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Third Circuit Holds That Mixed Present/Future Statements Are Protected By Reform Act Safe Harbor

In *In re Aetna, Inc. Securities Litigation*, No. 09-2970, 2010 WL 3156560 (3d Cir. Aug. 11, 2010), the United States Court of Appeals for the Third Circuit held that certain allegedly misleading statements regarding the pricing of insurance premiums by a large health insurance company were protected under the safe harbor provision of the Private Securities Litigation Reform Act of 1995 ("Reform Act"), 15 U.S.C. § 78u-5(c)(1). The Court reasoned that the statements warranted protection because they were not only forward-looking — despite containing both present and future elements — but also immaterial. This decision further clarifies the Court's analysis of mixed present/future statements for purposes of protection under the Reform Act's safe harbor for forward-looking statements.

Plaintiffs were investors who had purchased Aetna securities between October 27, 2005 and July 27, 2006, who initiated a class action against Aetna and four of its officers for violations of, *inter alia*, Section 10(b) and Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78t(a). Plaintiffs alleged that Aetna secretly relaxed its underwriting criteria in an effort to under price competitors and gain market share, while publicly characterizing Aetna's insurance premium pricing as "disciplined." Plaintiffs also alleged that a statement appearing in Aetna's April 27, 2006 SEC Form 10-Q report that "a percentage increase in per member medical costs . . . outpaced the percentage increase in per member premiums, due to higher medical cost trends for inpatient and outpatient facility and physician services," misleadingly blamed the increase in MCR on higher medical costs rather than lower premium pricing.

Aetna released its second quarter report for 2006 on July 27, 2006, announcing a 2% quarterly increase in MCR. That same day, Aetna's stock price fell by 17%, causing a market capitalization loss of $3.58 billion. During the class period, the price of Aetna's stock ultimately fell from $52.48 to $33.25. Plaintiffs claimed that, contrary to the officer's characterization of the increase in MCR as "slight," the 2% increase was in fact substantial, as evidenced by the sharp decrease in Aetna's stock price.

Defendants moved to dismiss, arguing that the "disciplined" pricing statements were "classic forward-looking statements" because Aetna could not confirm whether it had succeeded in 'achieving premium yields in line with [its] medical cost trend' until future actual medical costs incurred on policies were known. Defendants thus invoked the Reform Act safe harbor for forward-looking statements, which protects

from liability statements that are (1) identified as forward-looking and accompanied by meaningful cautionary statements; or (2) immaterial; or (3) made without actual knowledge that the statement was false or misleading. Defendants also claimed the Form 10-Q was not misleading because it explicitly stated the fact that Aetna had underpriced some of its policies.

The United States District Court for the Eastern District of Pennsylvania dismissed plaintiffs' claims under Sections 10(b) and 20(a), holding all statements which formed the basis of plaintiffs' claims expressed expectations about Aetna's medical cost trend, which the court called "a specific measure of future performance." The statements, characterized as "statement[s] of the plans and objectives of management for future operations" and "statement[s] of future economic performance," were thus well within Reform Act's definition of "forward-looking." Plaintiffs appealed dismissal of their Section 10(b) and 20(a) claims.

The Third Circuit observed that statements plaintiffs identified here were akin to those at issue in *Institutional Investors Group v. Avaya, Inc.*, 564 F.3d 242 (3d Cir. 2009) [blog article here]. *Avaya* addressed protection of "mixed present/future" statements under the safe-harbor provision. *Avaya* held that while mixed present/future statements are "not entitled to the safe harbor with respect to the part of the statement that refers to the present," when the present-tense statements can not "meaningfully be distinguished from the future projection of which they are a part," to the extent that those statements contained assertions about the present, "the assertions of current fact are too vague to be actionable."

The Third Circuit in *Aetna*, applying *Avaya*, found that despite that certain elements of defendants' statements were partly historical and partly present-tense, those elements could not be distinguished from the statements' assertions about the future. Specifically, "whether Aetna's pricing was, in fact, disciplined could not have been determined at the time defendants made the statements," because "[a]t the time the statements were made, the medical costs had not yet been incurred and could not be ascertained until later. Thus, to the extent that 'disciplined' pricing said anything about the current price of premiums, it did so in the form of a projection." Further, while the statement in Aetna's Form10-Q report was historical and not forward-looking, it was not misleading because it did not hide the fact that the increase in medical costs exceeded any increase in Aetna's premium revenue.

Having determined that the statements were "forward-looking" the Court went on to analyze the statements' materiality and whether they were accompanied by any meaningful cautionary language. Plaintiffs argued that the language in Aetna's financial reports filed with the SEC — that "[t]here can be no assurance regarding the accuracy of medical cost projections assumed for pricing purposes, and if the rate of increase in medical costs in 2006 were to exceed the levels projected for pricing purposes, our results would be materially adversely affected" — was insufficiently cautionary because it only addressed risks related to medical cost projections and failed to disclose Aetna's alleged practice of underpricing premiums.

The Court found this language provided "adequate" precautions under the Reform Act because it gave investors clear warning that "the accuracy of medical costs [could] be assured, actual medical costs [could] exceed projections assumed for purposes of setting premiums, medical costs in excess of projections [could not] be recovered through higher premiums, and inaccurate medical cost projections [could] have a materially negative effect on profitability."

Furthermore, the Third Circuit held that the statements were immaterial as a matter of law. Comparing the defendants' statements to those at issue in *In re Advanta Corp. Securities Litigation*, 180 F.3d 525, 537 (3d Cir. 1999), the Court held that "oblique references to Aetna's pricing policy" and "[g]eneral statements about the company's dedication to 'disciplined' pricing and commitment to 'discipline and rigor'" were "too vague to ascertain anything on which a reasonable investors would might rely," and "could not have meaningfully altered the total mix of information available to the investing public."

Investors claiming statements containing both present and future elements are "misleading" must now be able to show the present components are clear and distinct from any future components, lest the entire statement be regarded as forward-looking and fall under Reform Act's safe harbor protection. This case demonstrates the high bar investors must clear before a court will refuse to interpret such mixed statements as forward-looking.

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