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Recent Case Emphasizes the Need to Include Well-Drafted Forward-Looking Statements Cautionary Language

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A recent decision by the influential Second Circuit of the U.S. Court of Appeals reinforces the need to be mindful to ensure that well-drafted forward-looking statement cautionary language accompanies forward-looking statements included in any public statements made by an SEC reporting company.

Provisions of the Private Securities Litigation Reform Act (PSLRA) of 1995 insulate SEC reporting companies and persons acting on their behalf from liability for material misstatements or omissions with respect to forward-looking statements if: (1) such forward looking statement is identified as such 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"; (2) such forward looking statement is immaterial; or (3) the plaintiff fails to prove that such forward-looking statement was made with actual knowledge that the statement was false or misleading.

At issue in *Slayton v. American Express Company*, 604 F.3d 758 (2d. Cir. 2010), was American Express Company's statement in its quarterly report on Form 10-Q for the quarter ended March 31, 2001 that expected

losses on its high-yield investments (through its subsidiary American Express Financial Advisors (AEFA)) during the remainder of the year "are expected to be substantially lower" than the $182 million in losses reported for the first quarter. The court found that, while sufficiently identified as forward-looking, the statement was not accompanied by meaningful cautionary language despite the company's identification of "potential deterioration in the high-yield sector, which could result in further losses in AEFA's investment portfolio" as a potential "risk and uncertainty" that could cause actual results to differ materially from those expressed by forward-looking statements in the report.

Shortly before American Express filed the Form 10-Q on May 15, 2001, AEFA's Chairman and CEO was informed by its CFO that the company was facing additional losses on its high-yield investment portfolio beyond what it had already booked, despite a first quarter internal review of the investments that had concluded that the worst losses were behind them. The company's Chairman, President and CEO was advised the following day of the situation and the fact that the potential deterioration in the portfolio was due to sharp increases in defaults on the underlying bonds. He was also informed, however, that the magnitude of the situation was not yet known. As a result, the company began a further investigation of the situation that would have company personnel draw their own conclusions about the bonds that underlied the securities instead of relying on reports generated by outsiders as it had done previously. By July the review was completed and the company announced additional write-downs, but in the meantime the first quarter Form 10-Q was filed including the statement of lower levels of expected losses and without any discussion of the increase in defaults in the bonds underlying the company's high-yield investments as a potential risk in the forward-looking statement warning.

The defendants argued that they warned of the exact risk that materialized. The court, however, found the company's cautionary statement too vague to be "meaningful," as it referred to deterioration in the high-yield sector in general and not to the true risk of rising defaults on the bonds underlying its own investment-grade collateralized debt obligations that would eventually cause the losses in its portfolio. The court further stated that the cautionary language "verges on the mere boilerplate, essentially warning that 'if our portfolio deteriorates, then there will be losses in our portfolio.'" Importantly, the court noted that "the cautionary language [in the company's filings] remained the same even while the problem changed," i.e., even after the new information that surfaced in May 2001, "bel[ying] any contention that the cautionary language was 'tailored to the specific future projection.'"

On the positive side, the court agreed that a forward-looking statement need not be included in a discussion clearly labeled "forward-looking statements" or specifically labeled as such in order to be sufficiently identified as forward-looking. Rather, as is standard practice, "the use of linguistic cues like 'we expect' or 'we believe,'

when combined with an explanatory description of the company's intention to thereby designate a statement as forward-looking, generally should be sufficient to put the reader on notice that the company is making a forward-looking statement." The case serves as reminder, however, that "boilerplate" forward-looking disclaimers will not suffice to protect a company from liability for forward-looking under the PLRSA.

While here the court found in favor of the defendants based on the plaintiffs' failure to prove the statement at issue was made with actual knowledge that it was false or misleading, SEC reporting companies should still take to heart the court's ruling with respect to what constitutes meaningful cautionary language. The prong of the forward-looking statements safe harbor for statements made without actual knowledge that they were false and misleading is a fact-intensive inquiry that companies should rely on as a fallback position only, and not take as a reason to not ensure that forward-looking statements they make are accompanied by meaningful cautionary statements as per the *Slayton* case. In particular, company personnel should ensure that the forward-looking cautionary language included in their company's SEC filings and other public statements are tailored to the statements actually made as well as the company's current knowledge and do not remain static as the underlying risks change. Notably, when a company becomes aware of new information that might impact actual results as compared to those expressed in forward-looking statements, the forward-looking cautionary language should be updated accordingly.

About Me

I am a former SEC attorney who also has prior "big firm" experience. I assist public as well as private companies with compliance with federal and state securities laws, including assisting public companies with their reporting obligations under the Securities Exchange Act of 1934, at competitive billing rates. Please contact me if you would like more information about my practice or to discuss how I can be of assistance to you.

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