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# Public Companies, Beware!

Safe Harbor protection requires thoughtful warnings and a sophisticated defense.



Public companies around the country labor under the misunderstanding that the Private Securities Litigation Reform Act’s “Safe Harbor” provision protects them from liability for publicly announced earnings guidance and other forward-looking statements. But the Safe Harbor is really not so safe; in fact, many judges go to great lengths to avoid the statute’s plain language and to hold companies responsible for false forward-looking statements.

The Safe Harbor was a key component of the 1995 reforms of securities class action litigation, through which Congress sought, in part, to encourage companies to disclose forward-looking information. The Safe Harbor, by its plain terms, is straightforward. A material forward-looking statement is not actionable if it either: (1) 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 (2) is made without actual knowledge of its falsity. [15 U.S.C. § 77z-2(c)(1); 15 U.S.C. § 78u-5(c)(1)]

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Yet, application of the Safe Harbor has been anything but straightforward. Indeed, courts commit basic legal errors in their attempts to nullify its protections. Foremost among them is the tendency to collapse the two prongs — thus essentially reading “or” to mean “and” — to hold that actual knowledge that the statement is false means that the cautionary language can’t be meaningful. Other errors include straining to convert forward-looking statements into present-tense declarations so that they are not protected. Frequently, courts go to great lengths simply to avoid the Safe Harbor. (In a September 3 post on our Firm’s blog, *D&O Discourse*, we provide examples of court decisions on these issues.)

The root of these problems is that many judges don’t like the idea that the Safe Harbor allows companies to escape liability for knowingly false statements. This judicial antipathy for the Safe Harbor won’t change. So, it is up to companies to draft cautionary

statements that will be effective in the face of this skepticism, and for securities defense counsel to make Safe Harbor arguments that resonate with dubious judges.

A company is more likely to obtain Safe Harbor protection if it can show that it really did its best to warn of the risks it actually faced. Judges can tell if a company’s risk factors aren’t thoughtful and customized. Too often, the risk factors become SEC-filing boilerplate and don’t receive careful thought with each new disclosure. But risk factors that don’t change period to period are less likely to be found meaningful, especially when it’s apparent that the risks have changed. And, even though many risks don’t fundamentally change every quarter, facets of those risks often do, or there are more specific risks that could be added.

Companies can help to inoculate themselves from lawsuits — or lay the groundwork for an effective defense — if they simply think about their risk factors each quarter and regularly supplement and adjust them. There are situations in which competitive harm or other considerations will outweigh the benefit of making new risk disclosures. But companies should at least evaluate and balance the relevant considerations.

Another key to maintaining Safe Harbor protections is being able to show that forward-looking statements were honestly made, even if mistaken. Although the Safe Harbor should protect forward-looking statements regardless, in practice it rarely works that way. Judges who believe that the forward-looking statements have a reasonable basis (and are thus assured that they were not knowingly dishonest) are more comfortable applying the Safe Harbor.

Although the Safe Harbor does not provide the blanket protections that Congress intended, with the right approach, companies can still provide forward-looking information to their investors without undue fear of liability.

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