IS PUFFERY MATERIAL TO INVESTORS? MAYBE WE SHOULD ASK THEM

Stefan J. Padfield*

"[W]hat we have here is fact versus outdated legal fiction . . . ."[1]

---

* Assistant Professor, University of Akron School of Law. B.A., Brown University; J.D., University of Kansas. The idea for this Article was presented at the Eighth Ohio Legal Scholars Workshop, held at Capital University Law School on January 27, 2007; the Article was presented both at the Central States Law Schools Association Annual Meeting held at Wayne State University Law School on October 27, 2007, and as part of the University of Akron Faculty Workshop Series on October 10, 2007. My thanks to all the participants for their helpful comments. My thanks also to Andrew D. Martin, David A. Hoffman and Samuel P. Baumgartner for additional helpful comments. John E. Matejkovic and Sarah Cravens allowed me to survey their students, for which I am very grateful. Finally, I would like to thank the University of Akron School of Law for providing me with a summer research grant to help me complete this project.

1. Richard J. Leighton, *Making Puffery Determinations in Lanham Act False Advertising Cases: Surveys, Dictionaries, Judicial Edicts and Materiality Tests*, 95 TRADEMARK REP. 615, 639 (2005) (emphasis added). The context of the cited quote is as follows:

> In [*Pizza Hut, Inc. v. Papa John's International, Inc.*, 227 F.3d 489 (5th Cir. 2000)], the jury found by special interrogatory that "Better Ingredients. Better Pizza." "is false or misleading and was a false or misleading description or representation of fact which deceived or was likely to deceive a substantial number of the consumers to whom the slogan was addressed." That finding by a jury (consumers all) of widespread deception as a matter of fact, was overturned by the appeals court, as a matter of law. . . . [T]he Fifth Circuit panel's thinking went like this: (1) "Better" is a vague and generalized description that has been found to be puffery as a matter of law in other cases where it was used to describe other products and services in similarly general terms; (2) thus, consumers never would be *justified in relying* on the challenged slogan to buy pizza; (3) even if a substantial number of consumers actually did (or might) rely on it, as the jury found. It is significant that the appellate court did not (and could not) determine that such consumers were *not* misled by the slogan; it preemptively determined that they had no legal justification for being misled. The appellate court also did not (and could not) find that no reasonable jurors could determine that such consumers were misled or that no reasonable consumers would have been misled by the claim. Thus, what we have here is fact versus outdated legal fiction, and use of the latter to nullify a jury verdict.

Id. (quoting *Pizza Hut*, 227 F.3d at 493 n.2). While the quoted language focuses on materiality in the context of a Lanham Act claim, I will discuss below how there is

I. INTRODUCTION

Federal securities laws make it illegal to make a material misstatement in connection with a securities transaction.[2] Materiality is generally deemed to be a fact-intensive issue only to be resolved on the basis of pretrial motions when no reasonable shareholder could find the challenged statement material.[3] Nonetheless, and despite assertions to the contrary, materiality is often resolved pretrial.[4] One of the doctrines relied upon by courts to dismiss securities claims on the basis of immateriality is the puffery defense. "Puffery" has been defined as ambiguous, promotional, or hyperbolic speech commonly known as "sales talk."[5] While the puffery doctrine has been the subject of a great deal of criticism,[6] it continues to be relied upon by courts—in fact, its use may be increasing.[7]

Given this state of affairs, one issue that arises is how well judges are applying the puffery doctrine (assuming it is valid at all). As Professor Langevoort has noted, "here we run into the ever-troublesome distinction between the normative and the descriptive. . . . Is it clear that typical investors do not rely on puffery? There is little research that studies this specifically, and so many judges are guessing."[8] This Article seeks to fill

---

sufficient overlap between materiality analysis in the Lanham Act and securities regulation contexts to warrant cross-referencing.

2. *See, e.g.*, Securities Exchange Act of 1934 Rule, 17 C.F.R. § 240.10b-5 (2007) ("It shall be unlawful for any person . . . [t]o make any untrue statement of a material fact . . . in connection with the purchase or sale of any security.").

3. *See* TSC Indus. v. Northway, Inc., 426 U.S. 438, 450 (1976) ("Only if the established omissions are 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law' by summary judgment.") (quoting Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970)). *TSC Industries* involved a challenge to a proxy statement arising under Rule 14a-9. Nonetheless, the discussion of materiality in that case is generally applicable to securities litigation. *See* Basic Inc. v. Levinson, 485 U.S. 224, 231-232 (1988) (adopting the *TSC Industries* standard for Rule 10b-5 actions).

4. *See* David A. Hoffman, *The "Duty" To Be a Rational Shareholder*, 90 MINN. L. REV. 537, 542 (2006) ("In this Article, I present evidence that courts dismiss securities claims on the ground of presumed immateriality in *half of opinions considering materiality*.").

5. Jennifer O'Hare, *The Resurrection of the Dodo: The Unfortunate Re-emergence of the Puffery Defense in Private Securities Fraud Actions*, 59 OHIO ST. L.J. 1697, 1698 (1998).

6. *See, e.g.*, David A. Hoffman, *The Best Puffery Article Ever*, 91 IOWA L. REV. 1395, 1405-06 (2006) (noting "hostility from scholars" towards application of the puffery doctrine).

7. *See id.* at 1406 ("[D]efendants have been increasingly successful in obtaining dismissals based on puffery arguments.").

8. Donald C. Langevoort, *Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 184 (2002); *see also id.* at 137-38 ("Securities regulation is an especially important subject in which to take

some of the void of empirical research in this area by reporting the results of an investor survey (the "Puffery Survey"), focusing on materiality determinations in the puffery context, and comparing these responses to judicial predictions that no reasonable investor could find the surveyed statements material. What the survey results show is that while the judges in the four surveyed cases concluded that no reasonable investor could find the statements challenged therein to be material because they constituted non-actionable puffery, between 33% and 84% of reasonable investors surveyed deemed the statements material. These results have implications for both our confidence in the accuracy of judicial determinations in this area, as well as the potential utility of survey evidence for bringing judicial conclusions more in line with actual investor behavior.[9]

Following this Introduction, Part II will provide some relevant background, regarding both securities regulation generally and the puffery doctrine in particular, including a number of the criticisms levied against the doctrine. The discussion will include an analysis of what it means to say information is material in the securities litigation context, as well as an examination of who the "reasonable investor" is, whose opinion on the issue is allegedly decisive. Part III will then discuss the use of surveys as evidence of materiality in Lanham Act cases, as well as the makeup, criticisms, results and analysis of the Puffery Survey at issue here. Part IV will then conclude with a discussion of some of the implications of the Puffery Survey. Primarily, Part IV will argue that the Puffery Survey suggests that judges do a poor job predicting the materiality determinations of investors, and allowing the use of surveys on the question of materiality in securities cases could improve judicial performance in this area. Among other things, this would be consistent with the growing role of empiricism in legal analysis.[10]

---

measure of the behavioral claims . . . . It is still not easy, but if empirical headway is to be made anywhere in behavioral law and economics, it is likely to be made here.").

9. Here, and throughout this paper (except where it is expressly stated to the contrary), when the quality of judicial determinations of puffery is discussed, it is done so on the assumption that the proper role of judges is to come as close to capturing actual investor behavior as possible, rather than applying their own normative ideal of investor behavior.

10. *See* N. William Hines, *Empirical Scholarship: What Should We Study and How Should We Study It?*, AALS NEWSL. at 1, 4 (Ass'n of Am. Law Sch., Washington, D.C.), Feb. 2005, *available at* http://www.aals.org/services_newsletter_presFeb05.php ("[A]n informal survey of prominent legal scholars in the mid-1990s revealed a near consensus that there was a need for a much greater emphasis on empirical research in the law. . . . 'To what extent, if at all, should . . . our scholarly agenda endeavor to . . . make use of empirical research. . . . [A]s a rational system of social control the legal system must consider whether it is achieving its stated objectives and at what cost. From this standpoint, the legal scholar who confines law scholarship to the law library would be irresponsible' . . . ." (quoting Harvard Law School Byrne Professor of Administrative Law Emeritus Clark Byse, endowed lecture at the University of Iowa (1988)).

II. BACKGROUND: SECURITIES REGULATION & PUFFERY

This section will provide a brief background of both securities regulation generally and the puffery doctrine in particular. The discussion of securities regulation will focus on the issue of materiality, both in the context of the anti-fraud rules as well as in the context of affirmative disclosure obligations. Both the definition of materiality generally, and the role of the "reasonable investor" in the formulation of that definition, will be discussed. Reference will be made to the fact-intensive nature of the materiality analysis, as well as the interests the test seeks to balance. Finally, the discussion of the puffery doctrine will focus on its definition, history, and criticisms.

A. *Securities Regulation*

Following the stock market's Great Crash of 1929, Congress enacted the Securities Act of 1933 and the Securities Exchange Act of 1934 to restore investor confidence.[11] The goal of these regulations is full and fair disclosure.[12] One of the primary vehicles for ensuring full disclosure in the securities markets is antifraud Rule 10b-5.[13] Rule 10b-5 makes it unlawful

---

11. *See* Robert A. Prentice, *The Inevitability of a Strong SEC*, 91 CORNELL L. REV. 775, 803 (2006) (describing how Congress passed the Acts to regain investor confidence by mandating disclosure and punishing fraud); *see also* Kenneth B. Firtel, *Plain English: A Reappraisal of the Intended Audience of Disclosure Under the Securities Act of 1933*, 72 S. CAL. L. REV. 851, 857 (1999) ("Coupled with the goals of investor protection and deterrence was a desire to restore investor confidence in the capital markets. The Crash created a national distrust of the capital markets as average investors withdrew their capital for fear of exploitation by the issuers of securities.").

12. *See* Firtel, *supra* note 11, at 856-58 ("Congress viewed the new disclosure system [of the '33 Act] as a means to protect average investors, many of whom had lost their savings through the Crash, by forcing issuers to divulge all facts, favorable or unfavorable, to the public for examination. . . . By mandating disclosure, Congress intended to protect the layperson from fraudulent practices in the capital markets. . . . Through the '33 Act, Congress sought to provide for full and fair disclosure to the average investor."); *See generally*, Stefan J. Padfield, *Who Should Do the Math? Materiality Issues in Disclosures that Require Investors to Calculate the Bottom Line*, 34 PEPP. L. REV. 927, 931 (2007) (describing the broad goals of securities regulations in the United States to be fair and full disclosure).

13. Securities Exchange Act of 1934 Rule, 17 C.F.R. § 240.10b-5 (2007). Rule 10b-5 is not the only liability provision serving the purposes of our securities regulation regime. *See* Securities Act of 1933 § 11(a), 15 U.S.C. § 77k (2000) (creating an express right of action for damages by purchasers of securities when untrue statements of material fact or omissions of material fact are contained in a registration statement); Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2) (2000) (creating a private remedy for the purchasers of securities if there was an "untrue statement of a material fact or [an omission of] a material fact" in connection with the sale or offer for sale of a security); Securities Act of 1933 § 17(a), 15 U.S.C. § 77q (2000) (prohibiting fraudulent schemes, "any untrue statement of a

for any person, in connection with the purchase or sale of a security, "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . ."[14] The elements of a Rule 10b-5 claim are: "1) a misstatement or omission 2) of material fact 3) occurring in connection with the purchase or sale of a security, that 4) was made with scienter and 5) upon which the plaintiff justifiably relied, 6) and that proximately caused injury to the plaintiff."[15] The element of primary significance to us here is materiality.[16] Successful application of the puffery doctrine defense in a Rule 10b-5 action undermines the ability of the plaintiff to satisfy the element of materiality.[17]

Information is deemed to be material for purposes of Rule 10b-5 "'if there is a *substantial likelihood* that a reasonable shareholder would consider it important' to the investment decision."[18] An alternative formulation is that information is material if it would alter the "total mix" of facts available.[19] Thus, included in the definition of materiality is the

---

material fact or any omission to state a material fact" in connection with the sale of securities and fraudulent transactions); Securities Exchange Act of 1934 Rule, 17 C.F.R. § 240.14-9 (2007) (prohibiting false or misleading statements and omissions of statements "with respect to any material fact" in connection with the solicitation of proxies); Securities Exchange Act of 1934 § 14(e), 15 U.S.C. § 17n (2000) (prohibiting "untrue statements [or omissions] of a material fact . . . or fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer . . . .").

14. 17 C.F.R. § 240.10b-5.

15. Rubinstein v. Collins, 20 F.3d 160, 166 (5th Cir. 1994).

16. Materiality is not only relevant to 10b-5 actions. Professor Huang notes some additional areas of relevance. *See* Peter H. Huang, *Moody Investing and the Supreme Court: Rethinking the Materiality of Information and the Reasonableness of Investors*, 13 SUP. CT. ECON. REV. 99, 109-10 (2005) ("The question of whether a particular item of information is material is central to securities litigation and enforcement. Rule 408 of the Securities Act requires that registration statements contain, in addition to particular specifically required disclosures, 'such further material information . . . as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.' Rule 12b-20 of the Securities Exchange Act imposes the same requirement in mandated periodic disclosures. Questions of materiality arise in the anti-fraud civil liability provisions of sections 11 and 12(a)(2) of the Securities Act and Rule 10b-5 of the Securities Exchange Act, in particular insider trading cases. Regulation FD prohibits the selective disclosure of material, non-public information by issuers of securities.") (footnotes omitted) (quoting the Securities Exchange Act of 1934 Rule, 17 C.F.R. § 230.408 (2002)).

17. *See* EP Medsystems, Inc. v. EchoCath, Inc., 235 F.3d 865, 872 (3d Cir. 2000) ("Material representations must be contrasted with . . . general statements of optimism, which 'constitute no more than "puffery" and are understood by reasonable investors as such.'" (quoting *In re* Advanta Corp. Sec. Litig., 180 F.3d 525, 538 (3d Cir. 1999))).

18. Milton v. Van Dorn Co., 961 F.2d 965, 969 (1st Cir. 1992) (quoting Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988)).

19. *See* TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would

concept of a "reasonable investor." There are differing notions as to who exactly this reasonable investor is for purposes of materiality determinations under the securities laws.[20] Some argue the reasonable investor for purposes of assessing materiality is "a savvy person who grasps market fundamentals."[21] Specifically, under such a formulation "the reasonable investor grasps . . . the time value of money, the peril of trusting assumptions, and the potential for unpredictable difficulties to derail new products."[22] However, courts have not spoken in one voice on this point,[23] and other commentators argue that the "better reasoned authorities have concluded that 10b-5 applies to all investors, whether or not

---

consider it important in deciding [whether to buy or sell] . . . . *Put another way*, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.") (emphasis added).

20. *See* Piambino v. Bailey, 610 F.2d 1306, 1320 (5th Cir. 1980) (analogizing reasonable investor to the torts standard of a reasonable person); Hoffman, *supra* note 4, at 540 n.12 ("Both 'reasonable' and 'investor' have multiple variants: rational, prudent, informed, lay, and typical; shareholder, stockholder, businessman, man, and person."). *Cf.* U.S. SEC, THE WHEAT REPORT, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS 51-52 (1969) ("At what audience should disclosure be aimed? Is the literature elicited by the Commission's requirements intended primarily to aid the unsophisticated? Is it, on the contrary, designed to assist the assiduous student of finance who searches for every clue to the intrinsic value of securities? Or should the Commission strive to meet the needs of a hypothetical 'reasonable' investor of 'reasonable' sophistication? Throughout its history, the Commission has struggled with these questions. They may well be unanswerable.").

21. Margaret V. Sachs, *Materiality and Social Change: The Case for Replacing "the Reasonable Investor" with "the Least Sophisticated Investor" in Inefficient Markets*, 81 TUL. L. REV. 473, 473 (2006); *see also*, *In re* Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 377 (3d Cir. 1993) (noting that a "reasonable investor should have known of the economic downturn in the Northeast[ern United States]"). *But cf.* Hoffman, *supra* note 4, at 563 ("[Behavioral Law & Economics] teaches us that individuals do *not* process disclosures rationally. Courts' equation of reasonableness with rationality is a normative move. It transforms materiality from a requirement that reflects ordinary behavior to one that may instead sanction it.").

22. Sachs, *supra* note 21, at 475-76 (citing Levitin v. PaineWebber, Inc., 159 F.3d 698, 702 (2d Cir. 1998); Harris v. Ivax Corp., 182 F.3d 799, 807 (11th Cir. 1999); Hillson Partners Ltd. P'ship v. Adage, Inc., 42 F.3d 204, 213 & n.7 (4th Cir. 1994) (footnote omitted)); *see also*, James O. Hewitt, *Developing Concepts of Materiality and Disclosure*, 32 BUS. LAW. 887, 895 (1977) ("Not all men are investors so it would seem that a test focusing on the 'reasonable man' would not reflect . . . a degree of knowledge about the markets, that a 'reasonable investor' would possess.").

23. *See* Sachs, *supra* note 21, at 498-500 (citing SEC v. George, 426 F.3d 786 (6th Cir. 2005) (holding promise of 2400% annual return material); SEC v. Infinity Group Co., 993 F. Supp. 324 (E.D. Pa. 1998), *aff'd*, 212 F.3d 180 (3d Cir. 2000) (finding guarantee of risk-free 138-181% annual return to be material); SEC v. Hasho, 784 F. Supp. 1059 (S.D.N.Y. 1992) (finding guarantee of 100-200% annual return to be material)). As Professor Sachs notes, if these courts were employing the concept of a reasonable investor as financially savvy, they could never have reached these results because no such reasonable investor would rely on such incredible promises in making an investment decision.

sophisticated."[24] Furthermore, conceptualizing the reasonable investor as sophisticated for materiality purposes may impose a duty upon shareholders to be rational, which would be contrary to the "story" of corporate law that is based largely upon a duty-free shareholder.[25] More importantly, the SEC has consistently focused on protecting the "average" investor in executing its regulatory and enforcement functions.[26] Any definition of the reasonable investor that goes beyond this "average" investor conceptualization places the courts in direct conflict with the SEC—the administrative agency charged by Congress with regulating the securities markets.[27] Both corporate managers and retail investors would be on notice that various types of material information must be disclosed, however they would be unclear whether a particular disclosure's materiality should be assessed vis-à-vis the average retail investor or the sophisticated institutional investor. This would likely lead to increased costs because both corporations and investors must factor in this uncertainty when deciding what information to disclose and how to weigh the information that is disclosed. Perhaps the best view, then, is that the term "reasonable investor" is meant simply to make the standard an

---

24. ARNOLD S. JACOBS, 5B DISCLOSURE & REMEDIES UNDER THE SEC. LAWS § 6:9 *available at* 5b SECDRSL s 6:9 (noting that "some older opinions refer only to the protection of naïve investors"). *Cf.* Firtel, *supra* note 11, at 857 (noting that disclosure under the '33 Act "is intended for the unsophisticated investor").

25. *See* Hoffman, *supra* note 4, at 537-38 ("American public shareholders are uniquely blessed by the freedom to do what they will with their capital. Unlike other stakeholders, shareholders owe the corporation no legal duties. . . . Or so the story goes. In reality, courts hold purchasers of securities to something similar to a duty of care. Courts require investors to investigate their purchases, to coldly process risk, to disregard oral statements of optimism, and in general to be *economically rational.* If investors fail to meet these expectations, judges deny them the protection of the securities laws. In this way, courts impose on public securities investors a special kind of legal duty, novel in scope and, I will argue, ungrounded in principle.") (footnotes omitted).

26. *See* Langevoort, *supra* note 8, at 173 ("Both Congress and the SEC have a strong interest in the support of the retail investor community and the presence of strong public markets. Indeed, in some ways, a fair amount of what the Commission does, especially the Division of Corporate Finance's review and comment on registration statements, is in the name of making disclosure 'accessible' to the average investor."); Firtel, *supra* note 11, at 851 ("The [SEC] has maintained that disclosure should be geared toward all types of investors, from the average investor to the professional financial analyst."). *But cf. id.* at 853 ("[A]ny attempt to gear disclosure toward the average investor hinders the efficacy of the disclosure regime.").

27. *See* Securities and Exchange Act of 1934 § 4, 15 U.S.C. § 78d (2000) (establishing the SEC by Congress); *see also* O'Hare, *supra* note 5, at 1723-24 ("Congress took several significant steps to restore investors' trust in statements made by companies. Most importantly, numerous anti-fraud provisions were included in the federal securities laws. The SEC was established to enforce these provisions.") (footnote omitted).

objective one, excluding idiosyncratic investing decisions, rather than favoring a particular level of sophistication.[28]

Two further points are worth making here about the concept of the reasonable investor as materiality yardstick. First, it has been argued that where a security is traded in an efficient market, the market itself should serve as the reasonable investor. As the Third Circuit stated in *In re Burlington Coat Factory* (one of the cases utilized in the Puffery Survey here):

> Ordinarily, the law defines "material" information as information that would be important to a reasonable investor in making his or her investment decision. In the context of an "efficient" market, the concept of materiality translates into information that alters the price of the firm's stock. This is so because efficient markets are those in which information important to reasonable investors (in effect, the market) is immediately incorporated into stock prices.[29]

In fact, the Fourth Circuit, in another case used in this survey, *Raab v. Gen. Physics Corp.*,[30] seemingly defined puffery in this way when it stated that "'puffing' statements . . . lack materiality because the market price of a share is not inflated by vague statements predicting growth."[31] However, there are a number of problems with equating the reasonable investor with the market. Perhaps most glaring is the fact that such a formulation seems directly at odds with the Supreme Court's materiality test, which frowns upon the use of bright-line tests. As the court in *No. 84 Employer-Teamster Joint Council Pension Trust v. Am. W. Holding Corp.*, stated:

> In *Basic*, the Supreme Court expressly adopted the "reasonable investor" standard set forth in *TSC Industries* for determining materiality in the Section 10(b) and Rule 10b-5 context. . . .

28. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445 (1976) ("The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor."); Allan Horwich, *The Neglected Relationship of Materiality and Recklessness in Actions Under Rule 10b-5*, 55 BUS. LAW. 1023, 1025 (2000) ("Courts generally hold that whether or not a fact is material is objective, it is dependent upon the 'reasonable investor.' To the extent that materiality depends upon the perspective of an individual plaintiff, the defendant is liable only if he is aware of the special concerns of that plaintiff.").

29. 114 F.3d 1410, 1425 (3d Cir. 1997) (citations omitted). *But see* Padfield, *supra* note 12, at 936-37 (acknowledging that stock price movement can constitute strong evidence of materiality, but pointing out various problems with using price movement as a bright-line rule—particularly where defendants seek to use lack of price movement to prove immateriality).

30. 4 F.3d 286 (4th Cir. 1993).

31. *Id.* at 289.

> Pursuant to *Basic*, we reject Defendants' argument for adoption of a bright-line rule requiring an immediate market reaction. The market is subject to distortions that prevent the ideal of "a free and open public market" from occurring. As recognized by the Supreme Court, these distortions may not be corrected immediately. Because of these distortions, adoption of a bright-line rule assuming that the stock price will instantly react would fail to address the realities of the market. Thus, we decline to adopt a bright-line rule, and, instead, engage in the "fact-specific inquiry" set forth in *Basic*.[32]

In addition, to the extent courts are relying on a market-as-reasonable-investor formulation, their analysis is less than clear. For example, in *Raab*, cited above for its seemingly strong market-based view of puffery, the court stated that it deemed the defendants' statements to be puffery, at least in part because "[n]o reasonable investor would rely on these statements . . . ."[33] Thus, until the issue is squarely put to rest to the contrary, whether actual investors agree with judicial determinations about puffery should continue to be a central area of focus in analyzing the doctrine.[34]

A second point is that the reasonable investor standard may have nothing to do with actual investors at all, but rather is based upon some

32. 320 F.3d 920, 934 (9th Cir. 2003) (citations omitted).

33. *Raab*, 4 F.3d at 290.

34. It might also be argued that at least some of the statements evaluated by the survey could be protected by the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 STAT. 737 (1995); *see also* Richard A. Rosen, *The Statutory Safe Harbor for Forward-Looking Statements: A Scorecard in the Courts From November 2004 Through November 2006*, 39 SEC. REG. & L. REP. 54 (2007) (noting that the PSLRA "provides a safe harbor from liability for forward-looking statements . . . if: (1) the statement is identified as forward-looking and is accompanied by meaningful cautionary language; or (2) that statement is immaterial; or (3) plaintiffs fail to establish that defendants had actual knowledge of the falsity of the statement."). Note that while it is true that at least some of the statements may be characterized as forward-looking under § 78u-5(c), the courts in the cases surveyed could only have applied the PSLRA safe harbor to the extent they found the statement otherwise immaterial (i.e., these were not cases involving statements identified as forward-looking and accompanied by cautionary language, nor was the actual knowledge prong of the safe harbor in play). This brings us back to the issue of reasonable investor perception. And, despite the fact that even critics of the puffery doctrine have argued that its application is more justified when the challenged statements are forward-looking, such arguments are still grounded on assumptions about investor reaction—assumptions that should be empirically tested. *See, e.g.*, O'Hare, *supra* note 5, at 1737 ("Because forward-looking statements are understood to be somewhat unreliable, reasonable investors are less likely to find such statements to be significant.").

"normative idealized type of behavior."[35] If that is to be the standard, however, it is highly questionable whether courts should be the ones deciding upon the norms—particularly without any express acknowledgement thereof.[36] "If what we want is some semblance of market price integrity (i.e., unmanipulated markets), we have little other choice"[37] except to "keep the definition [of materiality] . . . tied to what is commonplace or normal, whether we admire the behavior or not."[38]

Beyond the definition of materiality and the reasonable investor, the Supreme Court has stated that materiality determinations should only rarely be dismissed on the basis of pretrial motions:

> The determination [of materiality] requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment.[39]

And, in addition to admonitions about the fact-intensive nature of materiality determinations, the Court has also made clear, as noted above, that the issue of materiality is not to be reduced to a set of bright-line rules. Specifically, the Supreme Court has noted that:

> A bright-line rule indeed is easier to follow than a standard that requires the exercise of judgment in the light of all the circumstances. But ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.[40]

35. Huang, *supra* note 16, at 111; *see also* Langevoort, *supra* note 8, at 184 n.203 ("To be sure, one could say that there is a normative dimension here and that judges are saying that investors should not rely on these things, whether or not they do in fact.").

36. *See* Huang, *supra* note 16, at 111 (noting that if courts are in fact utilizing the reasonable investor standard to enforce some type of normative goal, "one can question whether the practice of courts continuing to utilize such a definition of reasonable investor and the related standard of materiality is relevant or appropriate").

37. Langevoort, *supra* note 8, at 186.

38. *Id.*

39. TSC Indus. v. Northway, Inc., 426 U.S. 438, 450 (1976) (quoting Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970)) (footnote omitted).

40. Basic, Inc. v. Levinson, 485 U.S. 224, 236 (1988); *see also* Ganino v. Citizens Utilities Co., 228 F.3d 154, 162 (2d Cir. 2000) ("Following *Basic*, we have consistently rejected a formulaic approach to assessing the materiality of an alleged misrepresentation.").

Finally, the materiality test is intended to strike a balance between protecting investors and allowing corporate managers to disseminate information without undue fear of liability.[41] There is a tension that arises out of this balancing act, however, between the desire to protect investors via full and fair disclosure[42] and the desire to avoid the negative consequences of excessive litigation[43] and overly burdensome disclosure requirements.[44] This tension is exacerbated by the reality that corporations are often under tremendous pressure to settle even frivolous claims that survive pretrial motions to dismiss.[45] In order to manage this tension in the course of actual litigation, courts have come up with various "safety valves" to allow them to dispose of what they see as frivolous claims.[46] One of these safety valves is the puffery doctrine.[47]

41. *TSC*, 426 U.S. at 448-49 ("[I]f the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.").

42. *See, e.g.*, The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 STAT. 745 (2002) ("An Act [t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws . . . .").

43. *But see* Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L. J. 83, 121 (2002) ("[T]here is little agreement in the academic community on whether there is a problem of frivolous suits in this area.").

44. *See, e.g.*, Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 STAT. 737 (1995) ("An Act [t]o reform Federal securities litigation . . . .").

45. *See generally*, Padfield, supra note 12, at 945 (discussing pressure to settle).

46. *See* Hoffman, *supra* note 4, at 573 ("Scholars have identified four common techniques in recent works: (1) puffery; (2) bespeaks caution; (3) zero price change; and (4) triviality. Four additional labels for courts' decisions are present in the cases: (5) failure to read; (6) fraud by hindsight; (7) truth on the market; and (8) failure to understand consequences.") (footnotes omitted). There is another story, however, wherein courts use doctrines like puffery not to strike a balance between the competing interests of protecting investors and not overburdening management, but rather to solve their own problems of limited resources and risk aversion. *See, e.g.*, Bainbridge & Gulati, *supra* note 43, at 114 (describing the materiality safety valve employed by courts, where once immateriality has been determined, the case is closed and concluding that such court heuristics are acceptable as long as they are "fact-based, vague, and a matter of discretion (or reasonableness)"). Of course, the possibility that all this is merely rhetorical cover for a pro-business bias has also not gone unnoticed. *Cf. id.* at 87 (identifying prior literature on procedural heuristics as "criticiz[ing] judicial rules of thumb as being biased toward defendants").

47. *See* Hoffman, *supra* note 4, at 586 ("Over time, as I have explored, courts have become more willing to apply 'puffery' and 'bespeaks caution' doctrines which are (1) bright-line rules that focus on the language of disclosures, (2) associated with each other, and (3) more likely to appear at early stages in lawsuits.").

B. Puffery

While the general notion that certain statements are too boosterish to warrant any reasonable reliance seems beyond dispute, pinning down what exactly constitutes immaterial puffery is fraught with difficulties. In this section, we will get a clearer picture of just how difficult this can be. First, we will look at the history and definition of puffery. Second, we will examine some of the criticisms of the doctrine, particularly in the securities regulation area. The sum of all this will (hopefully) lead the reader to agree that if we are going to apply the puffery doctrine in the securities regulation area, we should at least do what we can to ensure that our related assumptions about investor behavior are empirically supported.

1. History & Definition

Historically, the roots of the puffery defense may be traced to the doctrine of caveat emptor ("let the buyer beware").[48] Richard Leighton relates the colorful history:

> A concept that became a basis of the puffery exclusion predates 1534, when a compiler of English law gave the following example about the potential sale of a horse. "If he be tame and have been rydden upon [by the potential buyer], then *caveat emptor* [let the buyer beware]." The strange legal terms "puffer" and "puffery" apparently became associated with commercial activities in the mid- to late-18th Century. A "puffer" was a person secretly hired by a seller to bid up auction prices ("puffing"), thereby creating a deliberate and material deception that was outlawed by statute in many jurisdictions. By the 19th Century, the term "puffery" (sometimes called "sales talk" or "dealer's talk") had transmogrified into a contrary connotation as a legal defense for vindicating salespeople accused of common law fraud and deceit.[49]

Consistent with the doctrine of caveat emptor, courts that have recognized the puffery defense have often justified that position by

48. *See* Leighton, *supra* note 1, at 637 (stating that the doctrine of caveat emptor was justified on the beliefs that "(1) the potential purchaser can inspect what is to be purchased prior to sale and thereby determine the truthfulness of any statements made by the seller, and (2) everyone knows that you should not rely on what sellers say because they 'will naturally overstate the value and qualities of the articles which they have to sell'") (quoting Kimball v. Bangs, 11 N.E. 113, 114 (Mass. 1887)).

49. Richard J. Leighton, *Materiality and Puffing in Lanham Act False Advertising Cases: The Proofs, Presumptions, and Pretexts*, 94 TRADEMARK REP. 585, 616-17 (2004) (alteration in original) (footnotes omitted) (quoting ANTHONY FITZHERBERT, BOKE OF HUSBANDRIE § 118 (1534)).

reference to a none-too-flattering view of human nature. For example, in *Kimball v. Bangs*, the Supreme Court of Massachusetts asserted that "[t]he law recognizes the fact that men will naturally overstate the value and qualities of the articles which they have to sell. All men know this, and a buyer has no right to rely upon such statements."[50] Similarly, in *Vulcan Metals Co. v. Simmons Mfg. Co.*, Judge Learned Hand, before carving out an exception for fiduciary relationships, stated that "[t]here are some kinds of talk which no sensible man takes seriously, and if he does he suffers from his credulity. If we were all scrupulously honest, it would not be so; but, as it is, neither party usually believes what the seller says about his own opinions, and each knows it."[51]

Puffery has been described generally as "a 'vague statement' boosting the appeal of a service or product that, because of its vagueness and unreliability, is immunized from regulation."[52] In the securities regulation context, puffery has been described as "a 'vague statement of corporate optimism' that is said to be 'so obviously unimportant to a reasonable investor that reasonable minds could not differ.'"[53] Statements of optimism about the future are even more protected than statements concerning current conditions.[54]

The puffery doctrine has been applied in a number of areas of the law, including "mail fraud, securities fraud, common-law fraud, legal ethics, common-law contracts, Uniform Commercial Code warranty cases, promissory misrepresentation, [and] false advertising . . . ."[55] Still, while puffery is often loosely described as "vague optimism," a more precise

---

50. Kimball v. Bangs, 11 N.E. 113, 114 (Mass. 1887)

51. Vulcan Metals Co. v. Simons Mfg. Co., 248 F. 853, 856 (2d Cir. 1918)

52. Hoffman, *supra* note 6, at 1397.

53. *Id.* at 1406 (footnotes omitted). *See also* Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1217 (1st Cir. 1996) (describing puffery as "rosy affirmation[s] commonly heard from corporate managers and numbingly familiar to the marketplace—loosely optimistic statements that are so vague . . . that no reasonable investor could find them important . . . .").

54. *See* Hoffman, *supra* note 6, at 1408-09 ("[C]ourts generally h[o]ld that forward-looking puffery is only actionable if it creates a 'substantial certainty' about the company's predicted course or if the statement is made with 'actual knowledge' that it is false. The end result is a doctrine that is quite protective of vague but intentionally false optimism about the future.") (footnote omitted); *id.* at 1409 n.80 ("The Private Securities Litigation Reform Act of 1995, H.R. 1058, Pub. L. No. 104-67, 104th Cong. (1995), provides additional safeguards for predictions under its 'safe harbor' provision. 15 U.S.C. § 77z-2(c) (2000). The provision protects forward-looking statements that are (1) so-identified and accompanied by cautions; or (2) are themselves immaterial. *See id.* at § 77z-2(c)(1)(A).").

55. Hoffman, *supra* note 6 at 1396-97 (footnotes omitted). *Cf. id.* at 1398 n.20 ("There is evidence . . . that many investors treat stock purchasing as a process involving similar emotional factors as ordinary purchase decisions.").

definition to guide courts and others is elusive.[56] One suggested line of demarcation distinguishes puffery from statements of fact. As the Eighth Circuit stated in the context of a Lanham Act false advertising claim in *American Italian Pasta Co. v. New World Pasta Co.*:

> Puffery and statements of fact are mutually exclusive. If a statement is a specific, measurable claim or can be reasonably interpreted as being a factual claim, i.e., one capable of verification, the statement is one of fact. Conversely, if the statement is not specific and measurable, and cannot be reasonably interpreted as providing a benchmark by which the veracity of the statement can be ascertained, the statement constitutes puffery.[57]

However, courts have been less than consistent in carrying out the task of differentiating factual from non-factual statements.[58]

Another approach is to equate a seller's opinion with mere puffery.[59] However, as Judge Learned Hand recognized almost 100 years ago, even mere opinion can be actionable if given by a fiduciary or an expert: "[w]hen the parties are so situated that the buyer may reasonably rely upon the expression of the seller's opinion, it is no excuse to give a false one."[60] This conclusion was echoed by the Supreme Court seventy-three years later.[61]

As we have seen, the puffery defense is rooted in the doctrine of caveat emptor. However, the ubiquity of that doctrine has been whittled away over time. This decline is due in part to increasing criticisms of two of the doctrine's underlying assumptions: (1) "that the parties are on equal footing, with equal access to information," and (2) "that the purchaser has no reason to trust a seller's sales talk."[62] These have been called into

56. *See id.* at 1401 n.30 (noting "the evident need for clarification in the law (in the securities arena particularly).").

57. 371 F.3d 387, 391 (8th Cir. 2004).

58. *See* Hoffman, *supra* note 6, at 1403-04 ("Because neither courts nor regulators consider empirical evidence about which claims imply facts, their application of a nominally coherent doctrine creates a host of decisions in which relatively similar language receives different levels of protection."); *id.* at 1403 & n.43 (stating that while "authorities assume it is possible to distinguish factual from nonfactual speech by looking at the speech itself[,]" researchers argue "it is not easy to distinguish speech conveying factual claims from speech that does not, and that much of the speech that the FTC refers to as puffery in fact *implies* facts, which themselves might be false.").

59. *See id.* at 1403 (discussing the FTC's view of puffery as relatively harmless opinion).

60. Vulcan Metals Co. v. Simons Mfg.Co., 248 F. 853, 856 (2d Cir. 1918).

61. Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1092 (1991) ("Such statements are factual in two senses: as statements that the directors do act for the reasons given or hold the belief stated and as statements about the subject matter of the reason or belief expressed.").

62. O'Hare, *supra* note 5, at 1705.

question in many circumstances.[63] This leads us into our discussion of the criticisms of the puffery doctrine.

2. Criticisms

The puffery doctrine has been the subject of much academic criticism.[64] In the hope of providing a useful analytical framework, the criticisms have been divided into three categories: (1) criticisms focused on the definition of materiality; (2) criticisms focused on securities regulation generally; and, (3) criticisms focused on market realities.

a. Criticisms based on the definition of materiality

The puffery doctrine has been broadly criticized for being based on a view of materiality that is contrary to the Supreme Court's guidance. Specifically, the doctrine runs afoul of three essential guidelines to the assessment of materiality set forth by the Supreme Court: (1) that the analysis of materiality is fact-intensive and should thus generally be left for the trier of fact;[65] (2) that courts should avoid bright-line rules in making materiality determinations;[66] and (3) that an assessment of materiality should include an assessment of the total mix of information available to the investor.[67]

As to the first point, the puffery doctrine can be seen as taking cases from the jury prematurely.[68] For example, in one survey, over 70% of

---

63. *See id.* at 1706 ("As courts began to recognize that the assumptions underlying the doctrine were no longer present, the doctrine of caveat emptor became disfavored. The doctrine has been curtailed or rejected in several substantive areas. For example, in contract law, it has been largely replaced with implied warranties of merchantability and fitness for a particular purpose. In real property law, the courts have replaced caveat emptor with the implied warranty of habitability in residential property transactions. In securities regulation, it has been replaced by a mandatory disclosure system.") (footnotes omitted).

64. *See, e.g.*, Bainbridge & Gulati, *supra* note 43, at 99 ("[T]he limited scholarly work on [the puffery] doctrine has been largely critical.").

65. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976) (noting that materiality determinations are "peculiarly ones for the trier of fact.").

66. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 236 (1988) ("Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive.").

67. *See* TSC, 426 U.S. at 449 (noting that information is material if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

68. *See* Huang, *supra* note 16, at 117 ("The problem with judicial early dismissal of a securities puffery case as a matter of law under Federal Rule of Civil Procedure 12(b)(6) or at summary judgment is that a reasonable jury might have decided differently had that jury been given the opportunity to do so."); O'Hare, *supra* note 5, at 1699 ("[A] judge accepting the puffery defense may impermissibly infringe upon the role of the fact finder."). Concern

securities litigation dismissals involved materiality determinations.[69] To the extent these materiality determinations included application of the puffery defense, the doctrine is helping to make a mockery of the oft-asserted "rule" that materiality issues should be left to the trier of fact.[70] As Professors Bainbridge and Gulati note:

> [I]f a high percentage of securities disclosure cases are dismissed at the motion to dismiss stage on grounds that the information in question was immaterial, but each opinion has in it the caveat that "materiality is ordinarily an issue for the finder of fact, and it is only in the rare case that it can be decided at the motion to dismiss stage," things do begin to look suspicious.[71]

Courts' reliance on the doctrine to dispose of cases pretrial may also interfere with the sound development of the law.[72]

As to the second point, judicial application of the puffery doctrine also seems to blatantly ignore the Supreme Court's admonition against the use of bright-line rules in the materiality analysis.[73] Not only can use of the puffery doctrine be seen as an inappropriate application of a bright-line rule, but when viewing the doctrine through the lens of the myriad of criticisms set forth here it arguably constitutes a very poor bright-line at that. To the extent the current judicial administration of the puffery doctrine "create[s] incentives for corporations to use words that they hope

for the negative consequences of taking cases from juries prematurely is not limited to securities regulation. *See generally* Arthur R. Miller, *The Pretrial Rush to Judgment: Are the "Litigation Explosion," "Liability Crisis," and Efficiency Clichés Eroding Our Day in Court and Jury Trial Commitments?*, 78 N.Y.U. L. REV. 982 (2003) (examining the use of summary judgment and motions to dismiss in light of growing concerns over efficiency in the federal judicial system).

69. Bainbridge & Gulati, *supra* note 43, at 116 n.94 ("Of the 91 (out of 100) cases that were decided at the motion to dismiss stage, 64 involved materiality determinations in favor of defendants (i.e., over 70 percent).").

70. *See* Hoffman, *supra* note 4, at 541-42 ("[J]urists . . . conclude that materiality issues in securities cases are almost always left for jury resolution. . . . In this Article, I present evidence that courts dismiss securities claims on the ground of presumed immateriality in *half of opinions considering materiality*."); Bainbridge & Gulati, *supra* note 43, at 116 n.94 ("[A]ccording to our survey of opinions, the question of materiality that is 'ordinarily' to be a question for the trier of fact and is to be decided in favor of the defendant at a threshold stage only if it is so 'obvious' that reasonable minds could not differ, turns out to be the subject of extensive [pretrial] discussion in the majority of cases. . . . In other words, what is supposed to be rare and unusual, turns out to be routine.").

71. Bainbridge & Gulati, *supra* note 43, at 115.

72. *Id.* at 88 ("When judges invoke substantive heuristics, however, the use of such heuristics channels, and even dominates, the ongoing evolutionary process of the (quasi-common) law of securities regulation.").

73. *Cf.* Hoffman, *supra* note 4, at 589-90 (noting a shift in judicial decision-making on determinations of materiality from standard-based model to a model based on bright-line rules).

will induce reliance, but which may be rendered legally irrelevant; [it is a] bright-line rule[] that enable[s] fraud."[74]

Finally, as to this first broad criticism of the puffery doctrine, there is the issue of the "total mix." The puffery doctrine generally fails to view statements in context.[75] This failure to consider context not only is contrary to Supreme Court guidance, but places the doctrine at odds with another "safety valve" used to dismiss securities claims—the "bespeaks caution" doctrine. The bespeaks caution doctrine allows "the presence of meaningful cautionary language [to] preclude a finding that investors were misled by projections or other forward-looking statements."[76] As Professors Bainbridge and Gulati put it, "[i]f putting the statement into context lends credence to dismiss, the bespeaks caution doctrine is invoked. If taking a statement out of context makes dismissal more plausible, however, puffery is invoked."[77]

b. Criticisms related to securities regulation generally

Certainly in the securities regulation area, the philosophy of caveat emptor, upon which the puffery doctrine is based, seems to stand in direct opposition to the philosophy of full disclosure underlying the regulations.[78] As the Supreme Court of the United States explained in *SEC v. Capital Gains Research Bureau*:

> The Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental purpose, common to

---

74. *Id.* at 588. *Cf.* Bainbridge & Gulati, *supra* note 43, at 138 (positing that heuristics can create "safe harbors for bad behavior" if based on incorrect assumptions about firms and market behaviour).

75. *See* O'Hare, *supra* note 5, at 1700 (noting that in applying the puffery defense in securities litigation "courts have improperly limited their focus to the *words* or *language* of the company's statement, while ignoring such important factors as who made the statement and where the statement was made.").

76. Padfield, *supra* note 12, at 935.

77. Bainbridge & Gulati, *supra* note 43, at 123.

78. *See* Huang, *supra* note 16, at 117 ("[T]he SEC has been unwilling to dismiss enforcement actions against brokers based upon the puffery defense, holding that the puffery defense does not apply to such securities contexts."); Leighton, *supra* note 49, at 627 ("The Securities and Exchange Commission has emphatically rejected puffing defenses in enforcement actions, sometimes emphasizing the inappropriateness of such *caveat emptor* arguments in actions under consumer protection statutes.").

> these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.[79]

In fact, at least one Supreme Court justice has noted that puffery was very specifically one of the "evils" the Securities Act was designed to protect against:

> The stated purpose of the 1933 Act was '[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce . . . .' The evil addressed was the tendency of the seller to exaggerate, to 'puff,' and sometimes fraudulently to overstate the prospects and earning capabilities of the issuing corporation. The decade of the 1920's was marked by financings in which the buying public was oversold, and often misled, by the buoyant optimism of issuers and underwriters. The 1933 Act was intended to compel moderation and caution in prospectuses, and this is precisely the way that Act has been administered by the SEC for more than 40 years.[80]

Perhaps it is not surprising, then, that the puffery defense was deemed by at least some to be inapplicable in securities regulation cases.[81] A leading treatise had in fact concluded that the defense "has all but gone the way of the dodo,"[82] and the SEC itself "has consistently rejected the use of the puffery defense, holding that the defense is inapplicable in the securities regulation context."[83] However, a more recent edition of that treatise no longer takes such a view[84] and the reality is that "the puffery defense is alive and well" and "appellate courts in almost every federal circuit have recently used the puffery defense to dismiss private securities fraud actions . . . ."[85] Professor O'Hare correlates this "re-emergence" of the puffery defense with an expansion of the scope of its liability shield:

---

79. 375 U.S. 180, 186 (1963).

80. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 759 n.4 (1975) (Powell, J., concurring) (citation omitted). *Cf.* Feit v. Leasco Data Processing Equip. Corp., 332 F. Supp. 544, 549 (E.D.N.Y. 1971) ("Given an honest and open statement, adequately warning of the possibilities of error and miscalculation and not designed for puffing, the outsider and the insider are placed on more equal grounds for arms [sic] length dealing. Such equalization of bargaining power through sharing of knowledge in the securities market is a basic national policy underlying the federal securities laws.").

81. *See, e.g.*, Anschutz Corp. v. Kay Corp., 507 F. Supp. 72, 74 (S.D.N.Y. 1981) (casting doubt on the applicability of the puffery defense in securities litigation "in view of the heightened standards of disclosure established by the federal securities laws . . . .").

82. 7 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 3434 (3d ed. 1991).

83. O'Hare, *supra* note 5, at 1708.

84. 7 LOUIS LOSS & JOEL SELIGMAN, SECURITIES, REGULATION 3424 (3d ed. rev. 2000) ("[A]las, however, the puffing concept in the securities context, which for decades had all but gone the way of the dodo, has recently experienced a revival.").

85. O'Hare, *supra* note 5, at 1697.

> The courts have long used the puffery defense to insulate securities brokers from liability for statements such as: "This security is a great investment." More recently, however, courts have extended the protections of the puffery defense to *non-broker* defendants, such as corporate officers and directors. In these cases, the courts used the puffery defense to dismiss actions based on vague statements of corporate optimism concerning future events, such as: "We expect significant growth in earnings during the next fiscal year."[86]

In spite of these apparent problems of fit between the puffery doctrine and securities regulation, the doctrine continues, as already noted, to thrive. Not surprisingly, this continued application and expansion of the doctrine in the securities litigation area has been met with additional criticism, particularly about the apparent disconnect between the doctrine and market reality.

c. Market reality criticisms

We have already touched on the criticism that certain realities of securities transactions—such as the inequality of informational access[87] and presence of fiduciary duty in many of these cases[88]—conflict with fundamental assumptions underlying the puffery doctrine.[89] There are, however, other criticisms of the puffery doctrine related to market reality. These include the criticisms that: (1) the puffery doctrine is contrary to empirical evidence about investor behavior; (2) the puffery doctrine is contrary to the reasonable reliance investors arguably place on "vague" statements by corporate officials; (3) the puffery doctrine is contrary to the market's own apparent high valuation of puffery; and, (4) the increasing application of the puffery defense may well impede the efficient flow of capital.

---

86. *Id.* at 1698-99. *See also id.* at 1699-1700 ("In short, the courts have significantly expanded the scope of a powerful defense to dismiss potentially meritorious securities fraud actions with little or no analysis or consideration of the effect of their decisions.").

87. *See* Virginia Bankshares Inc. v. Sandberg, 501 U.S. 1083, 1091 (1991) ("Shareholders know that directors usually have knowledge . . . far exceeding the normal investor's resources . . . .").

88. *See* O'Hare, *supra* note 5, at 1700 (stating that "because reasonable investors are entitled to trust a company's vague statements of corporate optimism, the puffery defense is inappropriate in private securities fraud actions.").

89. *See In re* B. Fennekohl & Co., 41 S.E.C. 210, 216 (1962) ("The concept of 'puffing' is derived from the doctrine of *caveat emptor* and arises primarily in the sale of tangibles where it appears that examination by the purchaser may offset exaggerated statements and expressions of opinion by the salesman. It can have little application to the merchandising of securities.").

The empirical literature undermines the rhetorical justifications that judges give for dismissing claims under the puffery doctrine.[90] Indeed, "'no behavioral studies have reported the finding, assumed by the law, that consumers typically see puffery . . . as meaningless.'"[91] In fact, "[e]xperimental literature analyzing puffery confirms that individuals are unable to ignore vague optimism and expressions of confidence."[92] Thus, by failing to employ empirical evidence in their analysis, it may be that judges have failed to demonstrate sufficient competence in administering the puffery doctrine.[93] To the extent this criticism is valid, it may be related

90. *See* Hoffman, *supra* note 6, at 1435 ("Jurists and regulatory authorities routinely assume that buyers of goods, services, and securities ignore puffing statements. This straightforward application of many 'individual [jurists'] personal theorizing' is in tension with real-world evidence of the utility of persuasive advertising. In any event, it is simply untrue. Marketing scholars have demonstrated that puffing statements are believed on their own terms and lead some individuals to further imply facts about the puffed speech that are untrue.") (quoting Klaus G. Grunert & Konrad Dedler, *Misleading Advertising: In Search of a Measurement Methodology*, 4 J. PUB. POL'Y & MARKETING 153, 154 (1985))(alteration in original) (footnotes omitted); Huang, *supra* note 16, at 99 (2005) ("This Article develops how and why the core notions of materiality of information and the reasonable investor should be revised in light of recent empirical data, experimental evidence, and theoretical models of moody investing. . . . In particular, this Article argues that current judicial treatment of puffery is flawed because it neglects the power of puffery to alter moods."); *id.* at 118 ("The legal and policy implication of the literature about decision-making and moods is that unquestioning judicial acceptance of the so-called puffery defense is unwarranted."). *Cf.* Bainbridge & Gulati, *supra* note 43, at 120 n.104 ("The SEC has expressed grave concerns about the market effects of false rumors released in Internet chatrooms by unverifiable sources, which flatly contradicts the puffery doctrine.").

91. Ivan L. Preston, *Puffery and Other "Loophole" Claims: How the Law's "Don't Ask, Don't Tell" Policy Condones Fraudulent Falsity in Advertising*, 18 J.L. & COM. 49, 82-83 (1998).

92. Hoffman, *supra* note 4, at 587.

93. *See* Bainbridge & Gulati, *supra* note 43, at 84 ("[T]he real puzzle is that federal judges are claiming—at least implicitly—a level of expertise about the workings of markets and organizations that, in some areas, not even the most sophisticated researchers in financial economics and organizational theory have reached."); *id.* at 120-21 ("The idea that judges possess the sophisticated understanding of investor behavior and market dynamics necessary to validate the puffery doctrine, however, is bizarre. . . . Not one case referred to actual evidence that investors or markets were unaffected by vague statements of corporate optimism."); Hoffman, *supra* note 6, at 1398 ("The problem with puffery doctrine is not doctrinal chaos; courts and regulators have simply chosen a normative target that they are institutionally ill-suited to hit. In this context, walking the line between overdeterrence of speech and underdeterrence of fraud turns out to be beyond courts' competence. This institutional incapacity, coupled with a traditional fear of overregulating speech, leads authorities to overprotect commercial speech from liability."); *see also id.* at 1399 ("Courts and regulators are bad at distinguishing speech that produces 'good' or 'bad' consumption because they systematically underestimate when consumers rely on hyperbolic speech and the extent to which this speech communicates facts."); Donald C. Langevoort, *Disclosures That "Bespeak Caution,"* 49 BUS. LAW. 481, 493 (1994) ("There are no broad-based empirical studies that adequately describe how the normal investing population makes its investment decisions. In the absence of good data, lawyers and judges asked to determine

to certain attitudes judges bring with them to the task.[94] This not only highlights the need for empirical evidence playing a role in puffery determinations, but also brings us back to the problem of taking the case from the jury prematurely. As Professor Huang notes: "in terms of institutional competence, juries may possess a comparative advantage over judges in being able to determine if puffery affects moods and in so doing, securities investing."[95]

Another criticism is that by immunizing "vague" statements as a matter of law, courts ignore the realities of the market place. Professor O'Hare explains why a court should not necessarily brand vague commentary about present facts as puffery:

> Statements characterizing present facts are necessarily vague. When a company evaluates an on-going transaction or its past financial performance, it will examine the relevant facts, analyze them, and then distill them into a general statement. For example, when a company is asked to describe its present financial health, it could respond with a simple dollars and cents statement of earnings, allowing its audience to draw their own conclusions. However, the information the market really wants to know is the company's own assessment of its health (*i.e.*, Is the company's condition 'strong?' 'Fair?' 'Improving?'). Similarly, when a company is asked to comment on the status of its attempt to acquire another company, for example, its response may be that the transaction is proceeding 'very well,' 'well,' or perhaps 'not so well.' All of these evaluative words are sufficiently vague to be labeled puffery. However, such a result would mean that a company's statement characterizing present facts would *always* be immaterial and therefore non-actionable. Courts should recognize, then, that the vagueness of a statement

---

what a reasonable investor would do have little choice but to draw implicitly on their own knowledge and experience. This introduces a serious risk of unconscious bias, for perceptions about the economic behavior of others can be quite inventive.").

94. *See* Hoffman, *supra* note 4, at 589 ("[J]udges in securities cases are subject to 'lawyers' biases,' which make them overconfident with respect to their ability to understand how the world 'really works,' complete with a sneer toward 'laypeople' who do not understand the game. Empathy for investor incompetence is hard for judges who always analyze disclosures in hindsight armed with briefs which explain financial, accounting, and legal concepts in concise, readable ways.") (footnotes omitted) (quoting Donald C. Langevoort, *Are Judges Motivated to Create "Good" Securities Fraud Doctrine?* 51 EMORY L.J. 309, 318 (2002)).

95. Huang, *supra* note 16, at 117; *see also id.* at 122 ("[T]his inquiry does not have to rely solely on the introspection of judges or juries, but can and should benefit from empirical surveys of investors and expert witness testimony by economists, social psychologists, and marketing professors.").

characterizing present facts should not be dispositive to a materiality determination.[96]

Relatedly, the prevalence of puffery in the market belies the notion that no one is relying on it.[97] In fact, generous application of the doctrine may well create a cynical paradox wherein "sellers consistently demonstrate that puffery is economically valuable speech, but are protected from liability by jurists claiming that it is not."[98] In this way, the doctrine may lead to an increase in speech that impedes the efficient flow of capital by reducing the trust investors have in the market.[99]

96. O'Hare, *supra* note 5, at 1734-35; *see also id.* at 1735-36 (discussing Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1088 (1991), which held that director statements characterizing the value to be received by shareholders in corporate transaction as "high" and "fair" were not too indefinite to preclude liability).

97. *See* Bainbridge & Gulati, *supra* note 43, at 120 ("Anecdotally, it does not take much time watching investment programs on television to notice that even quite vague statements of optimism by corporate managers are considered important by the investment news media.").

98. Hoffman, *supra* note 6, at 1446.

99. *Id.* at 1440-41 ("If we cannot trust courts and regulators to intuit an optimal amount of puffing speech, we should look to the other legal actors involved in the process. Current doctrine essentially puts the burden on buyers of stocks and services to avoid the harms that puffing speech creates. This decision has had pernicious effects. *First*, it has encouraged sellers to expand their use of persuasive speech significantly. Thus, one student found that print advertising in *Time* contained less than half as many words in 2000 as in 1976. Persuasive messages that 'elicit only emotional responses, omitting virtually all information' are more popular than ever. To the extent that most persuasive advertising could also be characterized as puffery, such an expansion casts some doubt on the economic model of non-regulated advertising [which argues that market forces will prevent puffery].") (footnotes omitted) (quoting Sarah C. Haan, Note, *The "Persuasion Route" of the Law: Advertising and Legal Persuasion*, 100 COLUM. L. REV. 1281, 1288 (2000)); Langevoort, *supra* note 8, at 185 ("In terms of commonplace investor behavior, a hands-off legal approach would only invite a high incidence of exploitation."); O'Hare, *supra* note 5, at 1723 (noting that while "[o]ne of the primary goals underlying the enactment of the federal securities laws was the restoration of public confidence in the securities markets[,]" acceptance of the puffery defense "encourages and rewards a distrust" between corporate managers and investors); *see also* H.R. REP. NO. 73-1383, at 5 (1934) *reprinted in* 5 Legislative History of the Securities Act of 1933 and Securities Exchange Act of 1934 (J. S. Ellenberger & Ellen P. Mahar comps.) (2001) ("If investor confidence is to come back to the benefit of exchanges and corporations alike, the law must advance. As a complex society so diffuses and differentiates the financial interests of the ordinary citizen that he has to trust others and cannot personally watch the managers of all his interests as one horse trader watches another, it becomes a condition of the very stability of that society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position. Unless constant extension of the legal conception of a fiduciary relationship . . . supports the constant extension of mutual confidence which is the foundation of a maturing and complicated economic system, easy liquidity of the resources in which wealth is invested is a danger rather than a prop to the stability of that system."). It is interesting, but beyond the scope of this article, to theorize as to what the cumulative effect is of all the ways courts provide safe harbors to corporations for misstatements via doctrines such as puffery, bespeaks caution, and truth-on-the-market.

Despite all these criticisms, courts continue to apply the puffery doctrine.[100] This leads us to the heart of this paper, which addresses a question raised above more specifically: Do judges apply the puffery doctrine properly and, if not, might surveys be a useful evidentiary tool to improve the doctrine's application?

III. THE RESEARCH QUESTION: IS JUDICIAL APPLICATION OF THE PUFFERY DOCTRINE VALID?

This section begins with a look at the use of surveys in Lanham Act cases. Since the definition of materiality is similar in both Lanham Act and securities regulation cases, perhaps judicial use of survey evidence in making materiality determinations in Lanham Act cases holds some promise for the utility of the practice in the securities regulation context. The discussion then moves on to an analysis of the Puffery Survey used here to assess actual puffery determinations.

A. The Use of Surveys in Determining Materiality Under the Lanham Act

Issues of materiality and puffery arise in many areas of the law.[101] Of particular relevance here is the similarity between these issues as they arise under the law of securities regulation and in false advertising claims under the Lanham Act.[102] Section 43(a) of the Lanham Act states in relevant part:

> Any person who, . . . in connection with any goods or services . . . uses . . . any . . . false or misleading description of fact . . . , which . . . misrepresents the nature, characteristics, qualities, or geographic origin of . . . goods, services, or commercial activities, shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.[103]

---

100. David Hoffman noted in his 2006 article that "[i]n recent years, and despite hostility from scholars, defendants have been increasingly successful in obtaining dismissals based on puffery arguments." Hoffman, *supra* note 6, at 1405-06. Peter Huang also noted in his 2005 article that "[r]ecently, appellate courts in virtually every federal circuit court have utilized the puffery defense to dismiss private securities fraud actions based upon vague statements of corporate optimism." Huang, *supra* note 16, at 116.

101. *See* Leighton, *supra* note 49, at 608 (noting that many courts have cited the common law action for deceit, and various derivations thereof, "as historical bases or persuasive authorities for materiality and puffing determinations in false advertising cases under the Lanham Act, FTC Act, various federal securities statutes, the Uniform Commercial Code and related state statutes.").

102. *See* Huang, *supra* note 16, at 113 ("The puffery doctrine is also closely related to so-called puffery claims arising in Federal Trade Commission (FTC) regulation of consumer product advertising . . . .").

103. 15 U.S.C. § 1125(a) (2000).

In enforcing this statute, courts have required plaintiffs to show that the allegedly misleading statement was material.[104] In addition, they have allowed defendants to argue immateriality via the puffery defense.[105] The similarities between this evidentiary standard and that under securities regulation law have not been lost on commentators.[106] As Richard Leighton notes:

> The legislative and judicial developments of federal securities laws and regulations are similar to those of Lanham Act false advertising law. One important difference is that many of the securities requirements are in large part based upon the perceived need for *full* disclosure of all material information to protect consumers of securities (*i.e.*, investors). Yet, as with the judicial development of the Lanham Act, there is a growing concern that in reacting to crowded dockets and frivolous investor litigation, the courts are eroding the bases for securities laws by dismissing too many cases on materiality and puffing grounds without sufficient analysis.[107]

The significance of this relationship for our purposes is that it begs the question of why survey evidence is an accepted part of the evidentiary makeup of a Lanham Act case, particularly as to the issue of materiality,[108]

---

104. *See* Am. Council of Certified Podiatric Physicians & Surgeons v. Am. Bd. of Podiatric Surgery, Inc., 185 F.3d 606, 613 (6th Cir. 1999) ("To state a cause of action for misleading advertisement under the Lanham Act, a plaintiff must establish the following: 1) the defendant has made false or misleading statements of fact concerning his own product or another's; 2) the statement actually or tends to deceive a substantial portion of the intended audience; 3) *the statement is material in that it will likely influence the deceived consumer's purchasing decisions*; 4) the advertisements were introduced into interstate commerce; and 5) there is some causal link between the challenged statements and harm to the plaintiff.") (emphasis added); *see also* Jean Wegman Burns, *Confused Jurisprudence: False Advertising Under the Lanham Act*, 79 B.U. L. REV. 807, 871 (1999) ("Although Congress did not expressly include a materiality requirement in either the 1946 version of or the 1988 amendments to section 43(a) of the Lanham Act, some courts, even before the 1988 amendments, read into the statute a materiality element.").

105. *See* Sarah K. Lee, *The Puffery Defense: From Used Car Salesman to CEO*, 30 SEC. REG. L. J. 440 (2002).

106. *Cf.* Hoffman, *supra* note 6, at 1398-99 ("By comparing uses of the puffery defense in false-advertising, securities, Uniform Commercial Code, and promissory estoppel settings, I unearth the implicit goals courts and regulators are advancing when they protect often wildly misleading speech.").

107. Leighton, *supra* note 49, at 611-12 (footnote omitted).

108. *See* Castrol Inc. v. Pennzoil Co., 987 F.2d 939, 950-51 (3d Cir. 1993) (Roth, J., dissenting) ("'The plaintiff must . . . show that defendant's misrepresentation is 'material, in that it is likely to influence the purchasing decision.' . . . Generally, the preferred evidence of an advertisement's influence over purchasing decisions is actual consumer survey evidence.") (quoting U.S. Healthcare, Inc. v. Blue Cross of Greater Phila., 898 F.2d 914, 922 (3d Cir. 1990)); JTH Tax, Inc. v. H&R Block E. Tax Servs., 128 F. Supp. 2d 926, 939 (E.D. Va. 2001) (noting that although consumer survey evidence is not required to establish materiality, where it is lacking the record must contain other "probative evidence");

but not securities regulation cases.[109] Certainly, surveys could have a role in securities litigation.[110] Guidelines for the admissibility of surveys are already in place,[111] and their acceptance by courts growing.[112] Perhaps the Puffery Survey described here can serve as some type of crude model.

Leighton, *supra* note 49, at 602 ("Obviously, evidence of the intended audience's perception of the importance of the offending claim should be probative. The results of perception surveys, introduced through experts, have become standard fare in Lanham Act false advertising cases when the offending claim is not literally false. It is also not unusual to see such surveys used to help prove that a substantial portion of the intended audience considers (or does not consider) the claim at issue to be important with respect to buying the relevant product or service.") (footnote omitted); Richard J. Leighton, *Using Daubert-Kumho Gatekeeping to Admit and Exclude Surveys in Lanham Act Advertising and Trademark Cases*, 92 TRADEMARK REP. 743, 743-44 (2002) ("In Lanham Act cases, expert testimony in the form of surveys and related opinion is regularly proffered to prove how advertisements or trademarks influence perceptions.").

109. *See* Hoffman, *supra* note 6, at 1417 ("In an ideal world, courts would have a sophisticated set of fact-finding devices on hand to distinguish actionable from immune speech . . . . [T]he court would run a survey of all of the potential hearers of [the challenged statement] to determine what facts it conveyed, and then determine whether those facts were false.").

110. *See* Huang, *supra* note 16, at 114 ("In deceptive advertising claims by competitors, and trademark infringement claims under the Lanham Act; courts already adopt empirical survey evidence and expert witness testimony in determining consumers' perceptions. Two legal scholars proposed that courts utilize measurable survey evidence to determine the actual perceptions of symbolic government action endorsing religion and in so doing test for violations of the Establishment Clause of the First Amendment. Similarly, this Article suggests that moody investing also argues for courts adopting survey evidence to determine if puffery affects moods and in so doing, securities investing.") (footnotes omitted); Hoffman, *supra* note 6, at 1427-28 ("Rather than ignoring and disbelieving puffing speech, consumers believe it and use it to make their purchase decisions. Evidence collected from the marketing and behavioral-psychology literature together highlight the need for a reform agenda that would better tie doctrine to actual evidence of consumer behavior."); *id.* at 1445 ("Puffing doctrine should move toward a more intense focus on scienter and manipulation, and away from a current focus on rational consumption that leads courts to idealized models of behavior that are weakly predictive of actual consumption practices. By contrast, a focus on intent and motive is well within legal authorities' traditional zone of competence. Courts should also consider evidence of actual reliance and implied false facts. . . . In practice, rebutting the intent, reliance, and causation presumptions would require sellers to present laboratory or empirical studies of marketplace reaction to puffery. Sellers likely will have cheaper access to this information than courts and buyers. Sources of proof might include . . . consumer surveys as to their perceptions of whether they were misled . . . ."); Hoffman, *supra* note 4, at 607 ("Whether certain behaviors are or are not ordinary and reasonable need not be resolved by informed judicial hunches. Courts have [another] option: use of experimental evidence of human behavior to help guide the relevant decision makers to a better understanding of how individuals actually act. This option is to be preferred.").

111. *See, e.g.*, Shari Seidman Diamond, *Reference Guide on Survey Research*, *in* REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 221(Federal Judicial Center, 2d ed. 2000) (describing the analysis performed on surveys to determine their legitimacy).

112. *See* Leighton, *supra* note 108, at 756-57 ("The recognized need for, and use of, survey type evidence in federal courts has evolved steadily since the later part of the 19th

B. *The Puffery Survey*

In this section, we will consider the survey construction, evaluative procedure, criticisms and results. We will first look at the way the survey was created, including the selection of survey participants as well as cases from which the survey fact patterns were derived. We will then consider some criticisms of the Puffery Survey. While the criticisms are by no means insignificant, they should not dispel the conclusion that the findings presented here are significant and meaningful. Finally, we will discuss the survey results and analyze them.

1. Survey Methodology

a. Survey construction

Two factors led me to construct this survey. The first was the reaction I had to various published puffery cases illustrating a disconnect between what the judges in those cases were telling me about reasonable investors and what my own experience, both as an investor myself and as an observer of financial markets, told me about them. The second was an experience I had working on a Lanham Act case while serving as a judicial law clerk following law school. Much of that case turned on the reactions of consumers to certain advertising—an issue litigated in large part on the basis of survey evidence. These factors led me to what seemed an obvious question: If what reasonable investors think is important to materiality determinations, why don't we just ask them?

In trying to answer whether there was any need to ask them (i.e., whether their responses would differ significantly from the judicial determinations), I did not set out to create the definitive survey of the issue. In fact, I tried to keep the experiment as simple as possible at every step. Thus, when it came time to seek out survey participants, I simply asked groups of people I was in regular contact with—law professors, law students, and undergraduate business students. Specifically, the law professors surveyed (N = 12) were participants at the Eighth Ohio Legal Scholars Workshop, held at Capital University Law School on January 27, 2007.[113] The law students (N = 116) were surveyed in either one of two

century. . . . [The 1960 Judicial Conference Handbook] refuted the hearsay arguments and provided [an] evidentiary standard for expert survey testimony . . . .").

113. The law professors were given a survey that included an additional set of questions to assess materiality under the Supreme Court's alternative "total mix" formulation. Respondents reported these questions were confusing and they were removed from subsequent surveys. Only the professors' responses to the questions based on the "purchase or sell" formulation of materiality were included in the final calculations. *Cf.* 5 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION, § 32:163.50 (West

Corporations classes or a Torts class at the University of Akron School of Law during the spring of 2007. The undergraduate students that participated in the Puffery Survey were students in a course entitled "Legal and Social Environment of Business" at the College of Business Administration at The University of Akron, also during the spring of 2007.

Because the definition of "reasonable investor" for purposes of securities regulation is far from settled—stretching from "sophisticated" to "average" to "naïve"[114]—I have chosen to keep the designation simple for purposes of this exploratory study. Thus, anyone who endorsed having made an independent investment decision at any time was deemed a reasonable investor.[115] Using these criteria, 45 out of a total of 202 participants were deemed "reasonable investors" for purposes of the study (i.e., they answered "YES" to Question 1)[116]. I believe this approach of defining the reasonable investor broadly is consistent with the goal of protecting those who need protection the most.[117] The sample selection approach utilized in this particular study is further supported by the fact that college students (the primary respondents in the Puffery Survey) have become quite active in stock trading in recent years.[118] To the extent the

---

Group 4th ed. 2002) ("There is nothing biased or unfair about changes in either survey methodology or questions which are made as a result of the experience gained by running a pilot test.").

114. *See* Norris & Hirschberg, Inc. v. SEC, 177 F.2d 228, 233 (D.C. Cir. 1949) ("[T]he investing and usually naïve public needs special protection in this specialized field."); Charles Hughes & Co. v. SEC, 139 F.2d 434, 437 (2d Cir. 1943) ("The essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do.").

115. *See infra* Appendix, Question 1.

116. *Id.*

117. *See* Cynthia A. Glassman, Comm'r, SEC, Speech at Practicing Law Institute: My Top 10 Observations as an SEC Commissioner, (Mar. 5, 2004) (transcript available at http://www.sec.gov/news/speech/spch030504cag.htm) ("Survey after survey shows that investors at all stages of life are woefully lacking in the knowledge needed to make sound investment decisions."); Arthur Levitt, Chairman, SEC, Speech at Washington Post Investors Town Meeting: Investing with Your Eyes Open (Sept. 16, 2000) (transcript available at http://www.sec.gov/news/speech/spch401.htm) ("I'm concerned that some of the basic but important fundamentals of investing are being lost on investors.").

118. *See, e.g.*, Tanya Schevitz, *Students Swept Up in Stock-Market Mania: Nasdaq drop teaches real-life lesson*, S.F. CHRON., Feb. 25, 2001, at D1, *available at* http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2001/02/25/BU110948.DTL&hw=Students+Swept+Up&sn=001&sc=1000 ("From California to Florida, tech-savvy students are riding the wave of the stock market, investing extra cash or even their rent money . . . . At Stanford University, more than 250 students showed up last quarter for a free 'Guerrilla Course in Investing and Trading,' hosted by the school's student investment club. At the University of Florida in Gainesville, membership in the student investment club has soared from about 20 students two years ago to a high of 140 this year.").

use of college students can be criticized,[119] it is worth noting the similarity between the responses by the college students and those of the (albeit small sample size) law professors:

TABLE 1: PERCENTAGE OF INVESTORS FINDING ALLEGED PUFFERY TO BE MATERIAL

	Question 2	Question 3	Question 4	Question 5	Question 6
College Students (N = 39)	87%	51%	64%	33%	49%
Law Professors (N = 6)	67%	67%	50%	33%	33%

In an early version of the Puffery Survey, I asked respondents whether they would consider a particular statement: (1) "important in deciding whether to buy [X] stock;" and/or, (2) "as significantly altering the total mix of information available to you as an investor."[120] In response to respondent feedback expressing confusion about the meaning of "total mix" following an early administration of the Puffery Survey, I eliminated the second formulation.[121] This is consistent with the SEC's definition of materiality under Rule 405, which does not include the "total mix" formulation.[122]

b. The fact patterns

The cases included in the Puffery Survey were: *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588 (7th Cir. 2006);[123] *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410 (3d Cir. 1997); *Grossman v. Novell, Inc.*, 120 F.3d 1112 (10th Cir. 1997); and *Raab v.*

---

119. *See* Carl Bialik, THE NUMBERS GUY: *Too Many Studies Use College Students As Their Guinea Pigs*, WALL ST. J., Aug. 10, 2007, at B1 (noting that "[c]ollege students aren't representative by age, wealth, income, educational level or geographic location," but also recognizing that "[e]very study is hampered by possible differences between those who volunteer to participate and those who don't. . . .").

120. Originals on file with author.

121. *See infra* Appendix. *Cf.* MCCARTHY, *supra* note 113.

122. Securities Exchange Act of 1934 Rule, 17 C.F.R. § 230.405 (2007) ("The term *material*, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.").

123. This case was vacated and remanded on scienter grounds by *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499 (2007).

General Physics Corp., 4 F.3d 286 (4th Cir. 1993). These cases have all been cited as examples of application of the puffery doctrine to justify dismissing securities law claims.[124] As can be seen in the Appendix, these four cases generated the four fact patterns and five statements that survey participants rated material or immaterial. Question 1 of the Puffery Survey determined the investor status of the participant. Question 2 tested the statement from *Raab*; Question 3, *Grossman*; Questions 4 and 5, the two statements from *Makor*; and Question 6, *Burlington*. While the relevant facts of these cases can be derived simply by reading the Puffery Survey itself,[125] I will briefly summarize them here as well.

Makor involved an action against Tellabs, Inc., a fiber optic cable network equipment manufacturer.[126] In late 2000, Tellabs announced a multi-year, $100 million contract with Sprint for the TITAN 6500, one of Tellabs's next-generation products.[127] Among other claims, two statements, made by Tellabs CEO Richard Notebaert on January 23, 2001, were at issue. In the first remark, Notebaert stated that demand for the 6500 "is exceeding our expectations."[128] In the second, Notebaert stated that "we feel very, very good about the robust growth we're experiencing."[129] Plaintiffs asserted that these statements constituted actionable misstatements because they were made in the face of negative facts known to Notebaert. They alleged that these negative facts ultimately led to Tellabs's stock price falling from a high of $67 per share around the time of the announcement of the Sprint contract to $15.87 per share approximately six months thereafter.[130] The Seventh Circuit, however, relied on the puffery doctrine to find the statements immaterial as a matter of law. The court asserted that "[i]t is doubtful that an investor would rely on statements like 'we feel very, very good about the robust growth we're experiencing.'"[131] Such "vague comments," continued the court, are "unlikely to induce an investor to purchase Tellabs's stock."[132] As for Notebaert's statement regarding demand on the 6500, the court deemed it "essentially . . . meaningless,"[133] and concluded that "[t]his is precisely the

124. *See, e.g.*, O'Hare, *supra* note 5 (citing *Burlington Coat Factory*, *Grossman*, and *Raab*); WILLIAM K.S. WANG & MARC I. STEINBERG, INSIDER TRADING, § 4:2 (P.L.I. 2007), *available at* WL PLIREF-INSDTR § 4:3.2 (citing *Makor* "[f]or discussion of the defense that corporate puffery is immaterial as a matter of law.").

125. As will be apparent from reviewing the Puffery Survey in the Appendix, I changed the names of the parties for purposes of conducting the survey.

126. 437 F.3d at 591.

127. *Id.* at 591-92.

128. *Id.* at 592.

129. *Id.*

130. *Id.* at 593.

131. *Id.* at 597.

132. *Id.*

133. *Id.*

type of statement that the marketplace views as pure hype, and accordingly discounts entirely."[134] Respondents to the Puffery Survey disagreed,[135] with twenty-eight out of forty-five respondents (62%) finding the first statement to be material, and fifteen out of forty-five (33%) finding the second statement to be material. These results—which clearly contradict the judicial conclusion that *no* reasonable investor could find the statements material[136]—are consistent with the view set forth above that investors seek and reasonably rely on exactly these types of "vague" appraisals of current status.[137]

Burlington Coat Factory involved a claim against Burlington Coat Factory Warehouse Corporation ("BCF"), a leading retailer of outerwear in the United States, following a 30% drop in the stock price that occurred within a day of the disclosure of negative financial results.[138] During the period leading up to the release of the poor financials, the company's Chief Accounting Officer released a statement asserting that "BCF 'believe[d] [it could] continue to grow net earnings at a faster rate than sales . . . .'"[139] Plaintiffs argued that this statement constituted an actionable misrepresentation, but the Third Circuit relied on the puffery doctrine to find the statement immaterial as a matter of law. The court characterized the CAO's statement as "a general, non-specific statement of optimism or hope . . . ."[140] Relying on the fact that "[c]laims that these kinds of vague expressions of hope by corporate managers could dupe the market have been almost uniformly rejected by the courts,"[141] the court concluded that "the statement at issue is too vague to be actionable."[142] Again, the reasonable investors surveyed disagreed,[143] with twenty-one of the forty-five (47%) deeming the CAO's statement of belief to be material. This is arguably consistent with the view that, while it may be true that forward-

134. *Id.* at 597-98 (quoting *In re* Allaire Corp. Sec. Litig., 224 F. Supp. 2d 319, 331 (D.Mass. 2002)).

135. This fact pattern was replicated in Questions four and five of the Puffery Survey. The survey is reprinted in its entirety in the Appendix.

136. I will show below that these results differ from the judicial prediction in a statistically significant way and are not merely a function of sampling error.

137. *Cf.* McCarthy v. C-Cor Elec., 909 F. Supp. 970, 976 (E.D. Pa. 1995) (noting that a vague statement that corporate earnings are "strong" would "certainly be material" if used to describe a corporation's present financial status); O'Hare, *supra* note 5, at 1738 ("A statement characterizing present facts should be held immaterial as a matter of law only in very rare circumstances.").

138. *In re* Burlington Coat Factory, 114 F.3d 1410, 1414 (3d Cir. 1997).

139. *Id.* at 1427 (alteration in original).

140. *Id.*

141. *Id.* at 1427.

142. *Id.* at 1428.

143. This fact pattern was replicated in Question 6 of the Puffery Survey. The survey is reprinted in its entirety in the Appendix.

looking statements are relied upon by investors to a lesser degree than statements regarding present fact, the present tense implications thereof (i.e., "I, the CAO, currently believe, based upon currently available inside information, that our growth will continue") remain meaningful to investors.

In *Grossman*, Novell, Inc. (Novell), a computer network operating software company, had merged with WordPerfect Corp., producer of the well-known word processing application, and issued stock in connection therewith.[144] The merger was completed June 24, 1994.[145] Subsequently, on August 19, 1994, Novell announced lower than expected earnings and its stock price dropped 7% in trading the next business day.[146] As a result, a lawsuit was filed against Novell on the grounds that a statement made by Novell's CEO, Robert J. Frankenberg, during the post-merger period was materially misleading and had the effect of artificially inflating the stock's price. Specifically, Frankenberg had stated that the merger had been progressing, "faster than we thought it would."[147] As did the courts in *Makor* and *Burlington*, the Tenth Circuit relied on the puffery doctrine to find the statements immaterial as a matter of law.[148] The court prefaced its conclusion by stating that "[s]tatements classified as 'corporate optimism' or 'mere puffing' are typically forward-looking statements, or are generalized statements of optimism that are not capable of objective verification. Vague, optimistic statements are not actionable because reasonable investors do not rely on them in making investment decisions."[149] Against this backdrop, the court went on to find the statements at issue to be "immaterial statements of corporate optimism," and, "the sort of soft, puffing statements, incapable of objective verification, that courts routinely dismiss as vague statements of corporate optimism."[150] Yet again, respondents disagreed, with twenty-four of forty-five (53%) finding the statement material.[151] Again, while the court viewed the statement as forward-looking, it can also be understood as a statement

144. Grossman v. Novell, 120 F.3d 1112, 1115 (10th Cir. 1997).

145. *Id.* at 1116.

146. *Id.*

147. *Id.* at 1117.

148. Grossman, 120 F.3d at 1119-20; *see also* Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588 (7th Cir. 2006); *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1414, 1427 (3d Cir. 1997).

149. Grossman, 120 F.3d at 1119 (footnote omitted).

150. *Id.* at 1121-22.

151. This fact pattern was replicated in Question 3 of the Puffery Survey. The survey is reprinted in its entirety in the Appendix.

regarding the current progress of the merger in generalized terms that investors deem to be meaningful when made by insiders.[152]

Finally, in *Raab*, the General Physics Corporation (General Physics), a company that provided "personnel training and technical support services to the domestic nuclear power industry,"[153] issued a statement in its 1991 Annual Report to Shareholders asserting that "'[r]egulatory changes resulting from [accidents at Three Mile Island and Chernobyl], combined with the rising importance of environmental restoration and waste management, have created a marketplace for the DOE Services Group with an expected annual growth rate of 10% to 30% over the next several years . . . .'"[154] However, approximately two-and-a-half months later General Physics disclosed that "earnings would be less than expected because of continuing delays in the award of DOE contracts and costs resulting from the need to retain professional staff pending new contracts."[155]

The next day General Physics' share price fell 36% and purchasers of its stock filed suit claiming, among other things, that the optimistic statement in the 1991 Annual Report constituted a material misstatement in light of the then-existing reality of slowdown in government contract awards.[156] The Fourth Circuit, however, found the statement to be immaterial as a matter of law because it constituted a "'[s]oft,' 'puffing' [and] 'vague statement[] predicting growth.'"[157] The court determined that "[t]he whole discussion of growth is plainly by way of loose prediction, and both the range of rates cited, as well as the time for their achievement, are anything but definite. No reasonable investor would rely on these statements. . . ."[158] Here, the very strong response by investors in the Puffery Survey that the statement was material—thirty-eight out of forty-five (84%)—is perhaps best explained by the use of specific percentages in the scenario presented to those investors surveyed.[159]

---

152. *Cf.* O'Hare, *supra* note 5, at 1720 (claiming that "when a company states that negotiations with a potential merger partner are proceeding 'well,' it is basing this statement on information that is not generally available to investors.").

153. Raab v. Gen. Physics Corp., 4 F.3d 286, 287 (5th Cir. 1993).

154. *Id.* at 288 (second alteration in original).

155. *Id.*

156. *Id.*

157. *Id.* at 289.

158. *Id.* at 290. *But see* Hoffman, *supra* note 6, at 1407-08 (arguing that the Raab court, by basing its decision on both the theory that share price is not inflated by vague statements predicting growth and the policy argument that liability would deter companies from making appropriate disclosure "ignore[s] the dissonance between an explanation that defined forward-looking puffery as speech that reasonable investors would ignore, and an explanation that depended on the informational value of such puffery to the securities markets.").

159. This fact pattern was replicated in Question 2 of the Puffery Survey. The survey is reprinted in its entirety in the Appendix; *Cf.* Newman v. Rothschild, 662 F. Supp. 957

2. Survey Criticisms

"[N]o survey is beyond criticism,"[160] and the survey methodology I employ here is certainly no exception. Some of the obvious criticisms include: (1) I am not a qualified survey expert;[161] (2) I used a "convenience sample";[162] (3) the sample size was small;[163] and (4) there is no certainty that the survey responses would in fact correlate with actual investor behavior.

The use of a convenience sample raises issues of potential bias.[164] Here, the use of a sample population arguably more highly educated than a random sample population might actually strengthen the survey findings. If even highly educated people don't discount the proffered statements as puffery, who would? Regardless, the fact that a convenience sample was used does not invalidate the results.[165] Also, while a large sample size is certainly preferable, "there is no magic minimum number of respondents that will make a sample per se reliable with respect to any particular survey. Sample sizes as low as thirty-two respondents have been found to have some probity . . . ."[166] Thus, while certainly not free of shortcomings, the findings here are important[167] at the very least as yet another salvo in the ongoing, empirically-grounded assault on the citadel of judicial materiality determinations in securities regulation cases.[168] It is the hope of this author

---

(S.D.N.Y. 1987) (holding that a prediction of 20 to 30% return was not dismissible based on a claim of puffery because it was quantifiable and subject to verification).

160. Leighton, *supra* note 108, at 744.

161. *See* Diamond, *supra* note 111, at 238 ("Experts prepared to design, conduct, and analyze a survey generally should have graduate training in psychology (especially social, cognitive, or consumer psychology), sociology, marketing, communication sciences, statistics, or a related discipline . . . .").

162. *See* Leighton, *supra* note 108, at 774 ("A 'convenience sample' is often used where each member of the universe in question cannot be identified or reached with acceptable practicality. . . .").

163. *See id.* at 777 ("The larger the size of the sample, the more confidence the courts have about the accuracy of the results.").

164. *See id.* at 774 ("[A]ll else being equal and proper, the convenience sample is statistically less reliable than a probability sample because, among other reasons . . . there may be selection bias . . . .").

165. *See id.* ("Notwithstanding such relative shortcomings, it would appear that the use of [convenience] surveys in Lanham Act cases satisfies the Daubert factor for general acceptance and other factors as well.").

166. *Id.* at 777.

167. *Cf.* Leighton, *supra* note 108, at 763 ("[C]ourts should not require that a survey be perfect before it may be accepted into evidence. A relevant and reliable survey may very well have technological or methodological weaknesses . . . .").

168. *See generally* Hoffman, *supra* note 4 (employing empirical analysis of judicial decisions to argue that courts dismiss securities regulation cases for immateriality at a rate much higher than the judicial rhetoric surrounding materiality determinations supports); Huang, *supra* note 16 (using empirical studies from behavioral economics to argue that

that this work may facilitate the increased use of empirical evidence in this area.[169] The Puffery Survey also lays the groundwork for a larger and more rigorous survey, with a broader target of respondents, random samples, etc.

3. Survey Results[170]

Assuming that courts dismissing securities claims for lack of materiality under the puffery doctrine are effectively predicting that 0% of reasonable investors would find the challenged statement material,[171] then the Puffery Survey results strongly suggest that courts are grossly misapplying the doctrine (assuming we accept the doctrine at all). All of the statements surveyed were deemed material by at least 33% of the investors;[172] three of the five statements were deemed material by more than 50% of the investors; and one of the statements was deemed material by 84% of the investors. A table summarizing the responses to each of the questions follows:

---

courts are ignoring key characteristics of actual investors in making materiality determinations).

169. The push for empirical support continues in related areas as well. *See* Evory v. RJM Acquisitions Funding L.L.C., 505 F.3d 769, 776 (7th Cir. 2007) (calling for the use of survey evidence in assessing deception under the Fair Debt Collection Practices Act because judges "are no more entitled to rely on our intuitions in this context than we are in deciding issues of consumer confusion in trademark cases, where the use of survey evidence is routine.").

170. All of the raw data results were double-checked by a research assistant. Statistical analysis calculations are provided herein for review by any reader desiring to do so.

171. *Cf.* Bainbridge & Gulati, *supra* note 43, at 120 ("In effect, the invoking court is saying that the vague statement 'is so obviously unimportant to a reasonable investor that reasonable minds could not differ.'") (quoting Ganino v. Citizens Util. Co., 228 F.3d 154, 162 (2d Cir. 2000)); *id.* at 122-23 ("The fly in the ointment, once again, is that these cases generally involve materiality determinations made at the motion to dismiss stage. The court, therefore, . . . is saying that there can be no disagreement, at least among reasonable people . . . .").

172. One could argue that without a control question (i.e., a question containing a clearly immaterial statement) it is impossible to know whether some portion of these respondents would have deemed any statement material. This is an issue that would certainly have to be addressed if surveys are to be used in judicial materiality determinations. Of course, one can see the possible problem of circularity here, given a definition of materiality that turns on the perception of the reasonable investor.

TABLE 2: PUFFERY SURVEY RESPONSES (JUDICIAL PREDICTION OF NUMBER OF RESPONDENTS FINDING STATEMENTS MATERIAL = 0).

	Material	**Not Material**
Question 2: Statement in annual report predicting "annual growth rate of 10% to 30% over the next several years."	38 (84%)	7
Question 3: CEO states that Company has experienced substantial success in the integration of the sales forces and operations of merger partner and that the merger process has been moving "faster than we thought it would."	24 (53%)	21
Question 4: CEO states that "demand for [critical] product is exceeding our expectations."	28 (62%)	17
Question 5: CEO states, "we feel very, very good about the robust growth we're experiencing."	15 (33%)	30
Question 6: Chief Accounting Officer states that the company "believes it can continue to grow net earnings at a faster rate than sales."	21 (47%)	24

To test whether the discrepancy between the judicial predictions and observed responses was merely a function of sampling (the null hypothesis (H_0)),[173] I used the chi-square test.[174] In order to apply the chi-square test, I first put the relevant data into a contingency table format (I am setting forth the data for Question 5 because it produced the least number of affirmative responses by investors—if the number of affirmative responses for this question is statistically significant, then we can assume the number of responses for the remaining questions are as well):

173. "The null hypothesis, H_0, represents a theory that has been put forward, either because it is believed to be true or because it is to be used as a basis for argument, but has not been proved. For example, in a clinical trial of a new drug, the null hypothesis might be that the new drug is no better, on average, than the current drug." John M. Restaino, *Toxic, Environmental, and Pharmaceutical Torts (STEP): Pharmacoepidemiology for the Lawyer, in* 1 AAJ ANNUAL CONVENTION REFERENCE MATERIALS (2007).

174. *See* ROBERT R. PAGANO, UNDERSTANDING STATISTICS IN THE BEHAVIORAL SCIENCES 429 (Thomson Wadsworth 8th ed. 2003) ("The inference test most often used with nominal data is a nonparametric test called *chi-square* (χ^2).").

TABLE 3: JUDICIAL PREDICTION AND ACTUAL INVESTOR RESPONSES TO QUESTION FIVE OF PUFFERY SURVEY

	Judicial Prediction	**Actual Investor Response**
Material	0	15
Not Material	45	30

To test the null hypothesis that there is no statistically significant difference between the judicial prediction of responses and those obtained from actual investors, we must calculate chi-square for our obtained data (χ^2_{obt}) and compare it with our critical value of chi-square (χ^2_{crit}).[175] We obtain χ^2_{obt} by first determining the frequency we would expect to see (fe) in each cell of our table if the null hypothesis were correct.[176] The table below sets forth fe in parenthesis in each cell:[177]

TABLE 4: EXPECTED FREQUENCY (IN PARENTHESIS) FOR JUDICIAL PREDICTION AND ACTUAL INVESTOR RESPONSES TO QUESTION FIVE OF PUFFERY SURVEY IF H_0 WERE CORRECT.

	Judicial Prediction	**Actual Investor Response**
Material	0 (8)	15 (8)
Not Material	45 (38)	30 (38)

Once we have calculated f_e for each cell in our table, we can calculate χ^2_{obt}.[178] In this case, χ^2_{obt} equals 17.1.[179] We compare χ^2_{obt} against the value of χ^2_{crit} for a given alpha (α) level.[180] Given that we have 1 degree of freedom (df) here, our χ^2_{crit} at $\alpha = 0.01$ is 6.635.[181] Since χ^2_{obt} (17.1) > χ^2_{crit} (6.6), we can reject the null hypothesis and conclude that the difference between the perceptions of materiality by judges and actual investors are not simply a function of chance.[182]

175. *Id.* at 435.

176. *Id.*

177. For an explanation of how f_e is calculated, see *id.* at 435-36.

178. For an explanation of how χ^2_{obt} is calculated, see *id.* at 437.

179. $\chi^2_{obt}=((0-8)^2/8) + ((45-38)^2/38) + ((15-8)^2/8) + ((30-38)^2/38)$.

180. *See id.* at 221 ("Commonly used alpha levels are $\alpha = 0.05$ and $\alpha = 0.01$.").

181. *Id.* at 548.

182. *See id.* at 440 ("Since $\chi^2_{obt} > [\chi^2_{crit}]$, we reject H_0."). The question from which this data was drawn can be found in the Appendix (showing the results of survey Question 5). One of the people whom I asked to comment on this Article suggested I remove the law professors from the sample because they were meaningfully different from the remaining student respondents. While I have not done so in the body of this Article, because I believe

4. Survey Analysis

Taken at face value, the Puffery Survey results suggest that judges are too quick to grant dismissals in securities cases on the basis of puffery. The results lend empirical support to the many criticisms of the puffery doctrine already existing and discussed earlier in this Article. Obviously, given the limitations of the study, further research is needed. Nonetheless, the survey evidence presented here seems to make such a compelling case against pretrial disposition of relevant puffery cases in favor of defendants that one has to wonder why plaintiffs have not sought to introduce such evidence.[183]

Survey evidence of the kind described here may be unappealing to plaintiffs because of the potential conflict between pretrial materiality determinations and materiality determinations at trial.[184] While surveys showing, for example, that 30% of respondents found a challenged disclosure to be material may provide the evidence necessary for a plaintiff to survive a pretrial motion to dismiss, the question quickly becomes what impact this evidence will have on later proceedings. Would a plaintiff want a jury to consider the fact that 70% of respondents found a challenged statement immaterial?[185] Of course, a rebuttal here could be that the survey only informs the decision of a judge vis-à-vis a pretrial motion; the jury should be left to make its own determination of materiality on a trial on the merits. Surveys may also facilitate efficient settlement discussions.

Furthermore, in fraud-on-the-market class actions, survey evidence of the type discussed here could be argued to both create typicality problems for plaintiffs and raise defendant-friendly arguments as to damages. These potential consequences raise some interesting questions. Since materiality is an objective standard, would class action plaintiffs in fact need to be "typical" in terms of their materiality determinations? And, it is certainly not the case that after a plaintiff has proven materiality as an objective matter, that he must prove that he himself found the statement material in

---

the definition of reasonable investor is more than broad enough to accommodate whatever differences there may be between the populations, I did run the chi-square test on Question 5, excluding the professors (Question 5 would again have been the most likely candidate to show mere sampling error, with the least affirmative responses sans professor responses: thirteen "yes" and twenty-six "no"). The results showed the differences between the judicial prediction and actual investor response to still be statistically significant: χ^2_{obt} (13.8) > χ^2_{crit} (6.6).

183. The author was unable to find a single case wherein plaintiffs sought to admit the type of survey evidence described here.

184. I am greatly indebted to David Hoffman for his insights into the potential problems of survey evidence discussed here.

185. Anecdotally, it has come to this author's attention that defendants may in fact be starting to employ empirical evidence derived from various behavioral economics arguments against securities plaintiffs.

order to claim damages.[186] That is a reliance issue, an issue where the fraud-on-the-market presumption becomes operative in plaintiffs' favor in many class actions.[187]

IV. CONCLUSION

The Puffery Survey suggests that judges may be improperly relying on the puffery doctrine to dismiss securities regulation claims prematurely. Certainly, there is a need for more research,[188] but a possible solution suggested by this project may be to include survey evidence in the evaluation of the materiality of alleged puffery. As Richard Leighton has stated, "[w]hat might have been a reasonable legal presumption based on selling a plow horse several centuries ago should not be applied unthinkingly across the board . . . today."[189]

---

186. *See* Fisher v. Plessey Co., 103 F.R.D. 150, 155 (S.D.N.Y.1984) ("Because the materiality test is concerned not with whether the investment decision of a particular individual would have been affected, but only 'whether a prototype reasonable investor would have relied,' the standard for resolving the materiality issue is obviously objective and general rather than subjective and individual." (quoting Chris-Craft Indus., Inc. v. Piper Aircraft Corp., 480 F.2d 341, 363 (2d Cir. 1973))).

187. *See id.* at 156 ("[A] presumption of reliance by all class members will arise upon plaintiffs showing of materiality and non-disclosure, and, notwithstanding the fears expressed by defendants, individual questions will not abound.").

188. *See* Langevoort, *supra* note 8, at 188 ("Neither the SEC nor academics have spent enough time on detailed field studies of investor behavior, so we lack a solid sense of how decisions occur or what social dynamics are at work that might drive market prices. In-depth interviews and survey data would take us in this direction, as would more laboratory studies on investor behavior.") (footnotes omitted).

189. Leighton, *supra* note 1, at 640.

APPENDIX

SURVEY INFORMED CONSENT

Title of Study: Materiality and the Reasonable Investor
Introduction: You are invited to participate in a research project being conducted by Asst. Prof. Stefan J. Padfield, a faculty member in the School of Law at The University of Akron.
Purpose: The purpose of this study is to evaluate what types of information people consider material in deciding whether to buy stock.
Procedures: You will be asked to complete a short survey, which should take you approximately 10 minutes. The survey consists of 6 questions spread over 5 pages setting forth 5 fact patterns involving corporate disclosures. *Simply circle either "Yes" or "No" following each question.*
Risks and Discomforts: There are no risks associated with this study.
Benefits: You will receive no direct benefit from your participation in this study, but your participation may help us better understand how people evaluate information in connection with the purchase of stock.
Right to refuse or withdraw: Your participation in this study is purely voluntary and you have the right to refuse to participate.
Anonymous Data Collection: No identifying information will be collected, and your anonymity is further protected by not asking you to sign and return the informed consent form. Completed surveys will be retained in a file cabinet in Prof. Padfield's office. Your participation in the survey constitutes your consent.
Whom to contact with questions: If you have any questions about this study, you may call Prof. Padfield at 330-972-2328. This project has been reviewed and approved by The University of Akron Institutional Review Board. If you have any questions about your rights as a research participant, you may call the IRB at (330) 972-7666 or 1-888-232-8790.

SURVEY

1. Have you ever personally made an investment decision to purchase the stock or bonds of a particular company (answer "No" if you have only done so via a mutual fund or solely on the basis of someone else's advice)?

Yes No

2. **Background**: GP Corporation provides personnel training and technical support services to the domestic nuclear power industry. In addition, the company's DOE Services Group provides services to the Department of Energy (DOE) and to the prime contractors who generally manage and operate DOE nuclear weapons production and waste processing sites. In a recent public offering, the company sold four million shares; those shares are traded on the New York Stock Exchange.

On February 20th, a large investment bank issues a six page research report recommending the purchase of GP stock. The report cautions, however, that:

> "Fourth-quarter results were adversely impacted by a slowdown in the procurement of new contracts by the Department of Energy (DOE). The decision last fall to reduce U.S. nuclear weapons has Congress and the DOE reevaluating the nuclear weapons complex. As a result, the procurement of some contracts has been delayed. GP has indicated that the pace of contract awards has increased significantly in recent weeks."

On that same day, GP announces record revenues for the preceding year.

In a press release on March 30th, GP announces that first-quarter earnings are likely to be half of analysts' estimates. The company states that "the lower than anticipated earnings resulted primarily from administrative delays in contract awards by DOE and the resultant increased overhead costs associated with retaining professional staff pending contract awards by the DOE," but that it believed "conditions in the 1st quarter are temporary and that results during the remainder of the year should be in line with analysts' current projections."

Assume you are now considering buying GP stock and you receive the following additional information: The same day as the press release, March 30th, GP issues its Annual Report to Shareholders. The Annual Report states that: "Regulatory changes resulting from accidents at nuclear power plants, combined with the rising importance of environmental restoration and waste management, have created a marketplace for the DOE Services Group with an expected annual growth rate of 10% to 30% over the next several years."

Would you consider the additional information important in deciding whether to buy GP stock?

Yes No

3. **Background**: NewCo is the world's leading provider of network operating software. In March, NewCo announces it will acquire and merge with WouldBe, a company that develops and sells software applications, including a leading word processing program.

To complete the WouldBe merger, NewCo issues stock. In connection with the issuance of this stock, NewCo files a registration statement with the Securities and Exchange Commission on April 22d. During this same time NewCo purchases the QuadPo spreadsheet program from Border, Inc., for approximately $145 million in cash.

The registration statement includes a warning that the integration of NewCo and WouldBe could be difficult due to intense competition in WouldBe's market sector and the company's declining financial performance, and cautions that NewCo's earnings and stock price could fluctuate in the quarters following the merger. The registration statement further cautions that the acquisitions of WouldBe and QuadPo could be difficult because they are large acquisitions in new markets where NewCo does not have management or marketing experience. The registration statement warns that no assurance can be given that the various businesses can be successfully integrated. Also, the dominant competition expected from MicroPower, a worldwide leader in office software, is stressed. In addition, NewCo warns that the merger and acquisition will lead to higher expenditures in sales, marketing and support, and higher other costs. NewCo predicts that its future earnings and stock prices may be subject to "significant volatility, particularly on a quarterly basis" and warns that WouldBe's market is "characterized by severe competitive pressure" that may "materially adversely affect NewCo." Financial analysts are initially pessimistic about the near-term benefits of the WouldBe merger.

The merger is completed on June 24th.

Assume you are now considering buying NewCo stock and you receive the following additional information: On June 27th, NewCo's CEO states that NewCo has experienced substantial success in the integration of the sales forces and operations of WouldBe and that the merger process has been moving "faster than we thought it would."

Would you consider the additional information important in deciding whether to buy NewCo stock?

Yes No

4. **Background**: Telco is a manufacturer of specialized equipment used in fiber optic cable networks. On December 11th, Telco issues a press release stating that Telco and a large international telecommunications firm ("LargeCo") have signed a multi-year, $100 million contract for one of Telco's next-generation products, the T-6500. The release proclaims that "the T-6500 system is available now." In a call to financial analysts later that day, Telco's CEO predicts that in addition to the contract with LargeCo for the 6500, there will be "continuing growth of the T-5500," referring to the 6500's predecessor. Most market analysts recommend that investors buy Telco's stock. On January 23d, in a press release announcing Telco's "record sales and earnings in the most recent fourth quarter," Telco's CEO proclaims that "customers are buying more and more Telco equipment." In an accompanying call to analysts, the CEO states that Telco has "set the stage for sustained growth with the successful launches of several products."

Assume you are now considering buying Telco stock and you receive the following additional information: Later, in response to a question, Telco's CEO states, "On the 6500, demand for that product is exceeding our expectations."

Would you consider the additional information important in deciding whether to buy Telco stock?

Yes No

5. **Now, assume you receive the following further additional information**: In another interview that same day, the CEO states, "we feel very, very good about the robust growth we're experiencing."

Would you consider the further additional information important in deciding whether to buy Telco stock?

Yes No

6. **Background**: CoatCo is one of the leading retailers of coats in the United States. Its specialty is selling brand name clothes at discount prices. It operates a total of 185 stores in 39 states. The stores ranged in size from 16,000 to 133,000 square feet and feature outerwear (coats, jackets, and raincoats) and complete lines of clothing for men, women, and children.

CoatCo's fortunes have been on the rise over the past decade. Last year's Annual Report stated that "the Company's revenues have increased each year for the past 13 years, from $24 million in 1978 to over $1 billion." Further, CoatCo's earnings per share have risen from $0.60 to $1.06 in the last three years.

Assume you are now considering buying CoatCo stock and you receive the following additional information: CoatCo's Chief Accounting Officer states that the company "believes it can continue to grow net earnings at a faster rate than sales."

Would you consider the additional information important in deciding whether to buy CoatCo stock?

Yes No

END OF SURVEY
THANK YOU FOR YOUR PARTICIPATION