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Ninth Circuit Reinforces Private Securities Litigation Reform Act Protections for Forward-Looking Statements

By Jordan Eth and Mia Mazza

Yesterday, the Ninth Circuit confirmed that a forward-looking statement accompanied by meaningful cautions is not actionable under the federal securities laws, even where the speaker allegedly knew the statement was false when made.

In *In re Cutera Securities Litigation*, the Court affirmed the dismissal of a securities fraud class action for failure to meet the pleading requirements of the Private Securities Litigation Reform Act. The Court found that the defendants' earnings projections were protected under the Reform Act's safe harbor for forward-looking statements, despite the plaintiffs' allegations of defendants' actual knowledge of their falsity. It also found that allegedly incomplete disclosures about the company's sales force were "not material omissions made in violation of the securities laws," reinforcing that plaintiffs must plead the materiality of defendants' alleged misstatements.

SAFE HARBOR

In a year-end earnings conference call, Cutera projected revenue of \$26 million in the following quarter. After the first quarter ended, the Company announced revenue of \$23 million. The plaintiffs alleged that at the time the initial projection was made, the speaker knew that it was false. The Ninth Circuit held that regardless of whether the projection was made with actual knowledge of its falsity, it fell within the Reform Act's safe harbor for "forward-looking statements" and thus could not form the basis for a claim under the federal securities laws.

In relevant part, the safe harbor provision states that "a person . . . shall not be liable with respect to any forward-looking statement . . . if and to the extent that —

- (A) the forward-looking statement is . . . 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
- (B) the plaintiff fails to prove that the forward-looking statement . . . was made with actual knowledge . . . that the statement was false or misleading.

15 U.S.C. §78u-5(c)(1)."

The Court found that Cutera's revenue projection was "by definition a forward-looking statement," that it was appropriately identified as a forward-looking statement, and that it was accompanied by "cautionary language that spoke directly to the purported misstatements." At the beginning of the conference call, Cutera stated the following:

Client Alert.

- “these prepared remarks contain forward-looking statements concerning future financial performance and guidance;”
- “management may make additional forward-looking statements in response to [] questions;” and
- factors like Cutera’s “ability to continue increasing sales performance worldwide” could cause variance in the results. “Cutera affirmatively warned that its ability to compete and perform in the industry depended on the ability of its sales force to sell products to new customers and upgraded products to current customers, and that failure to attract and retain sales and marketing personnel would materially harm its ability to compete effectively and grow its business.”

The Court found that these cautions met the Reform Act’s safe harbor requirements and thus that the revenue projection was not actionable.

The Court rejected the plaintiffs’ argument that the safe harbor provisions should be read in the conjunctive — that “a sufficiently strong inference of actual knowledge would overcome a claim of safe harbor protection even for statements identified as forward-looking and accompanied by meaningful cautionary language.” The Court acknowledged that in *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. American West Holding Corp.*, 320 F.3d 920 (9th Cir. 2003), it had stated in dicta that “‘a strong inference of actual knowledge’ could except forward-looking statements from the safe harbor rule,” and that a handful of district courts had since “embraced that passing reference as a holding from this court.” The Court noted that its holding in *Cutera* “should clear up the issue,” with its “clear statement . . . that the statute should be read in the disjunctive.”

The Court’s confirmation of a “disjunctive” reading of the Reform Act’s safe harbor — which is consistent with both the statutory language and with “all of our sister circuits to consider the question” — holds true to one of the key objectives of the Reform Act: to encourage companies to make projections in a way that protects them from the cost of defending securities fraud lawsuits on factual issues, such as what their officers knew when a statement was made. The safe harbor allows a court, “where appropriate, [to] decide a motion to dismiss, without examining the state of mind of the defendant.” H.R. Conf. Rep. 104-369, at 44 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 743.

MATERIALITY

The plaintiffs in *Cutera* also attempted to plead securities fraud based on the Company’s statements about its sales force. The Court found that these statements, even if allegedly made with scienter, were immaterial and thus not actionable under the federal securities laws.

In the year-end call, Cutera’s CEO stated that in the fourth quarter the Company “didn’t get the productivity we were looking for” with adjustments it had made to its sales force, that the Company had “since made modifications” to the sales organization, and that “we anticipate having improved productivity from the sales force as a whole.” In later announcing disappointing results for the first quarter, the Company attributed the shortfall “primarily to lower than expected productivity levels of our recent sales expansion,” and provided a detailed explanation of how it was “implementing specific initiatives to address [the shortfall].”

The Court found that the plaintiffs had alleged — with factual support — that the statements made in the year-end call did not disclose everything the Company knew about the weakness of its sales force. Nevertheless, the initial statements

Client Alert.

were not actionable because they were immaterial: “[T]he investors have not raised a plausible claim that stock prices fluctuated with disclosures about the sales staff, or that a reasonable investor would have received a materially different impression of Cutera’s state of affairs had the company used the language from the [post-quarter] press releases to describe the sales shortfalls in its [year-end] statements.”

The Ninth Circuit’s emphasis on materiality as a threshold to liability provides similar assurance that only material disclosures will be fodder for a securities fraud claim. As the Court noted, “Often, a statement will not mislead even if it is incomplete or does not include all relevant facts.”

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