Exchange Act which alleged that a Private Placement Offering Memorandum contained intentional misrepresentations about potential tax and cash benefits of the underlying security. Id. at 56. The court, citing Polin,
years after *Luce* that the doctrine became a popular tool used by the courts when granting a motion to dismiss or a motion for summary judgment. Since the early part of this decade, eight additional circuits have adopted versions of the bespeaks caution doctrine with considerable variations, and while the doctrine itself has not yet been before the Supreme Court, lower courts have asserted that the Court implicitly has accepted its logic.

**B. Scope of the Doctrine's Protection**

The bespeaks caution doctrine has been used to grant motions to dismiss and motions for summary judgment in cases brought under sections 1130 and 12(2)38 of the Securities Act of 1933 ("Securities Act") and, most often, cases brought under Section 10(b) and Rule 10b-5 of the Exchange Act.39 Defendants in such suits typically are the issuer, its officers and directors, and underwriters and accountants who played a role in the issuer's registration with the SEC, or in the dissemination of information to investors.40

The bespeaks caution doctrine can apply to statements made in offering documents for initial public offerings, secondary offerings, stated that "[w]e are not inclined to impose liability on the basis of statements that clearly 'bespeak caution.'" *Id.* The court concluded that the Offering Memorandum clearly conveyed that the projections of potential tax and cash benefits were speculative and that it gave no assurance that the benefits would be realized. *Id.*

35. *See supra* note 11 and accompanying text.

36. It has been asserted that the Court's observation in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097-98 (1991), that inconsistencies between true and misleading statements may render the misleading statement immaterial was an implicit acceptance of the doctrine's logic. *See, e.g.*, United States v. Morris, 80 F.3d 1151, 1167-68 (7th Cir. 1996); *Harden v. Raffensperger Hughes & Co.*, 65 F.3d 1392, 1405 nn.9-10 (7th Cir. 1995); *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9th Cir. 1995); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 372 (3d Cir. 1993). *But see* Langevoort, *supra* note 4, at 489-91.


38. *Id.* § 77l(a)(2) (creates a private cause of action for purchasers for misstatements or omissions of material fact in a prospectus or oral statement involving an offer or sale of a security).

39. *Id.* § 77a et. seq.


41. *See generally* cases cited *supra* note 11.


43. *E.g.*, Rubinstein v. Collins, 20 F.3d 160 (5th Cir. 1994).
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vate placements, limited partnerships, as well as statements made in documents attached to offering materials. Some courts have also applied the doctrine to publicly-made statements and others have used it in controversial "fraud on the market" cases. It can be used to protect omissions as well as misstatements, although not all courts agree that the doctrine should apply to omissions.

The doctrine's scope is not limited to protecting those involved with making statements in Securities or Exchange Act documents. It has been expanded in at least one case to protect a fund manager and principal underwriter of a closed-end investment fund registered pursuant to the Investment Company Act of 1940. One of the most important aspects of the doctrine's scope is that it only applies to forward-looking statements, not to statements of current or historical facts. Thus, one cannot omit known or misstate which factors may affect the future of a prediction and later claim protection under the doctrine based on cautionary language.

The Fourth Circuit has applied the broadest approach to the bespeaks caution doctrine holding that unless forward-looking information is worded as a guarantee, it is not actionable under the federal securities laws. It is clear that this per se approach has little chance of being embraced by any other circuit, as most other courts minimally require cautionary language specifically tailored to warn the investor

44. E.g., Saltzberg v. TM Sterling/Austin Assocs., 45 F.3d 399 (11th Cir. 1995).
45. E.g., Romani v. Shearson Lehman Hutton, 929 F.2d 875 (1st Cir. 1991).
46. E.g., Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 949 F.2d 243 (8th Cir. 1991) (involving claim based on misrepresentations or omissions in a financial feasibility study attached as an exhibit to a bond offering memorandum).
47. E.g., Sinay v. Lamson Sessions Co., 948 F.2d 1037 (6th Cir. 1991) (protecting predictive statements made by management as reported in the Wall Street Journal and New York Times); In re Hyperion Sec. Litig., No. 93 Civ. 7179 (MBM), 1995 WL 422480 (S.D.N.Y. July 14, 1995) (protecting oral statements made to brokers during a roadshow where the prospectus containing the cautionary language was distributed at the same time).
50. In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1413 n.2 (9th Cir. 1994).
about risks that may cause the forecasts, opinions, or projections not to come to pass. Furthermore, the majority of courts follow the rule that boilerplate warnings will not suffice.

C. Application of the Doctrine

As previously mentioned, the bespeaks caution doctrine is based on two basic concepts of securities law: materiality and reliance. The courts have taken two different, but not necessarily separate and distinct, approaches to the doctrine based on these concepts. Under the materiality approach, a court can rule as a matter of law that the cautionary language rendered certain forward-looking statements immaterial. Under the reliance approach, the court can rule as a matter of law that as a result of the cautionary language, a reasonable investor would not have relied on the forward-looking statements. While at least one court has exclusively applied the reliance approach, most courts have focused on materiality or applied a combination of the two approaches. Either approach will yield the same result and there seems to be little, if any, advantage of one approach over the other.

The leading and most oft-cited case discussing and accepting the viability of the bespeaks caution doctrine, In re Donald J. Trump Casino Securities Litigation, focuses on a materiality approach, while also acknowledging the possible use of a reliance approach. In Trump, the plaintiffs, a class of investors who purchased bonds financing the acquisition and completion of the Taj Mahal hotel and casino, sued under Sections 11 and 12(2) of the Securities Act and Section 10(b) and rule 10b-5 of the Exchange Act, alleging that the prospectus contained materially misleading statements and omissions. The plaintiffs' primary argument focused on the Management Discussion and Analysis section...
Specifically, the plaintiffs alleged that the defendants had no honest or reasonable belief in the statement: "The Partnership believes that funds generated from the operation of the Taj Mahal will be sufficient to cover all of its debt service (interest and principal)."

The prospectus that the investors received contained abundant warnings and cautionary statements which stressed the following, the intense industry competition, the casino's unprecedented size, the potential inability to repay interest on the bonds, and the lack of operating history on which to base the casino's valuation. The defendants asserted that the cautionary statements alerted investors to obstacles "which qualif[ied] the statements plaintiffs claim they relied upon, [thus,] plaintiffs cannot, as a matter of law, contend that they were misled by the alleged misrepresentations and/or omissions." The court agreed.

As an issue of first impression in the Third Circuit, the court embraced the viability of the bespeaks caution doctrine. The Trump court used a context-based, materiality approach, but seemingly used a reliance approach to get there. The court stated its belief that given the cautionary language in the prospectus, a reasonable investor would not have been influenced by the statement in the MD & A that the Partnership would be able to cover its debt service. Based on this belief, the court held that the plaintiffs could not prove that the alleged misrepresentation was material. In essence, the court held that because a rea-
sonable investor would not have relied on forward-looking statements as a matter of law (reliance approach), the statements were immaterial as a matter of law (materiality approach).

In adopting the bespeaks caution doctrine, the court stated that the doctrine may be applied to allegations of both misstatements and omissions of forward-looking information. The court enumerated its standard for the bespeaks caution doctrine as follows:

[When an offering document's forecasts, opinions or projections are accompanied by meaningful cautionary statements, the forward-looking statements will not form the basis for a securities fraud claim if those statements did not affect the "total mix" of information the document provided investors. In other words, cautionary language, if sufficient, renders the alleged omissions or misrepresentations immaterial as a matter of law.]

What the court meant by "sufficient" is that cautionary language must contain substantive information that specifically applies to the challenged forward-looking statement, and that a boilerplate warning or disclaimer will not suffice.

The Trump court, by emphasizing specificity of cautionary language and the importance of a context-based analysis, was careful not to set forth too broad a standard, such as the Fourth Circuit's per se standard, in which cautionary statements will always negate materiality. Not all of the circuits have adopted the exact Trump formulation of the doctrine, although those courts using the doctrine after Trump have cited its formulation with approval.

D. Problems with the Doctrine

As a result of a lack of uniform application in the circuits and the fact that one circuit has yet to adopt any version of the doctrine, an issuer’s reliance on the protection of the bespeaks caution doctrine when drafting offering documents with forward-looking information is quite risky. This is especially true if the issuer is amenable to personal juris-

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67. Id.
68. Id.
69. Id. at 371-72.
70. E.g., Grossman v. Novell, 120 F.3d 1112, 1120 (10th Cir. 1997); United States v. Morris, 80 F.3d 1151, 1167 (7th Cir. 1996); In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1414 (9th Cir. 1994); Rubinstein v. Collins, 20 F.3d 160, 167-68 (5th Cir. 1994).
diction in more than one circuit due to contacts in various states.

From an investor’s point of view, the most dangerous loophole left by the doctrine is that if cautionary statements considered in context can render misrepresentations and omissions immaterial as a matter of law, the state of mind of the maker of the statement may never be questioned. In other words, under the Trump formulation of the doctrine, issuers, underwriters, accountants, and other parties involved in the dissemination of information about a registrant may implicitly be allowed to make a forward-looking statement which he or she may not necessarily believe is an accurate projection, as long as meaningful specific cautionary language accompanies such statement.

Meanwhile, the Fifth Circuit has made clear that "the inclusion of general cautionary language regarding a prediction [will] not excuse the alleged failure to reveal known material, adverse facts." This essentially means that if one intentionally makes an omission of information which might adversely affect the prediction, the doctrine will not apply. While this assertion seemingly alleviates the loophole in Trump, it addresses only omissions, not statements in which the maker did not have a reasonable belief. In such cases, investors may be forced to rely on the seldom-used Rule 175 and be faced with the difficult burden of proving that "such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith."

Other uncertainties of the doctrine include: whether the doctrine can rightfully be applied to omissions—as the Trump court asserted but other courts have rejected; whether the doctrine can be used to protect oral statements—as few courts have addressed the issue; and to whom and to what types of documents the doctrine applies—as no court has articulated a bright-line rule. As a result of such uncertainties, these issues are decided on a case-by-case basis. Because the interpretation is left up to the judiciary, which can refine or broaden the doctrine as it so desires, an issuer can never be absolutely certain that it will be protected from liability.

71. See Langevoort, supra note 4, at 400 (asserting that, under Trump, "even deliberate misrepresentation by the promoters apparently will be insulated from liability").
72. The Trump court never reached the question of whether the defendants possessed a genuine or reasonable belief in the statements made in the MD & A, which was the plaintiffs' primary allegation, because it decided that the cautionary statements rendered the projections immaterial. See 7 F.3d at 357.
73. Rubinstein, 20 F.3d, at 171.
74. 17 C.F.R. § 230.175(a).
75. See text accompanying supra notes 49-50.
It is clear that as the doctrine has developed from a phrase in a footnote to justify the dismissal of a claim, the standard has become narrower, requiring greater specificity in the cautionary language. What is yet to be seen is whether the SEC will recognize that this doctrine is partially usurped by the new Congressionally-created safe harbor for forward-looking statements, discussed below, and take action to codify the doctrine in order to provide one uniform standard which will put issuers, investors, and courts on notice as to which forward-looking statements may be actionable.

III. THE CONGRESSIONALLY-CREATED SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

A. The Development of the Safe Harbor

As part of its "Contract with America," the newly-empowered Republican Party was determined to end frivolous private securities litigation. While Congress eventually succeeded in passing the Reform Act, it was not without much debate. Of the many issues considered under the Reform Act, the safe harbor for forward-looking statements generated the greatest controversy. Like the courts, Congress recognized that the safe harbor promulgated by SEC Rule 175, "has not provided companies meaningful protection from litigation" and thus acknowledged the need for a new safe harbor with better protection.

When Senators Pete Domenici and Chris Dodd proposed the Reform Act, the SEC was in the process of considering the adoption of a safe harbor for forward-looking statements. As introduced, the Reform Act would have allowed the SEC to continue its rulemaking efforts, as well as make recommendations to Congress for legislative assistance. The project was eventually removed from the SEC's hands, but

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the SEC continued to make considerable contributions and provide input that was not always heeded. Before the Act reached its final form, the chairman of the SEC, Arthur Levitt, expressed concern that the safe harbor would provide immunity from liability for fraudulent statements.\textsuperscript{81} Several Senators agreed with him even after revisions took place.\textsuperscript{82} While the SEC may not have gotten exactly what it wanted,\textsuperscript{83} its efforts were far from fruitless. The SEC's role in the legislation produced many exclusions from the safe harbor that may prove to be controversial for parties that the SEC felt were problematic, such as blank check and penny stock issuers.\textsuperscript{84}

From beginning to end, the goal of the legislative safe harbor remained the same: to encourage issuers to disclose forward-looking information by insulating them from liability if such information did not come true.\textsuperscript{85} President Clinton supported the goals of the Reform Act to end frivolous lawsuits and to ensure that investors receive the best possible information by reducing the litigation risk for forward-looking statements; however, he vetoed the measure on December 19, 1995.\textsuperscript{86} Despite the President's support for the safe harbor for forward-looking statements, he objected to the language in the Conference Committee Report relating to the safe harbor, stating that it "attempts to weaken the cautionary language that the bill itself requires" and that "investors [may] find their legitimate claims unfairly dismissed."\textsuperscript{87} The House of Representatives voted to override the veto on December 20, 1995 by

\textsuperscript{81} Levitt stated, "I cannot embrace proposals which allow willful fraud to receive the benefit of safe harbor protection." Letter of May 25, 1995, to Senator D'Amato relating to S.240 as presented to the Senate, included as Exhibit 1 to Statement of Senator Sarbanes, 41 CONG. REC. S8905 (daily ed. June 22, 1995); see also John C. Coffee, Jr., The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Yet Sung, 51 BUS. LAW. 975, 989 (1996). ("Probably the most striking feature of the Reform Act's safe harbor is the immunity it seems to give a bald, knowing lie that is surrounded by 'meaningful cautionary sentiments'.")


\textsuperscript{83} Chairman Levitt implied in a speech that he did not give full approval to the legislation. He mentioned the President's veto message and stated that "[t]he points raised by the President were an attempt to make the bill a bit better. The Congress decided to go ahead with the legislation as it was. So be it." Arthur Levitt, Final Thoughts on Litigation Reform (Jan. 24, 1996) (visited November 20, 1997) <http://www.sec.gov/news/speeches/spch070.txt>.

\textsuperscript{84} Id.


\textsuperscript{87} Id; see also Michael K. Frisby & Jeffrey Taylor, Clinton Vetoes Bill Limiting Securities Suits, WALL ST. J., Dec. 20, 1995, at A3.
over a three to one majority and the Senate, after two days of debate, did the same on December 22, 1995, by voting over two to one to override the veto.

B. The Final Product

The final result, after much deliberation, was an amendment adding Section 27A to the Securities Act and an amendment adding Section 21E to the Exchange Act. Each of these sections is the same except that they appear in two separate statutory bodies of law.

In its final form, the safe harbor, like the bespeaks caution doctrine, provides protection from liability if the relevant factors and risks underlying the projection are adequately disclosed. Alternatively, protection is provided if the plaintiff cannot prove that the person making the projection had actual knowledge that it contained an untrue statement or omission of a material fact. The safe harbor protects only forward-looking statements, the definition of which was borrowed in large part from Rule 175. But unlike Rule 175, this safe harbor is not


91. Id. § 78u-5.

92. See text accompanying infra notes 102-07.

93. See text accompanying infra note 109.

94. Rule 175 defines forward-looking statements as:
(1) A statement containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;
(2) A statement of management's plans and objectives for future operations;
(3) A statement of future economic performance contained in management's discussion and analysis of financial condition and results of operations included pursuant to Item 303 of Regulation S-K ... or Item 9 of Form 20-F; or
(4) Disclosed statement of the assumptions underlying or relating to any of the statements described in paragraphs (C)(1), (2), or (3) of this section.

17 C.F.R. § 230.175(c) (1996). The safe harbor defines "forward-looking statement" as:
(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;
(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the...
limited to documents filed with the SEC; it extends to any statement within its scope. Finally, the safe harbor's protection is not available in SEC enforcement actions, it is only available in private actions arising under the Securities or Exchange Acts based on misstatements or omissions of material facts.95

Congress carefully carved out the scope of the safe harbor with several exclusions at the request of the SEC.96 Specifically, the safe harbor covers forward-looking statements made by issuers subject to the reporting requirements of Section 13(a) or 15(d) of the Exchange Act, anyone acting on behalf of such issuer, outside reviewers of the statements, and underwriters.97 Protection is not provided to issuers who have been convicted of certain securities violations98 or who have been the subject of a judicial or administrative decree involving the antifraud provisions of the securities laws in the preceding three years.99 The safe harbor also excludes statements made in a financial statement prepared in accordance with generally accepted accounting principles, made by an investment company, made in a disclosure of beneficial ownership, and made in connection with a tender offer, an initial public offering, partnership, limited liability company, or direct participation investment program.100

The centerpiece of the safe harbor is composed of two alternative prongs, the bespeaks caution prong, and the actual knowledge prong. Under the bespeaks caution prong:

a person [to whom this title applies] shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that—

(A) The forward-looking statement is—

96. See accompanying text supra note 84..
98. To be excluded, the conviction must have been in the past three years and been for one of the acts enumerated in Section 15(b)(4)(B)(i)-(iv). Id. §§ 77z-2(b)(1)(A), 78u-5(b)(1)(A).
100. Id. §§ 77z-2(b)(2), 78u-5(b)(2).
(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or
(ii) immaterial.\textsuperscript{101}

Like the bespeaks caution doctrine, boilerplate warnings will not suffice to satisfy the requirement of cautionary language.\textsuperscript{102} Instead, the cautionary statements must substantively relay information about particular factors relevant to the projection that could cause results materially different than those projected in the forward-looking statement.\textsuperscript{103} Furthermore, the “[f]ailure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean [in and of itself] that the statement is not protected by the safe harbor.”\textsuperscript{104}

The Conference Committee stated that under the bespeaks caution prong, courts are not to examine the state of mind of the person who made the forward-looking statement,\textsuperscript{105} which, like the Trump formulation of the bespeaks caution doctrine, may create a loophole for those who intentionally make a misleading statement but include the appropriate cautionary language. In addition, the Conference Committee provided little guidance for the meaning of ambiguous terms in this provision such as “meaningful,” “accompanied by,” and “important.”\textsuperscript{106}

\begin{itemize}
\item \textsuperscript{101} Id. §§ 77z-2(c)(1)(A), 78u-5(c)(1)(A). Interestingly, Congress claimed it relied on the principles of the bespeaks caution doctrine in formulating this first prong, but an analytical reading of the first prong as a whole leads one to believe that the function and end result of the doctrine was not fully understood. The first subdivision clearly reflects the underlying principle of the doctrine, which, in the courts, may render a forward-looking statement immaterial as a matter of law. See In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357 (3d. Cir. 1993). It seems redundant that a second, disjunctive subdivision is needed when immateriality is the result of satisfaction of the first subdivision. Moreover, materiality is a key concept in securities law; an investor may not even state a cause of action under the catch-all anti-fraud provision unless the alleged misstatement or omission is material. See 17 C.F.R. § 240.10b-5(b) (1996); see also Basic Inc. v. Levinson, 485 U.S. 224 (1988); TSC Indus., Inc. v. Northway, Inc. 426 U.S. 438 (1976).
\item \textsuperscript{103} Id. at 43-44, reprinted in 1996 U.S.C.C.A.N. 730, 743-44.
\item \textsuperscript{104} Id. at 44, reprinted in 1996 U.S.C.C.A.N. 730, 743.
\item \textsuperscript{105} Id. The stated purpose for not examining the state of mind of the person who made the forward-looking statement was to not give plaintiffs' lawyers the opportunity to conduct extensive discovery to determine what was and was not known at the time the statement was made. Id.
\item \textsuperscript{106} Six Senators urged the Conference Committee to clarify the terms of the safe harbor to provide a bright-line rule that is unmistakable to both potential plaintiffs and defendants. See S. REP. NO. 104-98, at 33-35, (1995), reprinted in 1996 U.S.C.C.A.N. 679, 711-13 (Additional Views of Senators Gramm, Mack, Faricloth, Bennett, Grams, and Frist). For a
\end{itemize}
The first subdivision of the bespeaks caution prong is the one most widely to be relied upon by issuers. This is because little was accomplished by the second subdivision of this prong which restates an established principal of securities law—that immaterial statements are inactionable.

Under the actual knowledge prong, there is no liability if:
the plaintiff fails to prove that the forward-looking statement—
(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or
(ii) if made by a business entity; was—
(I) made by or with the approval of an executive officer of that entity, and
(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading. 107

A literal reading of the actual knowledge prong appears to leave a loophole for anyone bent on making a fraudulent misstatement or omission. 108 Such statement could be made under the guise of the business entity by anyone who is not an executive officer of the entity and, even with the approval of an executive officer, without informing such officer that the statement is false or misleading. 109 Because lawyers draft or oversee the majority of disseminated information, this task would seem quite easy.

The safe harbor also protects oral statements 110 if the statements are identified as forward-looking and include a cautionary statement that complies with the requirements enumerated in the bespeaks caution prong. 111 Alternatively, oral forward-looking statements will be protected if they expressly state that actual results may materially differ
from those projected and if they clearly identify a "readily available written document, or portion thereof" that contains detailed cautionary statements that comport with the bespeaks caution prong. This portion of the safe harbor is available only to the officers, directors, and employees of the issuer or the same of those acting on the issuer's behalf.

Additional provisions in the safe harbor provide that there is no duty to update any forward-looking statement, and that in deciding a motion to dismiss, a court must consider any statements cited in the plaintiff's complaint as well as any cautionary statements accompanying the forward-looking statement at issue cited by the defendant. In addition, the safe harbor requires courts to stay discovery proceedings for matters unrelated to the safe harbor while a defendant's motion for summary judgment is pending, provided that the motion is based on a claim of protection under the safe harbor. Finally, and of significant importance, is the encouragement the Conference Committee voiced to the SEC to use its rulemaking power to expand the coverage of the safe harbor, provide additional exemptions, and consider the adoption of additional safe harbors to cover currently excluded statements.

C. The Issuers' Reaction

As a result of the enactment of the safe harbor, public companies have had to reevaluate their disclosure policies and procedures for forward-looking statements. It is overwhelmingly apparent that issuers are pleased with the legislation because a significant amount of companies

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112. "Readily available," for purposes of this provision, means "[a]ny document filed with the [SEC] or generally disseminated." Id. §§ 77z-2(c)(3), 78u-5(c)(3). "Generally disseminated" documents are not defined, but would likely include annual reports and other widely distributed materials, such as press releases.


114. Id. §§ 77z-2(c)(2), 78u-5(c)(2).

115. Id. §§ 77z-2(d), 78u-5(d). Under current case law, this does not, however, alleviate any existing duty to update. See Schneider & Dubow, supra note 24, at 1077 n. 36.

116. 15 U.S.C. §§ 77z-2(e), 78u-5(e) (1996). The cautionary statements the defendant cites must not be subject to material dispute. Id. The material dispute limitation seems to be somewhat ambiguous insofar as it is not clear what about the cautionary statements must not be subject to dispute—the existence of it, its cautionary nature, or whether it "accompanied" the forward-looking statement. The legislative history provides little guidance on this issue; therefore, its meaning will likely be left to the interpretation of the courts.

117. Id. §§ 77z-2(f), 78u-5(f).

have taken advantage of the first prong in their proxy statements and annual, quarterly, and special reports. An explicit example of an issuer's attempt to comport with the new safe harbor is Motorola's 1996 proxy statement.\textsuperscript{119} The MD & A portion includes under the heading "Other Matters" a section entitled "Cautionary Statement for Purposes of the 'Safe Harbor' provisions of the Private Securities Litigation Reform Act of 1995."\textsuperscript{120} This section enumerates the headings throughout the report that contain forward-looking statements and alerts the reader to the uncertainties in such statements.\textsuperscript{121} The section then exhaustively describes in detail the "important" factors which could cause Motorola's actual results to "differ materially from those expressed in any forward-looking statements made by, or on behalf of, Motorola."\textsuperscript{122}

Without precedent to set forth a standard of comparison, Motorola's MD & A appears to satisfy the bespeaks caution prong of the safe harbor because it specifically identifies statements that are forward-looking, and with reference to the statements, identifies important factors which could cause materially different results than those projected.\textsuperscript{123} Motorola's cautionary language clearly is not boilerplate. For those same reasons, the MD & A also appears to satisfy any formulation of the bespeaks caution doctrine. Then why should the courts continue to use the bespeaks caution doctrine if the safe harbor provides an efficient, statutory basis for reaching the same result? The doctrine and the safe harbor will not always provide identical protection; however, any disparity could be resolved if the SEC heeds the Conference Committee's encouragement to use its rulemaking power to expand or limit the safe harbor. First, though, the disparities between the doctrine and the statutes must be fleshed out.

IV. WHAT'S THE DIFFERENCE BETWEEN THE JUDICIAL DOCTRINE AND THE LEGISLATIVE SAFE HARBOR?

The Conference Committee acknowledged that the development of the safe harbor was based on aspects of the judicially-created bespeaks

\textsuperscript{119} Motorola Inc., DEF 14A (May 7, 1996), available in WESTLAW, EDGAR database at Filing 96536232.
\textsuperscript{120} Id. at 33.
\textsuperscript{121} Id. at 33-34.
\textsuperscript{122} Id. at 33. Such factors include a moderating growth rate in the cellular subscriber bases, underutilization of Motorola's plants and factories, growth in Motorola's selling, general, and administrative expenses, difficulties in obtaining raw materials, and risks related to the success of one of Motorola's new projects. Id. at 33-34.
\textsuperscript{123} See text accompanying supra note 101.
caution doctrine\textsuperscript{124} while also acknowledging that the safe harbor was not meant to replace the doctrine.\textsuperscript{125} As a result, issuers and investors are subject to the courts' \textit{ad hoc} interpretation of two separate, yet very similar, standards. At least one court has already erred in stating that the safe harbor is a codification of the bespeaks caution doctrine.\textsuperscript{126} Until action is taken to merge the two, it is important to understand the similarities and differences between the protections provided by the judicial doctrine and the legislative safe harbor.

The judicial doctrine and the legislative safe harbor share the same underlying purpose: to provide protection to issuers that disclose forward-looking information with protection from frivolous lawsuits.\textsuperscript{127} The bespeaks caution doctrine emphasizes that cautionary language must be "substantive and tailored to the specific future projections, estimates or opinions" at issue,\textsuperscript{128} and the safe harbor requires the cautionary language to be "meaningful" and contain specific "important" factors that may change the outcome of the projection.\textsuperscript{129} Thus, under both the doctrine and the safe harbor, it is clear that in order to be protected from liability for forward-looking statements that turn out not to come true, the cautionary language surrounding the statement must be issuer-specific and carefully crafted. They also share a seemingly broad scope insofar as the statements they may reach, including publicly-made statements and statements released to the media.\textsuperscript{130}

There are also some important differences between the Congressionally-created safe harbor and the judicially-created doctrine. The legislative history of the safe harbor states that the failure to include the specific factor that ultimately causes the forward-looking statement not


\textsuperscript{126} Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1213 n.23 (1st Cir. 1996) ("The doctrine has been codified in the Securities Litigation Reform Act.").

\textsuperscript{127} See supra notes 30, 76 and accompanying text.


\textsuperscript{130} The distinguishing factor between publicly-made statements protected under the doctrine and those protected under the portion of the safe harbor relating to oral forward-looking statements is that under the safe harbor, the listener must also be referred to a "readily available" document that likewise, or in more detail, enumerates the factors possibly affecting the realization of the forward-looking statement. Id. §§ 77z-2(c)(2), 78u-5(c)(2).
to materialize will not remove the safe harbor's protection. This essentially means that the safe harbor will protect omissions as long as proper cautionary language was present. At first blush, it seems that courts allowing omissions to fall under the bespeaks caution doctrine would agree with this provision. However, those courts using a materiality approach to determine whether an omission should be afforded protection under the bespeaks caution doctrine likely would find that the failure to include the specific factor which ultimately causes the forward looking statement not to materialize is not protected. This is because the standard set forth by the Supreme Court for materiality of omissions is whether there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." The fact that the facts or events constituting the omission caused the forward-looking statement to differ from its projection would weigh strongly in favor of finding that such omission was material. Thus, while the bespeaks caution doctrine may not protect the omission of the factor that ultimately causes the projection not to come true, the safe harbor may afford protection.

The most glaring difference between the safe harbor and the bespeaks caution doctrine is the safe harbor's exclusions. The Conference Committee did not include in the legislative history the reasons why initial public offerings, partnership offerings, tender offers, going private transactions, and others are not given the benefit of the safe harbor. It seems odd that Congress chose to embrace the essence of the bespeaks caution doctrine, yet excluded statements made in connection with particular transactions that are protected in some of the core bespeaks caution cases.

An analysis of the judicial doctrine versus the legislative safe harbor reveals that the principal of the bespeaks caution doctrine was codified in the safe harbor, but that the bright-line scope of the legislative safe harbor clearly distinguishes the two. What they do share is a world of uncertainty that will have to be looked through by the courts unless the SEC takes initiative to merge the judicial and legislative creations into a single uniform standard.

131. See text accompanying supra note 104.
133. See, e.g., In re Worlds of Wonder Sec. Litig., 814 F. Supp. 850 (N.D. Cal. 1993), aff'd, 35 F.3d 1407 (9th Cir. 1994) (initial public offering); Romani v. Shearson Lehman Hutton, 929 F.2d 875 (1st Cir. 1991) (limited partnership).
V. THE SEC'S CALL TO ACTION TO REFINE THE SAFE HARBOR

A. The Need for Change

What seems most peculiar about the legislative safe harbor in the Reform Act is that the Conference Committee implicitly accepted the viability of the bespeaks caution doctrine\(^\text{134}\) and used it as a basis in its drafting of the legislation, but then left the doctrine intact and encouraged the courts to further its development. What prevented Congress, in its painstaking process of producing the final legislation, from simply codifying the doctrine and providing one uniform body of law to which the courts, issuers, and investors could turn and clearly be put on notice of what kinds of statements would be actionable? Moreover, why did Congress, in its valiant effort to diminish frivolous litigation, set forth an ambiguous standard which invites litigation to determine its meaning?

B. Why the SEC?

While the recent efforts of the courts in developing the bespeaks caution doctrine have provided some protection for issuers, the doctrine is subject to judicial decision making and its future is at the mercy of the lifetime-tenured judges in the federal courts. These judges possess a wealth of knowledge on many subjects, but likely are not all experts in the area of securities regulation. There lies an inherent risk for issuers to rely on judge-made law to protect them from liability. This is due to the possibility that one judge might decide to narrow or even dispose of the bespeaks caution doctrine for policy reasons or on the basis of a persuasive argument on the day that particular issuer is in court.\(^\text{135}\)

Similarly, while it cannot be disputed that the Reform Act promulgated by Congress has been warmly welcomed and already put into use by issuers previously plagued by the fear of being sued on the basis of forward-looking information that does not materialize,\(^\text{136}\) Congress is

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134. When it based the premise of the safe harbor on the bespeaks caution doctrine and explicitly encouraged the courts to develop the doctrine, Congress voiced approval for its underlying principal and utility in securities litigation. See supra text accompanying notes 20-21.

135. The Conference Committee agreed that the judiciary is not the best entity to interpret and develop securities law. S. REP. NO. 104-98, at 4 (1995), reprinted in 1996 U.S.C.C.A.N. 679, 683. The Committee stated that judges have been “free to develop conflicting legal standards, thereby creating substantial uncertainties and opportunities for abuses of investors, issuers, professional firms and others.”

136. See, e.g., supra part III-c. See generally John P. Redd, Safe Harbor Protections:
not the best entity to refine the legislation to maximize its benefit to issuers and investors. Congress is subject to political powers in its decision making process such as the views of interest groups and the views of its constituents. In addition, to produce a consensus, Congress can be forced, as it was in the passage of the Reform Act, to compromise provisions that might have provided additional benefits. 137

Clearly the entity in the best position to clarify the legislation is the SEC. As the administrative agency created to regulate the securities industry, the SEC certainly possesses the knowledge and expertise to promulgate rules and regulations regarding forward-looking statements. Chairman Levitt has expressed the view that this approach is not only appropriate, but more efficient than legislation. 138 The SEC should heed the Conference Committee's suggestion to build upon the existing safe harbor 139 and provide clear and comprehensive standards protecting issuers from vexatious litigation. Moreover, should the SEC, at a minimum, provide interpretive releases of the ambiguous terms of the safe harbor, the courts would be required to defer to those interpretations under Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 140 thereby eliminating danger of a judicial misinterpretation.

C. A Task Left Unfinished

Before Senators Domenici and Dodd introduced the Reform Act, the SEC contemplated promulgating a safe harbor for forward-looking statements. 141 In response to notice of the SEC's intent, Professor John C. Coffee, Jr. proposed Rule 10b-22, a codification of a variant of the

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137. Senator Chris Dodd acknowledged that the need to produce a consensus in order to get Congress to pass the Reform Act resulted in the exclusion of certain provisions which he wished would have been included. S. Rep. No. 104-98, at 51, reprinted in 1996 U.S.C.C.A.N. 679, 729 (additional Views of Senator Dodd).

138. In testimony before the Securities Subcommittee, Chairman Levitt stated that "[b]ased on the Commission's experience with this issue to date, we believe that there is considerable value in proceeding with rulemaking, which can more efficiently be administered, interpreted and if needed, modified, than can legislation." Securities Litigation Reform: Hearings on S.240 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 104th Cong., (1995) (statement of Arthur Levitt, Chairman, Securities and Exchange Commission).

139. See text accompanying supra note 118.

140. 467 U.S. 837 (1984); see also Coffee, supra note 81, at 996.

bespeaks caution doctrine. 142 Professor Coffee's proposal provided protection to forward-looking statements made in a document filed with the SEC or made in connection with an annual report. 143 It protected statements regarding liquidity, capital resources, and operations results insofar as they described predictive trends, demands, commitments, or other uncertainties. 144 Such a statement would be protected only if it contained or was closely accompanied by "clear and specific cautionary language that explains in detail sufficient to inform a reasonable person of the level of risk associated with, or inherent in, the statement and that identifies the specific basis for such statement and for such level of risk." 145 The proposal also sought to include, as the safe harbor does, issuers subject to the requirements of section 13(a) or 15(d) of the Exchange Act, but sought to exclude only "penny stock" issuers and investment companies registered under the Investment Company Act of 1940. 146

By the time the SEC began to seriously consider the number of proposals it had received, such as Professor Coffee's, Congress had already taken action to develop the Reform Act. This does not mean, however, that the SEC cannot look back to what it started several years ago to further develop Congress' safe harbor.

D. What the SEC Should Do Now to Provide a Uniform Standard

Although the legislation has its faults, Congress has provided a workable foundation on which the SEC can build by filling in the gap between the safe harbor and the bespeaks caution doctrine and by providing definitions for ambiguous language. The SEC has already used its rulemaking power to adopt rules relating to the safe harbor in the context of derivative financial and commodity instruments and should continue down that path to further refine the safe harbor. 147

143. Id. at 85, 795.
144. Id. at 85, 795-96.
145. Id.
146. Id. at 85,795-96.
147. The SEC proposed amendments on April 6, 1996, and adopted them on January 31, 1997. These amendments expand the safe harbor to apply to quantitative market risk information for derivative and other financial instruments, as well as information about market risk regarding future reporting periods. This information will appear in Items 305(a) and 305(b)(3) of Regulation S-K and Item 9A(a) of Form 20-F. Disclosure of Accounting Poli-
The primary areas that SEC needs to address are safe harbor’s exclusions and the legislation’s ambiguous language. Concerning the exclusions, the SEC should first recognize the Conference Committee’s suggestion to give special considerations in their rulemaking efforts to established and reputable entities excluded from the safe harbor’s protections. This suggestion, however, seems just as ambiguous as Congress’ other efforts insofar as what “established and reputable” mean.

Similarly, the SEC should look to what the Advisory Committee on Corporate Disclosure suggested almost twenty years ago—to include all registrants, but leave intact the exception for issuers convicted of violating the securities laws and issuers subject to a judicial or administrative decree related to securities fraud in the past three years. It seems that if Congress was willing to give the safe harbor such a broad scope and apply it to all communications by an issuer, whether or not that communication is filed with the SEC, its scope should be just as broad and apply to all registrants, with minimal exceptions. The SEC should look to Professor Coffee’s suggestion to keep intact the exclusion of penny stock issuers, as well as other issuer transactions that are inherently risky, including blank check offerings and rollup transactions.

To codify the bespeaks caution doctrine, initial public offerings, partnership offerings, and registrants under the Investment Company Act of 1940 should not be excluded. As long as Congress has encouraged the courts to further develop the doctrine covering these offerings and parties, it is rational for the SEC to simply expand the scope of the safe harbor to reach the outer limits of the bespeaks caution doctrine to provide a uniform, rather than alternative, body of law.

Concerning the ambiguous language in the safe harbor, particularly the terms “accompanied by,” “meaningful,” and “important,” the SEC should consider the following interpretive rules. These rules would bring the safe harbor into parity with, and essentially usurp, the bespeaks caution doctrine because they codify the uses of the doctrine while also providing specific, bright-line rules.
1. "Accompanied By"

To receive protection under the safe harbor, a forward-looking statement must be accompanied by meaningful cautionary statements which identify important factors that could cause actual results to differ materially from those in the forward-looking statement. In a written document, "accompanied by" means within the same section or under the same heading of the document. It is also acceptable, within the section or under the heading of the document containing the forward-looking statements, to explicitly refer the reader to other sections of the same document that contain cautionary language. It is not acceptable for a written document to incorporate by reference cautionary statements contained in a separate document, regardless of whether that separate document is filed with the SEC.

The meaning of "accompanied by" for purposes of oral forward-looking statements is enumerated in the statutory safe harbor, but for clarification, reference to generally disseminated documents may include press releases.

2. "Meaningful" Cautionary Statements

The term "meaningful" is included to draw a distinction between boilerplate and substantive disclosure. To be considered "meaningful," cautionary statements must be industry and issuer-specific and explain to the reader or listener in detail why the forward-looking information does not affect the "total mix" of information provided to investors. In addition, the cautionary language should urge the reader or listener to consider the forward-looking information in context with the meaningful warnings.

3. "Important" Factors

Included with forward-looking information must be important fac-

151. This suggestion is based on the "contains or is closely accompanied by" language in Professor Coffee's proposal. See Safe Harbor Release, [1994-1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,436, at 85,795.

152. This addition prevents confusion on the part of potential investors who may not be familiar with the other types of documents available. By requiring that the forward-looking statements be "accompanied by" cautionary language in the same document, there is no risk that a reader would not have available all the factors which should or should not play into his or her investment decision.

153. See Coffee, supra note 81, at 987.

154. This language is included to codify the Trump formulation of the bespeaks caution doctrine. See In re Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 371 (3d Cir. 1993).
tors that, from the issuer's point of view, potentially could affect whether the forward-looking statement is realized. While issuers use their judgment to decide what is important enough to include, the determination of whether a factor is "important" should be judged on a "probability versus magnitude" basis. In other words, if the effect that a particular factor would have on a forward-looking statement would likely cause a significant change in the security's value, such factor should be included. Although the failure to include the particular factor that ultimately causes a forward-looking statement to materially differ from its projection is not fatal to the safe harbor's protections, based on the probability versus magnitude test, only on rare occasions would such exception apply.

In conclusion, the SEC must realize that if it does not take action to codify the bespeaks caution doctrine as part of its rulemaking powers, issuers, investors, and courts will be burdened with the uncertainties of two bodies of law. By adopting the suggestions proposed above and thus codifying the bespeaks caution doctrine in the form of SEC Rules or interpretive releases, problems such as the courts' misinterpretation and litigation challenging the scope of the safe harbor's ambiguous language can easily be avoided.

VI. CONCLUSION

In the midst of the judicial evolution of the bespeaks caution doctrine as a tool to dispose of frivolous securities litigation, Congress added an overwhelming factor to the mix. In its own effort to develop law that would end frivolous class-action and individual investor suits, Congress codified the essence of, but not the particularities of, the bespeaks caution doctrine. Congress expressed its approval of the doctrine, yet did not fully embrace its scope, leaving it instead to the courts to further the doctrine's development while alternatively applying and interpreting the similar, but different, legislative safe harbor.

The SEC, as the best equipped entity to prevent potential problems,
must take action to fully codify the bespeaks caution doctrine within the legislative safe harbor and to give a more precise meaning to the safe harbor's ambiguous terms. Until the day when issuers, investors, and courts are put on notice of a clear, uniform standard that will protect forward-looking statements from liability, it is quite possible that attorneys once busy with securities strike suits will turn their attention to challenging the scope of the doctrine and the safe harbor.

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