No. 17-1056

IN THE

# Supreme Court of the United States

QUALITY SYSTEMS, INC.; STEVEN T. PLOCHOCKI;
PAUL A. HOLT; SHELDON RAZIN,

*Petitioners,*

*v.*

CITY OF MIAMI FIRE FIGHTERS' AND POLICE OFFICERS'
RETIREMENT TRUST; ARKANSAS TEACHER RETIREMENT SYSTEM,

*Respondents.*

*On Petition for Writ of Certiorari to the*
*United States Court of Appeals for the Ninth Circuit*

# BRIEF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AND THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICI CURIAE* SUPPORTING PETITIONERS


Kevin M. Carroll
Ira D. Hammerman
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION
1101 New York Ave., N.W.
Washington, D.C. 20005

Steven P. Lehotsky
Janet Galeria
U.S. CHAMBER LITIGATION CENTER
1615 H Street, N.W.
Washington, D.C. 20062

Lewis J. Liman
*Counsel of Record*
Jared M. Gerber
Martha E. Vega-Gonzalez
CLEARY GOTTLIEB STEEN & HAMILTON LLP
One Liberty Plaza
New York, New York 10006
212-225-2000
lliman@cgsh.com

*Counsel for Amici Curiae*


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## INTEREST OF *AMICI CURIAE*[1]

The Securities Industry and Financial Markets Association ("SIFMA") is comprised of hundreds of member securities firms, banks, and asset managers. As an organization, SIFMA has an interest in the strong, accurate, and consistent enforcement of the federal securities laws. Moreover, because its members are frequent targets of securities class action litigation, SIFMA has an interest in the efficient and predictable resolution of these lawsuits. These interests are furthered by securities laws—including federal statutes and the judicial decisions that interpret them—that strike the right balance between allowing investors to pursue meritorious claims and protecting issuers from abusive litigation. SIFMA regularly files *amicus curiae* briefs in cases raising issues of vital concern to securities industry participants.

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million businesses and professional organizations of every size, in every industry sector, and from every region of the United States. An important function of the Chamber is to represent its members' interests in

[1] All parties have consented to this filing in letters on file with the Clerk of the Court. No counsel for a party has authored this brief in whole or in part, and no person other than the *amici*, their members, and their counsel has made a monetary contribution to the preparation or submission of this brief.

matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in cases that raise issues of concern to the nation's business community.

Whether a forward-looking statement, otherwise protected by the Private Securities Litigation Reform Act's ("PSLRA") safe harbor provision, can become actionable when accompanied by an allegedly false or misleading non-forward-looking statement raises issues important to the administration of the federal securities laws. The rule adopted by the Ninth Circuit would undermine principles that support the effective and efficient functioning of the securities markets, chill companies from providing investors with valuable forward-looking information, and threaten the health and stability of our capital markets. This result runs contrary to the interest of American companies and investors, and subverts a key purpose of the PSLRA.

## SUMMARY OF ARGUMENT

Congress enacted the PSLRA more than twenty years ago to stem the tide of abusive securities litigation. One key corrosive effect of the pre-PSLRA landscape was that American companies were discouraged from sharing forward-looking projections with investors, because any shortfall in their projections could give rise to unfounded, but costly, litigation by enterprising plaintiffs. Understanding the importance of such forward-looking information to the efficient functioning of the capital markets, Congress sought

to unmuzzle American companies by providing them with a flexible, bifurcated safe harbor for forward-looking statements that could otherwise be subject to securities law claims with the benefit of hindsight. The first prong of the safe harbor provides an objective test: forward-looking statements are rendered inactionable when they are accompanied by meaningful cautionary language.

The Courts of Appeals are split on what may be considered in determining whether cautionary language is "meaningful." The majority of courts follow a plain reading of the PSLRA safe harbor and decline to inquire into the speaker's mental state. By contrast, the Seventh and D.C. Circuits instead look to what was known to the defendant at the time the statement was made, thereby inviting frivolous litigation and subverting the PSLRA. But, the Ninth Circuit goes even farther afield, positing that cautionary language that does not correct allegedly false or misleading accompanying non-forward-looking statements can never be considered "meaningful." *See In re Quality Sys., Inc. Sec. Litig.*, 865 F.3d 1130, 1141 (9th Cir. 2017). The Ninth Circuit's ruling has no basis in either the text of the statute or its legislative history, and, if left to stand, would create a loophole that, applied literally, would swallow the first prong of the PSLRA's safe harbor. Under the Ninth Circuit's rule, any time a company failed to meet a projection, plaintiffs could avoid the safe harbor by alleging that the forward-looking projection was accompanied by a non-forward-looking statement that was allegedly false or misleading, regardless of

whether the company knew that that non-forward-looking statement was misleading or of whether that non-forward-looking statement was material to the forward-looking statement. As a practical matter, the Ninth Circuit's statement would effectively read the objective prong of the safe harbor out of the PSLRA and could make American companies reticent to share with investors their future prospects, thereby defeating Congress's intent in creating the safe harbor.

The confusion amongst the Courts of Appeals, which has been exacerbated by the Ninth Circuit's decision, burdens American capital markets without benefiting investors, and thus begs correction by the Court.

## ARGUMENT

### I. The PSLRA Safe Harbor Is Critical To Promoting The Flow Of Forward-Looking Information To Investors

#### *A. Before The PSLRA, The Specter Of Abusive Litigation Prevented Companies From Providing Valuable Forward-Looking Information To Investors*

While believing that proper securities litigation "promote[s] public and global confidence in our capital markets and help[s] to deter wrongdoing," in enacting the PSLRA, Congress was "prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and

maintain confidence in our capital markets." H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730. The House and Senate Committees that approved the PSLRA heard evidence that abusive practices committed in securities litigation included "the routine filing of lawsuits against issuers of securities and others whenever there [was] a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action," and "the abuse of the discovery process to impose costs so burdensome that it [was] often economical for the victimized party to settle." *Id.*

Beyond imposing litigation costs on American businesses, however, those abusive litigation practices also had a pernicious "muzzling effect" on American companies. *Id.* at 42. Although forward-looking information was "often considered a critical component of investment recommendations made by broker-dealers, investment advisers and other securities professionals," Safe Harbor for Forward-Looking Statements, Securities Act Release No. 33-7101, 57 SEC Docket 1999 (Oct. 13, 1994), and "[u]nderstanding a company's own assessment of its future potential would be among the most valuable information shareholders and potential investors could have about a firm," H.R. Rep. No. 104-369, at 43 (quoting testimony of Hon. Richard C. Breeden, former Chairman, SEC, before the Securities Subcommittee of the Senate Committee on Banking, Housing, and Urban

Affairs, April 6, 1995), American companies that made forward-looking statements prior to the enactment of the PSLRA did so at their own peril. As Congress recognized, "If a company fail[ed] to satisfy its announced earnings projections—perhaps because of changes in the economy or the timing of an order or new product—the company [was] likely to face a lawsuit." *Id.* A significant number of firms "were reluctant to discuss their performance with analysts or the public because of the threat of litigation," *id.*, and this corporate silence was enforced by "legions of lawyers scrub[bing] required filings to ensure that disclosures [were] as milquetoast as possible, so as to provide no grist for the litigation mill." *Id.* Ending this silence was a key objective of the PSLRA.

### *B. Congress Created A Flexible, Two-Pronged Safe Harbor To Enable American Companies To Share Forward-Looking Information With Investors*

To unmuzzle corporate leadership and thereby "enhance market efficiency," Congress created a statutory safe harbor for forward-looking statements in the PSLRA. *Id.* Building on SEC Rule 175 and the judicially-created "bespeaks caution" doctrine, Congress designed the statutory protection of forward-looking statements as a "bifurcated safe harbor that permits greater flexibility to those who may avail themselves of safe harbor protection." *Id.*

Under the first prong of the safe harbor, a forward-looking statement is not actionable so long as the 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 immaterial." 15 U.S.C. § 78u-5(c)(1)(A). This first prong sets forth an objective test to determine whether a forward-looking statement was accompanied by cautionary language that was meaningful. Crucially, and reflecting the understanding that hindsight is 20/20, the statute does not require that a forward-looking statement be accompanied by "all" meaningful cautionary statements. *See id.* S*ee also* H.R. Rep. No. 104-369, at 44 ("The Conference Committee expects that the cautionary statements identify important factors that could cause results to differ materially—*but not all factors*.") (emphasis added). To the contrary, Congress specifically indicated that "[f]ailure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor." H.R. Rep. No. 104-369, at 44. Moreover, the first prong neither requires nor permits an inquiry into the defendant's *mens rea*. *Id.* ("Courts should not examine the state of mind of the person making the statement.").

By design, the "second prong of the safe harbor provides an alternative analysis," *id.*, focusing on the "actual knowledge" of the speaker. *See* 15 U.S.C. § 78u-5(c)(1)(B) (a forward-looking

statement is not actionable if the plaintiff fails to prove that the defendant made or approved the statement with "actual knowledge" that the statement was false or misleading).

Together, these two independent prongs of the statutory safe harbor enhance market efficiency by giving American companies the freedom to share valuable forward-looking information with investors.

## II. Even Before The Ninth Circuit's Ruling, The Courts Of Appeals Were Split On What May Be Considered In Determining Whether Cautionary Language Is Meaningful

A key feature of the first prong of the PSLRA safe harbor is that a court can easily administer this objective test at the motion-to-dismiss stage,[2] thereby protecting issuers who provide investors with meaningful cautionary language from the costs of protracted litigation. Thus, for the safe harbor to function as designed, the inquiry as to the meaningfulness of cautionary language must focus objectively on the warning that was given, and not the warnings that could have, or *should* have been given. Indeed, analyzing what other warning *should* have been provided requires pulling back the curtain to understand what the speaker knew when it made a forward-looking statement. *See*

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[2] *See* H.R. Rep. No. 104-369, at 44 ("The use of the words 'meaningful' and 'important factors' are intended to provide a standard for the types of cautionary statements upon which a court may, where appropriate, decide a motion to dismiss, without examining the state of mind of the defendant.").

*Slayton v. Am. Express Co.*, 604 F.3d 758, 771 (2d Cir. 2010) (explaining that such an approach "requires an inquiry into what the defendants knew because in order to determine what risks the defendants faced, we must ask of what risks were they aware."). Such an approach is not supported by the text of the statute and is at odds with Congress's directive that "Courts should not examine the state of mind of the person making the statement." H.R. Rep. No. 104-369, at 44.

In keeping with the text of the statute and congressional intent, at least four Courts of Appeals have held that "if the statement qualifies as 'forward-looking' and is accompanied by sufficient cautionary language, a defendant's statement is protected regardless of the actual state of mind." *Miller v. Champion Enterprises Inc.*, 346 F.3d 660, 672 (6th Cir. 2003). *See also Edward J. Goodman Life Income Tr. v. Jabil Circuit, Inc.*, 594 F.3d 783, 795 (11th Cir. 2010) ("[A]n allegation of actual knowledge of falsity will not deprive a defendant of protection by the statutory safe harbor if his forward-looking statements are accompanied by meaningful cautionary language."); *OFI Asset Mgmt. v. Cooper Tire & Rubber*, 834 F.3d 481, 502 (3d Cir. 2016) ("[W]here a future-looking statement is accompanied by sufficient cautions, then 'the state of mind of the individual making the statement is irrelevant, and the statement is not actionable regardless of the plaintiff's showing of scienter.'") (internal citation omitted); *Julianello v. K-V Pharm. Co.*, 791 F.3d 915, 921 (8th Cir. 2015) (affirming dismissal of complaint containing a

forward-looking statement because it was accompanied by meaningful cautionary language and holding that there was no need to consider whether scienter was adequately pled); *Harris v. Ivax Corp.*, 182 F.3d 799, 803 (11th Cir. 1999) ("[I]f a statement is accompanied by 'meaningful cautionary language,' the defendants' state of mind is irrelevant.") (internal citation omitted).

Starting with the Seventh Circuit's decision in *Asher v. Baxter Int'l Inc.*, 377 F.3d 727 (7th Cir. 2004), however, some Courts of Appeals have allowed plaintiffs to probe defendants' mental state to show that cautionary language was not meaningful. More recently, the D.C. Circuit held that cautionary language cannot be meaningful if it is misleading in light of historical fact. *In re Harman Int'l Industries, Inc. Sec. Litig.*, 791 F.3d 90, 102 (D.C. Cir. 2015).[3]

But the court's reasoning in *Asher* itself shows how the subjective inquiry adopted by the Seventh and D.C. Circuits subverts the purpose of the PSLRA. There, the court recognized that the defendant had used cautionary language that could not be simply dismissed as boilerplate. *Id.* at 733. Nevertheless, the court erroneously concluded that the complaint could not be dismissed because it was impossible to determine without discovery whether the defendant had "omitted important variables from the cautionary language and so

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[3] See also *Slayton v. Am. Express Co.*, 604 F.3d 758, 770 (2d Cir. 2010) (noting in dicta that "cautionary language that is misleading in light of historical fact cannot be meaningful.").

made projections more certain than its internal estimates at the time warranted." *Id.* at 734. At the same time, the court conceded that it could not "exclude the possibility that if after discovery [defendant] establishe[d] that the cautions did reveal what were, *ex ante*, the major risks, the safe harbor may yet carry the day." *Id.*

This misses the point: Congress adopted the PSLRA precisely to protect issuers from "the abuse of the discovery process," which unscrupulous plaintiffs used "to impose costs so burdensome that it [was] often economical for the victimized party to settle." H.R. Rep. No. 104-369, at 31. The detailed factual inquiry required by *Asher* and its progeny, which gauge the meaningfulness of cautionary language by specific alleged omissions and the mental state of the speaker, are directly at odds with the text and purpose of the first prong of the PSLRA safe harbor.

## III. The Ninth Circuit's New Rule Functionally Eviscerates The Statutory Safe Harbor To The Detriment Of Investors And Public Markets

In the decision below, the Ninth Circuit created a new front in the pre-existing circuit split, one that opens the door to "the practice of pleading fraud by hindsight" that the PSLRA was enacted to prevent. *See Elam v. Neidorff*, 544 F.3d 921, 927 (8th Cir. 2008) (internal citation omitted). That rule could return companies to the pre-PSLRA state of affairs and incentivize them to withhold forward-looking information of the kind that

Congress deemed valuable to investors and market efficiency.

### *A. The Ninth Circuit's Rule Will Allow Plaintiffs To Strip Forward-Looking Statements Of Safe Harbor Protection By Alleging That They Accompanied A False Non-Forward-Looking Statement*

As crafted by Congress, the first prong of the safe harbor allows companies to "opt in" to safe harbor protection by bundling forward-looking statements with meaningful cautionary language. However, the Ninth Circuit adopted another bundling: holding that, when forward-looking statements are "accompanied by a non-forward-looking statement that supports the forward-looking statement" and "the non-forward-looking statement is materially false or misleading, it is likely that no cautionary language—short of an outright admission of the false or misleading nature of the non-forward-looking statement—would be 'sufficiently meaningful' to qualify the statement for the safe harbor." *In re Quality Sys., Inc. Sec. Litig.*, at 1146-1147. This rule finds no support in either the text of the statute or in its legislative history. To the contrary, as explained above, Congress specifically envisioned that the important factors companies identified in their cautionary language would be illustrative rather than exhaustive. Moreover, the Ninth Circuit goes far beyond even the Seventh and D.C. Circuits in dictating a specific warning that issuers must give—to the letter—in order to opt into the safe harbor.

The Ninth Circuit's invented rule would reach far beyond the specific facts of this case to strip American corporations of the objective protection Congress gave them through the first prong of the PSLRA safe harbor. An example illustrates the problem: consider a multinational plastics recycling company with plants around the world. Informed by SEC guidance that encourages companies to make forward-looking statements, the company makes an earnings projection at an investor presentation and accompanies that projection with extensive cautionary language. At the same conference, however, the company provides current information about the recently-increased capacity of its plants, including a plant in Germany. Because of a communications mistake, the presentation claims that the German plant can now process 100 million kilograms of plastic a year, but the correct figure is 100 million *pounds* (45.4 million kilograms). The company later discloses that it failed to meet projections due to a variety of negative events, including the bankruptcy of its primary customer and a protracted strike at its main facility.

A purchaser of the company's securities who can prove that it was misled by the reckless statement regarding the German plant and suffered loss as a result can recover for the loss caused by the falsity of the historic statement under the securities laws and without the aid of the Ninth Circuit's ruling. However, the Ninth Circuit's rule will now invite an enterprising plaintiff who suffered loss from an entirely different cause (*i.e.,* the shortfall in earnings against the projection) to sift through the

company's non-forward-looking statements that accompanied the projection and ground a lawsuit about the shortfall on the alleged overstatement of the capacity of the company's plant. Instead of defending the objective quality of its cautionary language and being protected by the quality of that cautionary language, the company will now have to defend both against a claim that there was a material overstatement of the German plant capacity[4] (when no investor claims to have suffered loss from that statement and the error was not known to the company) and against the claim that the company made the projection "with actual knowledge" that it was materially false or misleading. Moreover, the company could be exposed to extensive and costly discovery, not just in connection with the misleading non-forward-looking statement about plant capacity, but also on the significantly more expansive topic of its projections. This is precisely what Congress sought to curb when it enacted the PSLRA.

These defects are inherent in the rule that the Ninth Circuit created.[5] It leaves open the question of what it means for a forward-looking statement to be "accompanied" by a non-forward-looking

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[4] Courts often do not dismiss lawsuits for lack of materiality. *See, e.g., Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38-39 (2011) (noting that materiality is an "inherently fact-specific finding").

[5] Not even the Seventh or D.C. Circuits—though adopting an erroneous view of the law—would go so far as to make the actionability of a forward-looking statement turn upon the ability to allege that a historical statement was mistaken or inaccurate.

statement that "supports" the forward-looking statement.[6] The Ninth Circuit's rule provides that if any "accompanying" statements of current or historical fact are materially false, then the cautionary language must say so, or else it is not meaningful. Notably, on its face the Ninth Circuit's rule appears also to apply to situations where the misstatement of a non-forward-looking fact is not material to the forward-looking statement. The Ninth Circuit's language also appears to extend to situations where the underlying statements were not made with *knowledge* of their falsity;[7] since companies cannot caution against mistakes of which they are unaware, that rule would effectively destroy companies' ability to opt into safe harbor protection through the use of cautionary statements. Together, these deficiencies eviscerate the safe harbor and incentivize creative plaintiffs' lawyers, whose zeal necessitated the PSLRA, to comb through disclosures for an allegedly false or

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[6] Forward-looking statements, such as financial projections, are frequently accompanied by statements about the current or historic state of affairs that underlie those projections. *See In re Quality Sys., Inc. Sec. Litig.*, at 1147 (describing "mixed statements").

[7] To the extent the Ninth Circuit's rule can be read otherwise—*i.e.*, to apply only where the accompanying materially false or misleading non-forward-looking statements were made with scienter, this is at odds with the legislative history and the holdings of four Courts of Appeals that have held that subjective intent is irrelevant to the first prong of the safe harbor. *See* Parts I.A and II above. Moreover, the rule is unnecessary because a materially false non-forward-looking statement that causes loss and is made with scienter affords its own basis for a securities fraud claim.

misleading non-forward-looking statement that can infect forward-looking statements.

### *B. The Effect Of The Ninth Circuit's Rule Will Be To Restore The "Muzzling Effect" That The PSLRA Safe Harbor Was Enacted To Overcome*

The magnitude of the Ninth Circuit's decision cannot be underestimated. Companies' forward-looking projections are often accompanied by numerous and varied statements of present and historical fact. Consider a company in the consumer products industry. Its typical annual report will contain, alongside projections, numerous historical facts about many different aspects of its business, including: the performance of key products, its North American and various foreign segments, its employees, its largest customers, its products in research and development, its real estate holdings, its raw materials, its competitors, and the qualifications of its executive officers, not to mention trends and scores of different financial metrics. A company in the extractive industry might report, in addition to all of these facts, historical facts regarding workplace safety, injury rates, compliance, production rates, and environmental risks in each of numerous different mines in countries spanning the globe. The examples abound.

Prior to the Ninth Circuit decision, if a company incorrectly reported any of those historical facts (through accident or otherwise), it would only face suit if plaintiffs could allege that they relied on the

particular statement and it was made with scienter, was material, and caused loss. Those burdens are purposefully high. Under the Ninth Circuit decision, however, if a company fails to meet its projections and a plaintiff can allege that any one of the "accompanying" non-forward-looking statements was materially false—for whatever reason and regardless of whether the falsity of the historical statement caused loss—the company will be faced with a burdensome and expensive inquiry into both the non-forward-looking statement and its state of mind as to the forward-looking statement. The risk of that inquiry will have its inevitable effect. Companies will be incented to respond to this state of affairs as they did before the PSLRA—by "muzzling" themselves and declining to share forward-looking information with the market. *See* H.R. Rep. No. 104-369, at 42-43 (explaining that "corporate counsel advise clients to say as little as possible"). The risk of abusive litigation would once again be too great to do otherwise.

## IV. The Division Among The Circuit Courts Creates Confusion, Burdens America's Capital Markets, And Is Ripe For Review

Congress enacted the PSLRA to protect American companies and capital markets from abusive litigation. As explained above, the rules adopted by the Seventh, D.C., and now Ninth Circuits, subvert that congressional goal. But even beyond the specific pernicious results that flow from these courts' interpretation of the safe harbor, the circuit split itself imposes significant burdens

on American businesses. Consistent and predictable application of the securities laws is essential to the effective functioning of America's capital markets.

The Court has repeatedly noted that uncertainty in a lawsuit allows "plaintiffs with weak claims to extort settlements from innocent companies." *Stoneridge Inv. Partners, LLC v. Sci.-Atlanta*, 552 U.S. 148, 163 (2008) (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740-41 (1975)). The existence of three competing approaches to the application of the first prong of the safe harbor creates precisely the kind of confusion that allows aggressive plaintiffs to mire defendants in extended and potentially meritless litigation. And the confusion is severe. The Second Circuit has gone so far as to call out for additional guidance on "the reference point by which we should judge whether an issuer has identified the factors that realistically could cause results to differ from projections." *Slayton v. Am. Express Co.*, 604 F.3d 758, 772 (2d Cir. 2010). In light of the Ninth Circuit's opinion, the need for clarification is more urgent than ever.

The safe harbor was meant to reduce uncertainty as to how issuers could safely provide forward-looking guidance to investors and about how litigation would be resolved. Those courts that follow Congress's directive and gauge the meaningfulness of cautionary language by what is disclosed and not by second guessing the speaker through a review of alleged omissions and the speakers' *mens rea* properly further the statute's

aims. By contrast, the Seventh, D.C.—and now especially the Ninth—Circuits create grist for the litigation mill but provide little benefit for investors, who understand that projections are not promises and who have recourse against issuers that materially mislead them through omissions or misstatements of present or historical fact.

## CONCLUSION

For the foregoing reasons, the *amici* respectfully request that the Court grant the Petitioners' Petition for Writ of Certiorari.

Respectfully submitted,

Lewis J. Liman
*Counsel of Record*
Jared M. Gerber
Martha E. Vega-Gonzalez
CLEARY GOTTLIEB STEEN & HAMILTON LLP
One Liberty Plaza
New York, New York 10006
(212) 225-2000
lliman@cgsh.com

Kevin M. Carroll
Ira D. Hammerman
SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION
1101 New York Ave., N.W.
Washington, D.C. 20005

Steven P. Lehotsky
Janet Galeria
U.S. CHAMBER LITIGATION CENTER
1615 H Street, N.W.
Washington, D.C. 20062

*Counsel for Amici Curiae*

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