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Securities Fraud or Mere Puffery: Refinement of the Corporate Puffery Defense

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I. INTRODUCTION

A corporation's use of forward-looking corporate statements[1] is a common,[2] arguably essential,[3] element of the landscape of modern

1. For purposes of this Note, "corporate statement" refers to statements regarding the performance of the corporation made by those authorized to speak on behalf of the corporation, typically officers, directors, internal public relations departments, outside public relations firms, or other such designated representatives.

The securities laws define "forward-looking statement" as:

(A) a statement containing a projection of revenues, income (including income loss), earnings (including earnings loss) per share, capital expenditures, dividends, capital structure, or other financial items;

financial markets. Unfortunately, the failure to meet the expectations created by forward-looking statements often serves as the basis for a potentially devastating private action for securities fraud.[4] Before Congress responded to frivolous private securities

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(B) a statement of the plans and objectives of management for future operations, including plans or objectives relating to the products or services of the issuer;
(C) a statement of future economic performance, including any such statement contained in a discussion and analysis of financial condition by the management or in the results of operations included pursuant to the rules and regulations of the Commission;
(D) any statement of the assumptions underlying or relating to any statement described in subparagraph (A), (B), or (C);
(E) any report issued by an outside reviewer retained by an issuer, to the extent that the report assesses a forward-looking statement made by the issuer; or
(F) a statement containing a projection or estimate of such other items as may be specified by rule or regulation of the Commission.

15 U.S.C.A. §§ 77z-2(i)(1), 78u-5(i)(1) (West 1997); *see also* Bruce A. Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 MD. L. REV. 1114, 1116 (1987) (defining "soft" or forward-looking information as "information . . . that inherently involves some subjective analysis or extrapolation, such as projections, estimates, opinions, motives, or intentions").

In contrast to forward-looking statements, "hard" information includes historical or factual information usually subject to SEC disclosure requirements. *See id.* at 1116. Although some hard information contains some level of subjectivity, "what has been excluded from those filings as soft information seems to be distinguishable by the degree of subjectivity involved or the extent to which objective verification is possible." *Id.* For an extensive list of litorature specifically addressing the SEC's shift to protect soft information, see 7 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 622 n.66 (3d ed. 1991). Courts usually consider hard information to be material, and the SEC subjects it to mandatory disclosure requirements. *See* Victor Brudney, *A Note on Materiality and Soft Information Under the Federal Securities Laws*, 75 VA. L. REV. 723, 726-27 (1989) (citing extensive list of mandatory disclosure requirements of hard information).

2. Corporations commonly use forward-looking statements to discuss their future prospects. *See* Dale E. Barnes, Jr., & Constance E. Bagley, *Case Studies: Great Expectations: Risk Management Through Risk Disclosure*, 1 STAN. J.L. BUS. & FIN. 155, 155 (1994) ("Public companies depend on securities analysts te educate the market about their stocks.").

3. *See* Bart A. Basi et al., *A Comparison of the Accuracy of Corporate and Security Analysts' Forecasts of Earnings*, 51 ACCT. REV. 244, 252 (1976) ("[T]here is reasonable evidence that company forecasts were better than analysts' forecasts."). Despite the usefulness of forward-looking information to the financial markets, such information is typically not subject to mandatory SEC disclosure requirements. *See In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1427 (3d Cir. 1997); *In re* Lyondell Petrochemical Co. Sec. Litig., 984 F.2d 1050, 1052 (9th Cir. 1993).

4. In such actions, plaintiffs compare the company's stock price as a result of previous optimistic projections to the price after a decline allegedly resulting from the company's failure to meet its projections and allege that the officials releasing the projections must have had knowledge that their forward-looking statements were not entirely accurate. *See* John F. Olson et al., *Pleading Reform, Plaintiff Qualification and Discovery Stays Under the Reform Act*, 51 BUS. LAW. 1101, 1104-07 (1996) (describing and citing examples of abuse of securities fraud claims by professional plaintiffs and their attorneys); *see also* S. REP. NO. 104-98, at 15-16 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 694-95 (citing the vulnerability of companies to securities fraud lawsuits when projections are not met). These suits are especially disturbing given the importance of newly formed growth companies in the economy. *See* Anthony Q. Fletcher, Note, *Curing Crib Death: Emerging Growth Companies, Nuisance Suits, and Congressional Proposals for Securities Litigation Reform*, 32 HARV. J. ON LEGIS. 493, 495 (1995)

fraud class actions with the Private Securities Litigation Reform Act of 1995,[5] ("Reform Act") the judiciary took it upon itself to provide relief to burdened corporations.[6] In doing so, the courts focused on the materiality of the corporation's statements, an essential building block in the plaintiff's construction of a viable private securities fraud suit.[7] These courts developed two principal means by which a

("Empirical data evinces that the confidence of venture capitalists in the securities markets is critical to the overall health and stability of the economy.").

5. Pub. L. No. 104-67, 109 Stat. 737 (1995) [hereinafter the "Reform Act"]; *see infra* Part III.D (briefly discussing the safe harbors for corporate forward-looking statements under the Reform Act); *see also* Harvey L. Pitt et al., *Promises Made, Promises Kept: The Practical Implications of the Private Securities Litigation Reform Act of 1995*, 33 SAN DIEGO L. REV. 845, 847-52 (1996) (discussing the changes implemented under the Reform Act). The courts decided the cases to which this Note refers without the benefit of the Reform Act. Analysis of these cases, however, remains quite useful as the Reform Act left room to accommodate many judicially created doctrines. For example, the legislative history of the Reform Act indicates that Congress did not intend the safe harbor to replace the judicial Bespeaks Caution Doctrine or to foreclose further judicial development of that doctrine. *See* H.R. REP. NO. 104-369, at 46 (1995); *see also infra* note 172 (describing legislative intent to continue use of the puffing doctrine in securities fraud cases). Prior to the passage of the Reform Act, SEC Rules 175 and 3b-6 provided a limited safe harbor for forward-looking statements made in registered filings if the company made them in good faith and with a reasonable basis. *See* 17 C.F.R. §§ 230.175, § 240.3b-6 (1997); Safe Harbor Rule for Projections, Securities Act Release No. 6084 1979 SEC Lexis 1254 (June 25, 1979) (discussing the appropriateness of a safe harbor for projections made in good faith and with a reasonable basis). These limited safe harbors, however, are so fact-intensive that they were useful only at trial; thus, early dismissal of frivolous suits on summary judgment were nonexistent.

6. In *Blue Chip Stamps v. Manor Drug Stores*, the Court recognized problems with respect to securities fraud litigation that do not exist in other fraud cases. Securities fraud litigation permits a plaintiff with a groundless claim to conduct extensive discovery, consuming the time and money of potentially numerous people within the corporation. 421 U.S. 723, 741 (1975). This right represents an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence. Such a result is a net social cost rather than a benefit. *See id.* The Court also recognized the fact that even a complaint that has very little chance of success at trial creates a significant settlement incentive for the defendant if the court does not eliminate the suit by dismissal or summary judgment. The very pendency of the lawsuit may frustrate or delay the defendant's ordinary business activity. *See id.* at 740 (citing, inter alia, Michael P. Dooley, *The Effects of Civil Liability on Investment Banking and the New Issues Market*, 58 VA. L. REV. 776, 822-43 (1972), and James C. Sargent, *The SEC and the Individual Investor: Restoring His Confidence in the Market*, 60 VA. L. REV. 553, 562-72 (1974)).

The SEC also has recognized the "substantial unnecessary costs" of abusive private securities fraud claims. *See Common Sense Legal Reform Act: Hearings Before the Subcomm. on Telecomm. and Fin. of the House Comm. on Commerce*, 104th Cong. 196 (1995) (statement of SEC Chairman Arthur Levitt). Chairman Levitt noted that "the pendulum had swung too far toward plaintiffs, and it needs to be brought into better balance." Arthur Levitt, *Final Thoughts on Litigation Reform, Remarks at the Twenty-Third Annual Securities Regulation Institute*, *in* 1 SWEEPING REFORM: LITIGATING AND BESPEAKING CAUTION UNDER THE NEW SECURITIES LAW 400 (PLI Corp. Law and Practice Handbook Series Nos. B-923, B-924, 1996).

7. In order to proceed in an action for securities fraud under 10b-5, the plaintiff must prove that the corporation released a "(1) misstatement or an omission (2) of material fact (3) made with scienter (4) on which the plaintiff relied (5) that proximately caused his injury." Huddleston v. Herman & MacLean, 640 F.2d 534, 543 (5th Cir. 1981) (citations omitted), *rev'd*

corporate defendant could seek dismissal of such suits as a matter of law:[8] the Bespeaks Caution Doctrine and the Corporate Puffery Defense.[9]

Under the Bespeaks Caution Doctrine, a court will find forward-looking corporate statements immaterial as a matter of law if the statements are accompanied by meaningful cautionary statements and specific risk disclosure.[10] The Corporate Puffery Defense asserts

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on other grounds, 459 U.S. 375 (1983); *see also infra* Part III.A (discussing the definition and role of materiality in private securities fraud litigation). The materiality of a forward-looking statement is a pivotol element in an actionable claim of securities fraud pursuant to Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j (1995) [hereinafter the Exchange Act], and SEC Rule 10b-5. 17 C.F.R. § 240.10b-5 (1997) [hereinafter Rule 10b-5]. Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of a *material* fact or 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, or (c) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Id. (emphasis added).

8. *See* cases cited *infra* Part II. If the statements on which private securities fraud actions are brought are determined to be immaterial as a matter of law, the litigation ceases, and the court avoids the time and cost intensive discovery process on these issues. Therefore, the dismissal of private securities fraud claims on a motion to dismiss or a motion for summary judgment is an efficient method of avoiding discovery and trial costs.

9. The use of the puffery doctrine as a defense to securities fraud will hereinafter be referred to as the Corporate Puffery Defense so as to distinguish it from the commercial common law doctrine of puffery.

10. Such cautionary language, or risk disclosure, renders the offending misstatements legally immaterial so as not to recoguize any influence on a reasonable investor's investment decision. *See* Whirlpool Fin. Corp. v. GN Holdings, Inc., 873 F. Supp. 111, 122 (N.D. Ill. 1995) (stating that it is unreasonable as a matter of law for an investor to rely on projections as a forecast of the future if sufficiently cautionary language accompanies the projections); *see also In re* Donald J. Trump Casino Sec. Litig., 793 F. Supp. 543, 549 (D.N.J. 1992) (stating that where "an offering statement, such as a prospectus, accompanies statements of its future forecasts, projections and expectations with adequate cautionary language, those statements are not actionable as securities fraud"); Royce de R. Barondes, *The Bespeaks Caution Doctrine: Revisiting the Application of Federal Securities Law to Opinions and Estimates*, 19 J. CORP. L. 243, 251-68 (1994) (surveying applications of the Bespeaks Caution Doctrine across the circuits); Donald C. Langevoort, *Disclosures that "Bespeak Caution"*, 49 BUS. LAW. 481, 482-96 (1994) (defining the Bespeaks Caution Doctrine).

The Bespeaks Caution Doctrine does not treat the mere presence of cautionary statements as a "magic bullet," however. *See* Langevoort, *supra*, at 486 (discounting the strong use of the Bespeaks Caution Doctrine where the court mechanically applies the doctrine to dismiss claims that merely contain such cautionary language without undergoing the contextual inquiry as suggested by *Trump Casino Securities Litigation*). Cautionary statements must be tailored specifically to the misleading corporate statements and relevant in the context they were made. *See In re* Marion Merrell Dow, Inc., Sec. Litig., No. 92-0609-CV-W-6, 1993 WL 393810, at *8 (W.D. Mo. Oct. 4, 1993) (finding that the cautionary language was not repeated nor specific enough to be immaterial as a matter of law); *In re* Jenny Craig Sec. Litig., [1992-1993 Transfer Binder] Fed. Sec. L. Rop. (CCH) ¶ 97,337, at 95,723 (S.D. Cal. Dec. 19, 1992) (finding the

that some forward-looking statements are so vague or indefinite that they do not affect the price of the security and, therefore, are immaterial as a matter of law.[11] While the Bespeaks Caution Doctrine enjoys wide acceptance among the courts,[12] the Corporate Puffery Defense is less familiar to the judiciary and doctrinally underdeveloped by commentators.[13] Despite the remarks of some commentators that "the puffing concept in the securities context has all but gone the way of the dodo,"[14] every circuit has recently applied some variation of the puffery concept to dismiss private securities fraud actions.[15]

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cautionary statements to be "too weak" and "too general" considering the strength of the defendant's statements of optimism).

11. *See* Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993) (defining the puffery doctrine in the securities fraud arena). For examples of corporate language that has been held to be so vague or indefinite as a matter of law, see *infra* note 31. The use of the puffery doctrine in the securities fraud context is similar to the puffery doctrine developed under the commercial common law of fraud. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 109, at 757 (5th ed. 1984) (defining the puffery doctrine in the context of common law fraud cases); *see also infra* Part III.B (comparing the use of the puffery doctrine in securities fraud and commercial common law fraud).

12. *See, e.g.*, Gasner v. Board of Supervisors, 103 F.3d 351, 358 (4th Cir. 1996); Saltzberg v. TM Sterling/Austin Assoc., Ltd., 45 F.3d 399, 400 (11th Cir. 1995); *In re* Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1414 (9th Cir. 1994); Rubenstein v. Collins, 20 F.3d 160, 166-67 (5th Cir. 1994); *In re* Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 371-73 (3d Cir. 1993); Romani v. Shearson Lehman Hutton, 929 F.2d 875, 879 (1st Cir. 1991); I. Meyer Pincus & Assocs. v. Oppenheimer & Co., 936 F.2d 759, 763 (2d Cir. 1991); Sinay v. Lamson & Sessions Co., 948 F.2d 1037, 1040 (6th Cir. 1991); Polin v. Conductron Corp., 552 F.2d 797, 806 n.28 (8th Cir. 1977).

13. *See infra* Part II (discussing the competing methodologies of the Corporate Puffery Defense). Although the Bespeaks Caution Doctrine is theoretically distinct from the Corporate Puffery Defense, the two doctrines are sufficiently similar to guide courts in the proper application of the Corporate Puffery Defense. At the time of publication of this Note, few commentators have recognized the Corporate Puffery Defense; thus none have developed a coherent method for applying the doctrine. *See, e.g.*, LOSS & SELIGMAN, *supra* note 1, at 3434 (discussing application of the puffery doctrine to securities law); HAROLD S. BLOOMENTHAL, Securities Law Handbook, 755-58 (CBC 1997 ed.) (discussing the increased recognition of the puffing concept in securities law); Langevoort, *supra* note 10, at 487 (mentioning the application of the puffing concept to securities fraud in relation to the Bespeaks Caution Doctrine); *see also* Langevoort, *supra* note 10, at 487 (stating that the difference between the two doctrines should not be emphasized).

14. LOSS & SELIGMAN, *supra* note 1, at 3434.

15. *See, e.g.*, Parnes v. Gateway 2000 Inc., No. 96-1559, 1997 WL 448153 (8th Cir. Aug. 8, 1997); Grossman v. Novell, 120 F.3d 1112 (10th Cir. 1997); *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410 (3d Cir. 1997); Eisenstadt v. Centel Corp., 113 F.3d 738 (7th Cir. 1997); Shaw v. Digital Equip. Corp., 82 F.3d 1194 (1st Cir. 1996); San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc., 75 F.3d 801 (2d Cir. 1996); *In re* Royal Appliance Sec. Litig., No. 94-3284, 1995 U.S. App. LEXIS 24626, (6th Cir. Aug. 15, 1995) (not recommended for full text publication); Malone v. Microdyne Corp., 26 F.3d 471 (4th Cir. 1994); Kowal v. MCI Communications Corp., 16 F.3d 1271 (D.C. Cir. 1993); Krim v. BancTexas Group, Inc., 989 F.2d 1435 (5th Cir. 1993); *In re* Convergent Techs. Sec. Litig., 948 F.2d 507 (9th Cir. 1991).

Courts, however, seldom agree on the characteristics of forward-looking corporate statements that warrant a finding of immateriality as a matter of law. While some circuits have found only facially vague statements to be immaterial as a matter of law,[16] other circuits have expanded the puffing concept to protect any forward-looking statement that fails to rise to the level of a guarantee.[17] Still other courts have applied a contextual approach, which considers the forward-looking corporate statement in light of all the information available to the market.[18] This Note compares and analyzes the judicial struggles to devise a satisfactory standard for evaluating indeterminate forward-looking statements.[19] The purpose of this Note is to suggest a cognizable methodology to determine whether a given corporate statement sufficiently supports an actionable claim of securities fraud or amounts to nothing more than mere puffery.

Part II of this Note classifies and summarizes the different standards courts use to decide if forward-looking statements are immaterial as a matter of law and, thus, inactionable under the securities laws. Generally, courts use one of three different standards: the Vagueness Standard,[20] the Guarantee Standard,[21] and the Contextual Standard.[22] Part III analyzes these three standards' consistency with the following factors: (a) prior securities fraud jurisprudence; (b) commercial common law of fraud; (c) modern financial theory; (d) the Reform Act; and (e) public policy concerns underlying securities fraud litigation. This Note concludes that

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16. This methodology will hereinafter be referred to as the Vagueness Standard. *See infra* Part II.A (discussing the analysis posited by the circuits in dismissing claims based on facially vague corporate statements).

17. This methodology will hereinafter be referred to as the Guarantee Standard. *See infra* Part II.B (discussing the circuits' analysis when dismissing claims based on forward-looking corporate statements that fail to rise to the level of a guarantee).

18. This methodology will hereinafter be referred to as the Contextual Standard. *See infra* Part II.C (discussing the circuits' analysis when dismissing claims based on a contextual application of the Corporate Puffery Defense).

19. To a certain extent, the Corporate Puffery Defense clearly provides a valuable tool to hold back the floodgates of frivolous securities fraud claims and avoid liability for natural optimism. Drawing a bright line clearly defining what constitutes puffery in every instance, however, is impossible.

As the Supreme Court has stated:

> Fraud is infinite, and were a Court of Equity once to lay down rules, how far they would go, and no farther, in extending their relief against it, or to define strictly the species or evidence of it, the jurisdiction would be cramped, and perpetually eluded by new schemes which the fertility of man's invention would contrive.

SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 193 n.41 (1963) (quoting a statement first made in a letter of Lord Hardwicke to Lord Kames in 1759).

20. *See infra* Part II.A.

21. *See infra* Part II.B.

22. *See infra* Part II.C.

courts should not expand the defense to protect all forward-looking statements as suggested by the Guarantee Standard.[23] At the same time, they should continue to use the Corporate Puffery Defense to dispense with securities fraud claims based on facially vague language found immaterial in the context of all the information available to the markets.

Part IV recommends that courts use a two-part contextual analysis to evaluate forward-looking statements under the Corporate Puffery Defense. This Note recommends that the court evaluate whether the statement is inherently vague as a threshold matter. If the forward-looking statement is not specific,[24] the court should then evaluate the statement in the context of all information available to the market. If the court finds that the forward-looking corporate statement affected the market price of the security despite the vague language, the court should deny defendant's motion to dismiss or motion for summary judgment. This contextual application of the Corporate Puffery Defense allows courts to dismiss meritless securities fraud claims based on irrelevant puffing statements, yet it permits courts to proceed with deserving securities fraud claims by considering the context in which the market evaluates the information. Such an approach achieves an optimal balance between judicial efficiency and fairness to plaintiffs.

II. TAXONOMY OF FORWARD-LOOKING STATEMENTS UNDER THE FEDERAL SECURITIES LAWS

Although the SEC once discouraged the disclosure of forward-looking information to protect unsophisticated investors,[25] it changed its position in 1979 to permit such disclosures.[26] While permitting the

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23. The use of the defense to protect all uncertain forward-looking statements is entirely inconsistent with prior precedent assessing materiality, the commercial common law, modern financial theory, the Reform Act, and public policy. The analysis supporting this assertion is contained in Part IV.

24. *See* Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993) (finding corporate language to lack the specificity required to support a private securities fraud claim).

25. *See Disclosure of Projections of Future Economic Performance*, Securities Act Release No. 5362, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79211, at 82,666 (Feb. 2, 1973) [hereinafter *Projections*] ("It has been the long-standing policy generally not to permit projections to be included in prospectuses and reports filed with the commission.").

26. On June 25, 1979, the SEC adopted final rules providing safe harbors for forward-looking statoments in Rule 3b-6 under the Exchange Act, 17 C.F.R. § 240.3b-6 (1997), and Rule 175 under the Securities Act. *See* 17 C.F.R. § 230.175 (1997); *see also* HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, 95TH CONG., 1ST SESS., *REPORT OF THE ADVISORY*

disclosure of forward-looking statements, the SEC did not include forward-looking information in the list of mandatory disclosure requirements.[27] As a result, courts have advanced competing views of when, if ever, forward-looking statements are sufficiently material to support a private securities fraud claim.[28]

Within this morass of ambiguity, the Corporate Puffery Defense emerges as a valid and justifiable attempt to defeat securities fraud claims on a motion to dismiss or a motion for summary judgment. In an attempt to dismiss securities fraud claims efficiently, however, some courts have expanded the puffery concept beyond its theoretical limit.[29] For analytical purposes, this Note divides these decisions into three categories based on the courts' underlying rationale for dismissal: (1) the Vagueness Standard; (2) the Guarantee Standard; and (3) the Contextual Standard.[30]

A. The Vagueness Standard

Courts consistently have protected facially vague forward-looking statements made by corporations.[31] In *Raab v. General*

COMMITTEE ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION, 556, 556-60 (Comm. Print 1977) (discussing President Roosevelt's recommendation that the SEC's policy be changed to encourage the disclosure of management projections and other forward-looking information); LOSS & SELIGMAN, *supra* note 1, at 1953 (providing an in-depth summary of the SEC's changing positions on disclosure of soft information and the resulting divergent treatment of soft information among the lower courts). The Commission recognized the widespread use and reliance on institutional and individual investors' projections to determine future economic performance. *See Projections*, *supra* note 25, at 82,667; Hiler, *supra* note 1, at 1117-18 (discussing the problems of assessing liability on soft forward-looking statements).

27. Regulation S-K contains a toxtual description of the SEC's mandatory disclosure requirements. 17 C.F.R. § 229 (1996).

28. *Compare infra* Parts II.A, II.B, and II.C.

29. *See, e.g.*, Herman v. Legent Corp., 1995 U.S. App. LEXIS 5568, at *13-14 (4th Cir. Mar. 20, 1995) (holding that all forward-looking statements that do not constitute guarantees should be dismissed as immaterial as a matter of law); Hilson Malone v. Microdyne Corp., 26 F.3d 471, 479 (4th Cir. 1994) (same); Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 211-12 (4th Cir. 1994) (same); *Raab*, 4 F.3d at 289-90 (same).

30. These classifications are inherently imprecise because of the wide variety of language that has been alleged to constitute securities fraud. Even though courts' rationales usually fit into one of these categories, some courts alternatively apply both the Vagueness Standard and the Guarantee Standard to find the corporate statements immaterial as a matter of law. For cases applying both the Vagueness Standard and the Guarantee Standard, see Lasker v. New York State Elec. & Gas Corp. 85 F.3d 55, 58-59 (2d Cir. 1996); Searls v. Glasser, 64 F.3d 1061, 1066 (7th Cir. 1995); San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos., Inc., 73 F.3d 801, 811 (2d Cir. 1996); *Raab*, 4 F.3d at 290. The fact that many statements contain elements of more than one category and that some courts use more than one line of analysis further exacerbates the imprecision.

31. In addition to the *Raab* case discussed below, many other courts have considered some forward-looking statements to be so vague that no reasonable investor would rely on them to be immaterial as a matter of law. Quoting the language from *Raab*, the Eighth Circuit adopted the

Fourth Circuit's practice of dismissing vague statements of optimism as per se immaterial in *Parnes v. Gateway 2000*. 122 F.3d 539, 547 (8th Cir. 1997) (citing to *Hillson*'s reference te *Raab* and finding certain forward-looking statements so vague and "such obvious hyperbole that no reasonable investor would rely on them").

Similarly, the Third Circuit concurred with *Raab*'s vague statement analysis in *In re Burlington Coat Factory Securities Litigation*. 114 F.3d 1410, 1427-28 (3d Cir. 1997). In *Burlington*, the court found that the chief accounting officer's statements "that the company 'believe[d] [it could] continue to grow net earnings at a faster rate than sales' " te be the kind of "vague expressions of hope by corporate managers" that courts reject "almost uniformly." *Id.* at 1427. The *Burlington* court, however, distinguished some statements made by Burlington Coat Factery, finding that the Corporate Puffery Defense did not apply because the corporate statements specifically projected earnings per share to be between $1.20 and $1.30 for 1994. *See id.* at 1428 n.14. Likewise, in *Weiner v. Quaker Oats Co.*, the Third Circuit found defendant's statement at a public meeting (that Quaker Oats was " 'confident of achieving at least [seven percent] real earnings growth' in fiscal 1995") was a specific figure regarding a particular, defined time period and, therefore, could not qualify as an inactionable puffing statement. 129 F.3d 310, 320 (3d Cir. 1997).

The Tenth Circuit also accepted this notion of vague statements in *Grossman v. Novell, Inc.*, 120 F.3d 1112, 1119 (10th Cir. 1997). In *Grossman*, the court held that statements made by Novell and its CEO were "soft, puffing statements, incapable of objective verification" and should be dismissed as vague statements of corporate optimism. *See id.* at 1121-22. Statements made by Novell included: "By moving rapidly te a fully integrated sales force, we are leveraging our combined knowledge of the expanding scope of network solutions;" and that it "expects that network applications will quickly reshape customer expectations." *Id.* at 1121. Statements made by Novell's CEO included comments on Novell's substantial success in integrating the sales force of WordPerfect with its own; its merger moving "faster than we thought" and that the merger presented "a compelling set of opportunities" for Novell. *Id.* Whether the Tenth Circuit intended to add the absence of "objective verification" as a new element to the puffery determination is unclear. The *Grossman* court, however, did not base its holding on analysis focusing on the court's ahility to objectively verify Novell's statements. *See id.* at 1119-22 (focusing only on the vague indeterminacy of the corporate statements).

In *In re Royal Appliance Securities Litigation*, the Sixth Circuit seemingly agreed with the *Raab* analysis. No. 94-3284, 1995 U.S. App. LEXIS 24626, at *7 (6th Cir. Aug. 15, 1995) (not recommended for full text publication and limited by Sixth Circuit Rule 24 te specific situations). The *Royal Appliance* language, however, would be inconsistent with the Sixth Circuit's contextual treatment of the Bespeaks Caution Doctrine. *See id.* at *8-*13; *see, e.g.*, Stavroff v. Meyo, No. 95-4118, 1997 WL 720475 at *5 (6th Cir. Nov. 12, 1997) ("To determine whether statements fall under the bespeaks caution doctrine, we review the statements in context and examine the 'total mix' of information available to the reasonable investor."); Harner v. Prudential-Bache Sec., Inc., Nos. 92-1353, 92-1910, 1994 WL 494871, at *7 (6th Cir. Sept. 8, 1994) (finding that investers' reliance was unreasonable considering the information available to them under the circumstances).

The Seventh Circuit recognized vague statements' immateriality in *Searls v. Glasser*. 64 F.3d 1061 (7th Cir. 1995). In *Searls*, the court found that statements characterizing GATX as "recession-resistant" were too vague te be material, stating that such statements provided no useful information a reasonable investor could use in making investment decisions. *See id.* at 1066. The Seventh Circuit, however, declined to accept a per se rule regarding the immateriality of vague corporate statements. *See id.* at 1067.

The Ninth Circuit Court of Appeals declined to consider the concept of wholesale immateriality for vague statements of optimism. The court instead evaluated securities fraud claims for similar optimistic statements under a three-part test. This test, developed in *In re Apple Securities Litigation*, prohibits fraud claims if: (1) The statement was not believed, (2) the statement has a reasonable basis, or (3) the speaker was not aware of "undisclosed facts tending to seriously undermine the accuracy of the statement." 886 F.2d 1109, 1113 (9th Cir. 1989). Although the Ninth Circuit has not considered specifically the Corporate Puffery Defense, a large number of Ninth Circuit district courts have dismissed securities fraud claims as a matter

Physics Corp., for example, the plaintiffs alleged that they purchased General Physics stock in reliance upon certain statements that fraudulently inflated the stock's price.[32] These statements included General Physics's predictions in its 1991 annual report anticipating a ten to thirty percent annual growth rate over the next several years for the Department of Energy Services Group in the company,[33] and its statement that the group would likely carry the growth and suc-

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of law where the statements were too vague, mere puffery, or "soft forecasts" upon which reasonable investors would not rely. Given the focus of securities litigation in the high-tech sector, the proliferation of cases in the Northern District of California is not surprising. These cases provide an excellent forum to showcase examples of language that courts typically consider so vague as to be immaterial as a matter of law. *See, e.g.*, Howard Gunty Profit Sharing v. Quantum Corp., No. 9620111 SW, 1997 WL 514993, at *4 (N.D. Cal. Aug. 14, 1997) (holding that Quantum's vague statements that "customer interest is very exciting," and that the CEO was "confident that the company . . . will be successful with its new business model" would not be relied upon by reasonable investors and were "certainly not specific enough to perpetrate fraud on the market"); Fisher v. Acuson Corp., 1995 U.S. Dist. LEXIS 19968, at *9 (N.D. Cal. Apr. 26, 1995) ("[S]tatements such as that [product] was the 'gold standard' or that [company] is positioned well for the future are too vague to constitute material misstatements. . . ."); *In re* Valence Tech. Sec. Litig., [1995 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,793, at 92,793 (N.D. Cal. 1995) (holding the following statoments to be too vague and reflect general optimism: "We are very excited about the tremendous potential for lithium polymer batteries"; "We are loyal to our cause and excitod about our prospects"; "As you know the market offers a tremendous opportunity and we believe our technology is superior"; "This agreement provides us with the opportunity to apply our technology in another market"); O'Sullivan v. Trident Microsystems, Inc., [1993–1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,116, at 98,916 (N.D. Cal. 1994) (finding that the statement "we think Trident's potontial is substantial" to be an inactionable statement of vague optimism); Rogal v. Costello, [1992-1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,245, at 95,093-94 (N.D. Cal. 1992) (finding a "more positive outlook for the June quarter" and an " 'apparent upswing' in the buying intentions of U.S. customers" too vague to support a securities fraud action). None of the Ninth Circuit's or its district courts' cases adopt or refer to the Fourth Circuit's requirement that the statoments constitute a guarantee of future performance to be actionable. *See supra* note 29 (citing Fourth Circuit Guarantee Standard cases). These cases, however, demonstrate the trend toward a per se immateriality rule for vague statements of optimism, although the Ninth Circuit has not made such a sweeping statement.

32. 4 F.3d 286, 287-88 (4th Cir. 1993). Not all courts finding general forward-looking statements to be immatorial as a matter of law agree with the *Raab* court's analysis regarding vague statements. For example, in *McCarthy v. C-Cor Electronics, Inc.*, the court explicitly rejected the presumption that vague, forward-looking statements are per se immaterial as a matter of law. 909 F. Supp. 970, 977 (E.D. Pa. 1995). Instoad, the *McCarthy* court listed factors that, if present, would lead a reasonable investor to believe that the statements are grounded in a reliable basis. *See id.* Those factors, although not intended to be a comprehensive list, include: (1) the prediction's specificity; (2) whether the prediction is short-term or long-term; and (3) the degree to which the prediction is inherently difficult or unreliable. *See id.* Applying these factors, the *McCarthy* court found that a statement in the defendant's press release predicting strong revenues for the second half of the year and "a strong fourth quarter" was sufficiently matorial to support a claim of securities fraud. *Id.* Although the *McCarthy* court avoided declaring a per se rule for puffing statements, it offered guidance to corporations regarding their public statements and put the investing public on notice as to which statements are so vague that they are not worthy of reliance.

33. *See Raab*, 4 F.3d at 287-88.

cess of General Physics into the future.[34] When General Physics issued a press release stating that earnings for the second quarter would be less than expected,[35] the price of General Physics stock dropped thirty-six percent in one day.[36] Plaintiffs alleged that General Physics must have known about the factors causing decreased earnings prior to the press release and, therefore, had misled investors. The Fourth Circuit held that the statements were puffing statements, and because such vague statements predicting growth do not inflate the market price of a share, they are immaterial as a matter of law.[37]

The *Raab* court recognized that securities fraud claims alleging fraud on the market[38] hinge on the company's ability to trick the market. Finding that market professionals[39] rely only on specific statements in determining the price of a security,[40] rather than on

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34. *See id.*

35. *See id.* The earnings decline resulted from the "continuing delays in the award of Department of Energy contracts and costs resulting from the need to retain professional staff pending new contracts." *Id.*

36. *See id.*

37. *See id.* at 289 (citing, inter alia, *Howard v. Haddad*, 962 F.2d 328, 331 (4th Cir. 1992) and *Lewis v. Chrysler Corp.*, 949 F.2d 644, 652-53 (3d Cir. 1991)); *see also* Schoenhaut v. American Sensors, Inc., No. 95 Civ. 1464 (BSJ), 1997 WL 731804, at *6 (S.D.N.Y. Nov. 14, 1997) (finding statements that do not attempt te "ensure definite or guaranteed growth, make specific earnings projections, predict future financial performance, or set any benchmarks" te constitute immaterial information not relied upon by investors); Herman v. Legent Corp., 1995 U.S. App. LEXIS 5568, at *17 (4th Cir. Mar. 20, 1995) (finding that a press release predicting that Legent was firmly on its plan for earnings growth of 20% "simply lacke[d] the necessary level of specificity" and could not be found by a reasonable jury te constitute a guarantee, and therefore was not actionable as fraud); Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 212 (4th Cir. 1994) (holding that statements contained in press releases and the first quarter report stating "significant sales gains should be seen as the year progresses," that "1992 will produce excellent results for Adage," and that Adage was "on target toward achieving the most profitable year in history" were vague growth predictions that were immaterial as a matter of law).

38. *See infra* text accompanying notes 134-136 (defining the fraud-on-the-market theory).

39. Commentators have interpreted the court's use of the terms "analysts and arbitrageurs," to refer to market professionals or "market makers" in general. *See* John M. Newman, Jr. et al., Basic *Truths: The Implications of the Fraud-on-the-Market Theory for Evaluating the "Misleading" and "Materiality" Elements of Securities Fraud Claims*, 20 J. CORP. L. 571, 573 & n.23 (1995). Courts distinguishing between the average or reasonable investor and the professional investor have held implicitly that the standard of materiality necessary to perpetuate a fraud on the market is based on the professional investor's sophisticated ability to determine the relevance of information to the stock price because the professional actually moves markets. *See id.*; *see also infra* notes 142-43 (discussing the role of professional investors in setting the market price of a security). Despite the importance of market professionals in determining market price, many courts continue to use a reasonable investor standard in defining materiality for claims of securities fraud. *See* Newman, Jr. et al., *supra*, at 573 & n.23.

40. In *Cooke v. Manufactured Homes, Inc.*, the defending company supported its projections of future growth with specific statements of fact, such as its repurchase of 400,000 shares of its own stock and negotiations with an insurance company to act as a guarantor on its loans. 998 F.2d 1256, 1259-61 (4th Cir. 1993). Such factual statements were sufficient to create

mere optimism, the *Raab* court held that only specific statements are actionable.[41] Since a reasonable investor would not rely on such vague statements, market professionals would not consider corporate puffing statements in setting the market price of a security.[42] Where the market is unaffected by information, plaintiffs can make no securities fraud claim under the fraud-on-the-market theory.[43] Under the *Raab* court's application of the Corporate Puffery Defense, a court should determine whether a statement constitutes puffery by examining the corporate statement in the abstract, devoid of the context in which it was made.[44] Thus, in *Raab*, the Fourth Circuit essentially adopted a rule that such facially vague statements are immaterial as a matter of law.[45]

The Seventh Circuit expanded the Corporate Puffery Defense in *Eisenstadt v. Centel Corp.*[46] Using a reasonable investor standard, the *Eisenstadt* court stated that investors not only ignore puffing statements, but also *expect* a certain amount of puffing in corporate statements.[47] The Seventh Circuit encouraged this level of puffery in corporate statements, noting that given the expectation of puffery, completely candid statements would indicate that the actual prospects were much dimmer.[48]

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different interpretations as to whether the generalized forward-looking statements were material. *See id.* at 1261-62. Other courts have distinguished puffery from material misstatements based on the inclusion of specific percentages. *See, e.g.*, Cohen v. Prudential-Bache Sec., Inc., 713 F. Supp. 653, 658 (S.D.N.Y. 1989) (finding that the inclusion of specific percentage precluded a finding of puffery); Newman v. L.F. Rothschild, 662 F. Supp. 957, 959 (S.D.N.Y. 1987) (same). This analysis assumes that investors' reliance is triggered only by the use of specific data that leave little doubt as to content and significance of the statement; the lack of such data leaves the investor with an uncertain interpretation, rendering any reliance unreasonable. This rule for identifying puffery would render any forward-looking corporate statement that fails to include specific numbers immaterial as a matter of law. *See id.* (dismissing vague statements as mere puffery while maintaining securities fraud actions supported by corporate forward-looking statements containing specific percentages). *But see infra* Parts IV & V (arguing that the lack of specific information alone is insufficient to deem a forward-looking statement immaterial as a matter of law because some vague statements could impact the price of a security and should therefore be found material).

41. *See Raab*, 4 F.3d at 290; *see also infra* notes 142-43 (recognizing the importance of market professionals in determining the price of a security).

42. *See Raab*, 4 F.3d at 290.

43. *See infra* notes 134-36 (discussing fraud on the market).

44. *See Raab*, 4 F.3d at 288-90 (examining only the four corners of each statement independent of the total mix of information available to the market).

45. *See* Herman v. Legent Corp., 1995 U.S. App. LEXIS 5568, at *14 (4th Cir. Mar. 20, 1995) ("Once a statement is determined to be commonplace commercial puffery, our inquiry ends.").

46. 113 F.3d 738 (7th Cir. 1997).

47. *See id.* at 746 (stating that "Centel put a rosy face on an inherently uncertain process; investors would have expected no less").

48. *See id.*

B. The Guarantee Standard

Other courts have dismissed securities fraud claims based on forward-looking statements that fail to rise to the level of a guarantee.[49] The Fourth Circuit addressed the actionability of forward-looking corporate statements under this Guarantee Standard in *Hillson Partners Ltd. Partnership v. Adage, Inc.*[50] In *Hillson Partners*, the court stated that an articulation of a time frame within which a prediction by itself was insufficient to qualify as an actionable claim.[51] The court stated that to rise to the level of a guarantee, and thus be sufficiently material to support a private claim of securities fraud, the forward-looking statement must contain not only predictions of the time frame but also a specific dollar amount or numerous positive predictions.[52]

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49. In addition to the Fourth Circuit cases discussed below, other courts have held that forward-looking statements that fail to rise te the level of a guarantee are immaterial as a matter of law. In *San Leandro Emergency Medical Group Profit Sharing Plan v. Philip Morris Co.*, the Second Circuit analyzed corporate statements, including those indicating that the company was optimistic about earnings and that the company should perform well, under the Guarantee Standard, although the statements were arguably vague in nature. 75 F.3d 801 (2d Cir. 1996). The court said the company announcements were "puffery [which] cannot have misled a reasonable investor to believe the company had irrevocably committed itself to one particular stratogy." *Id.* at 811. In *San Leandro*, the Second Circuit incorrectly used the term "puffery" to describe forward-looking statements of opinion rather than to identify vague forward-looking statements. Such careless rhetoric has contributed to the confusion surrounding the Corporate Puffery Defense. Although the Second Circuit focused on the forward-looking nature of the statements in *San Leandro*, the Eastern District of New York cited this case to support a finding of immateriality as a matter of law for forward-looking statements that were too vague. *See In re* Symbol Tech. Class Action Litig., No. 92-CV-3492, 1997 U.S. Dist. LEXIS 365, at *12-14 (E.D.N.Y. Jan. 13, 1997). The Second Circuit affirmed its *San Leandro* holding later that year in *Lasker v. New York State Electric & Gas Corp.* 85 F.3d 55 (2d Cir. 1996). Like in *San Leandro*, the court in *Lasker* found the defendant's statements to be inactionable puffing statoments which did not constitute guarantees. *See id.* at 59. Specifically, the company stated that it "would not compromise its financial integrity," that it had a "commitment to create earnings opportunities," and that these "business strategies [would] lead te continued prosperity." *Id.* The *Lasker* court, however, did not expressly condition the finding of immateriality as a matter of law on the ability of the statement to qualify as a guarantee. *See id.* Despite holding that forward-looking statements can be immaterial as a matter of law under certain circumstances, the Second Circuit declined to apply a per se rule that forward-looking statements must rise to the level of a guarantee to be actionable. *See id.*

50. 42 F.3d 204 (4th Cir. 1994).

51. *See id.* at 214-15.

52. *See id.* at 215 (citing *Goldman v. Belden*, 754 F. 2d 1059, 1068-69 (2d Cir. 1985), and *Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489 (9th Cir. 1974), as examples to show that other cases have only considered timing when there were "allegations of specific evidence, other than timing, demonstrating that . . . [the] predictions had no factual basis").

The Fourth Circuit also derided the plaintiff's allegations that the statements were "hard statements of corporate operations and performance for the near term." *Id.* at 216. In addition, the Fourth Circuit identified a statement in the *Wall Street Journal* tbat " '[t]he executive is

The Fourth Circuit's Guarantee Standard repeatedly holds that all forward-looking statements that do not constitute guarantees are immaterial as a matter of law.[53] The Fourth Circuit attempts to justify this standard by stating that hindsight will often prove predictions of future growth to be wrong, and, therefore, courts should not hold corporations liable for predictions that fail to materialize.[54] The Fourth Circuit recognized that if buyers could sue when growth is less than predicted, while sellers could sue if this growth is greater than anticipated, companies would be in a "whipsaw," faced with certain litigation.[55] Corporations would then be reluctant to disclose any information.[56] To avoid this result, the Fourth Circuit gave considerable protection to corporations by holding that forward-looking statements would be immaterial as a matter of law unless they rose to the level of a guarantee.[57] This rule does not preclude explicitly private securities fraud claims against all forward-looking statements; however, in procedural terms, the likelihood that any forward-looking statement will meet the extremely high threshold of a guarantee is virtually nonexistent.[58] In this respect, the court seemingly implied that all forward-looking statements are immaterial as a matter of law.

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looking for 1992 sales of about $100 million and 1993 sales of about $110 million' " as obviously not rising to the level of a guarantee. *Id.*

53. *See, e.g.*, Herman v. Legent Corp., 1995 U.S. App. LEXIS 5568, at *13-*14 (4th Cir. Mar. 20, 1995) (holding that forward-looking statements are generally not actionable as a matter of law when they neither rise to the level of a guarantee nor include a specific statement of fact); Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 211-12 (4th Cir. 1994) (same); Malone v. Microdyne Corp., 26 F.3d 471, 479 (4th Cir. 1994) (same); Raab v. General Physics Corp., 4 F.3d 286, 289-90 (4th Cir. 1993) (same).

54. *See, e.g.*, cases cited *supra* note 53.

55. *See Raab*, 4 F.3d at 290 (noting that if a company makes a 25% growth prediction, a growth rate of 20% is just as statistically likely as a growth rate of 30%).

56. This result was especially disturbing to the Fourth Circuit because disclosure is the primary goal of the securities laws. *See id.*

57. *See id.* (citing Krim v. BancTexas Group, Inc., 989 F.2d 1435, 1446 (5th Cir. 1993)); *see, e.g.*, *Herman*, 1995 U.S. App. LEXIS 5568, at *13-*14 (holding that forward-looking statements are generally not actionable as a matter of law when they neither rise te the level of a guarantee nor include a specific statement of fact); *Hillson Partners*, 42 F.3d at 211-12 (same); *Malone*, 26 F.3d at 479 (same); *Raab*, 4 F.3d at 289-90 (same). In *Raab*, the Fourth Circuit did recognize that expressions of belief or fact relating to current facts could be material. 4 F.3d at 290 (citing Virginia Bankshares Inc. v. Sandberg, 501 U.S. 1083, 1090-95 (1991)). The court, however, did not believe this analysis could be applied to opinions on future events. *See id.*

58. At the present time, no court that has applied this Guarantee Standard to corporate statements has found the language to constitute an actionable guarantee. Stare decisis should have prevented such wholesale denial of claims of securities fraud based on forward-looking statements that fail to rise to the level of a gnarantee. *See* Isquith v. Middle S. Utils., Inc., 847 F.2d 186, 203 (5th Cir. 1988) ("Courts in the past have consistently recognized that a defendant does not place itself beyond the reach of the securities laws merely by disclosing information that is forward-looking in nature.").

These courts' decisions fail to distinguish forward-looking statements that are too vague to support a securities fraud claim from forward-looking statements that fail to rise to the level of a guarantee of future performance. While facially vague statements can look to future performance, not every forward-looking statement is vague, as some forward-looking statements may be sufficiently specific to induce the reliance of the markets.[59] Many courts have overlooked this distinction in their analysis.[60] Whereas evidence could prove current opinions arguably to be false, plaintiffs should have the opportunity at least to prove the fraudulent nature of the opinion before every forward-looking statement not rising to the Fourth Circuit's high threshold is dismissed on a motion to dismiss or on summary judgment.[61]

C. The Contextual Standard

The judicial efficiency gained by determining a statement's actionability in the abstract makes the vagueness standard and Guarantee Standard seductive; however, the boundary between puffery and actionable fraud is often more elusive than a cursory examination of syntax would reveal. When corporate statements contain specific language, investors' reliance is more probable, and reasonable investors could disagree as to whether the statement materially affected a security's price. At this point, courts should no longer decide statements are immaterial as a matter of law. Furthermore, even a statement that appears to be facially vague, could, in the proper context, provide reliable information to the market and could be deemed material in the context of all information available to the market. In short, the Corporate Puffery Defense requires a more contextual methodology to determine which corporate statements can support a securities fraud claim and which statements are nothing more than mere puffery. As the method used by *Raab* and its progeny[62] excludes some vague statements that could, under

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59. See, for example, the earnings estimate in *In re Burlington Coat Factory Securities Litigation*, 114 F.3d 1410, 1427 (3d Cir. 1997).

60. *See, e.g., Herman*, 1995 U.S. App. LEXIS 5568, at *13-14 (holding that forward-looking statements that do not constitute a guarantee are immaterial as a matter of law); *Malone*, 26 F.3d at 479; *Hillson Partners*, 42 F.3d at 211-12; *Raab*, 4 F.3d at 289-90.

61. *See Raab*, 4 F.3d at 289-90 (quoting Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1090-95 (1991)).

62. *See supra* Part II.A (discussing cases that determine immateriality solely on the specificity of language used in the corporate statement, absent the context of the information available to the market).

certain circumstances, induce a reasonable reliance by the markets, this Note recommends a more contextual application of the Corporate Puffery Defense.

A few insightful courts have applied such a Contextual Standard, rather than stringent categorical rules, to evaluate corporate puffing statements.[63] In *Shaw v. Digital Equipment Corp.*, the

63. The Fifth Circuit uses such a Contextual Standard to govern its application of the Corporate Puffery Defense, although its contextual analysis has been overlooked. The language from the Fifth Circuit's opinion in *Krim v. BancTexas*, 989 F.2d 1435 (5th Cir. 1993), is often cited by the Fourth Circuit to support the per se immateriality of forward-looking statements that fail to rise to the level of a guarantee. *See, e.g.*, *Herman*, 1995 U.S. App. LEXIS 5568, at *13-*14 (4th Cir. Mar. 20, 1995) (adopting language supporting the Guarantee Standard from *Krim*, 989 F.2d at 1446, as set forth in *Malone, Raab* and *Hillson Partners*); *Malone*, 26 F.3d at 479 (same as set forth in *Raab*); *Hillson Partners*, 42 F.3d at 211-12 (same as set forth by *Raab* and *Malone*); *Raab*, 4 F.3d at 289-90 (same as set forth in *Krim*). The *Krim* court, however, actually considered the corporate statements in the context in which they were presented. The *Krim* court considered each one of the defendant's statements that the plaintiff alleged to have been false or misleading in the context in which they were made and found each one to be incapable of serving as a basis for a claim of securities fraud. *See Krim*, 98 F.2d at 1447-50. While the court recognized that future projections generally are not actionable, *id.* at 1446 (citing *Friedman v. Mohasco Corp.*, 929 F.2d 77 (2d Cir. 1991), and *Hershfang v. Citicorp*, 767 F. Supp. 1251 (S.D.N.Y. 1991), as examples supporting the Guarantee Standard), the court stopped short of adopting a per se rule.

A Fifth Circuit district court further expanded this contextual analysis in *In re Browning-Ferris Industries, Inc. Securities Litigation*. 876 F. Supp. 870 (S.D. Tex. 1995). In that case, the court denied actionability for management's projections of growth because they were opinions that no reasonable investor would have interpreted to be a guarantee or assurance that the specified levels of growth would be attained. *See id.* at 881-82. The opinions indicate that the Fifth Circuit evaluates puffing statements in the context in which they were made. *See Krim*, 989 F.2d at 1448 ("Materiality is not judged in the abstract, but in light of the surrounding circumstances.").

In *Gilford Partners, L.P. v. Sensormatic Electronics Corp.*, the court reiterated the Seventh Circuit's denial of per se immateriality of corporate puffing statements. No. 96 C 4072, 1997 WL 757495, at *14 (N.D. Ill. Nov. 24, 1997) (citing Stransky v. Cummins Eugine Co., 51 F.3d 1329, 1332-33 (7th Cir. 1995)). The *Gilford Partners* court went on to consider the defendant's puffing statements in the context of the information available to the market in discussing part of the plaintiffs' claim on summary judgment. *See id.* ("Assuming Sensormatics' difficulties with its European sales, poor sales and negative cash flow, these vague statements cannot be considered materially misleading."). The court, however, found that defendant's statements that included "projections of annual increases in revenues, quantified predictions of overall revenue increases, and finally, specific projections for increases in earnings per share" within "fairly specific time frames" could not be characterized as mere puffery. *Id.* (citing Searls v. Glasser, 64 F.3d 1061, 1067 (7th Cir. 1995)).

Similarly, in *Schaffer v. Timberland Co.*, a district court recognized the Vagueness Standard and rejected the Guarantee Standard. 924 F. Supp. 1298, 1313-14 (D.N.H. 1996). The court recoguized the difficulty in distingnishing between actionable predictions and vague optimism or puffery. *See id.* at 1314. The court stated that although predictions about future events are inherently uncertain, they are not exempt from claims of securities fraud. *See id.* at 1313; *cf. Herman*, 1995 U.S. App. LEXIS 5568, at *13-*14; *Hillson Partners*, 42 F.3d at 211-12; *Malone*, 26 F.3d at 479; *Raab*, 4 F.3d at 289-90 (all implying that because future events are uncertain, forward-looking statements are generally exempt from securities laws). The *Schaffer* court instead made an ad hoc determination of the immateriality of the statements in the context of the overall pleadings. *See Schaffer*, 924 F. Supp. at 1314. Rather than putting the statements in the context of the information available to the market during the class period, the *Schaffer*

First Circuit accepted the viability of the vague statement analysis but explicitly refused to adopt an absolute rule preventing expressions of corporate optimism from supporting a private securities fraud claim.[64] While admitting that the materiality requirement of securities fraud actions must be reserved for the fact-finder in most circumstances,[65] the *Shaw* court recognized that some statements are so vague, so general, or so loosely optimistic, they clearly are the speakers' opinions and "no reasonable investor could find them important to the total mix of information available."[66] The court in *Shaw* considered the statement in the context of all other information available to the market.[67] The *Shaw* court reasoned that investor claims under

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court based its decision on the information available to the *defendants*. *See id.*; *cf.* Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1217-18 (1st Cir. 1996) (evaluating corporate puffery on the basis of all the information available to the market). In this respect, *Schaffer* departs significantly from the immateriality standard applied by all other jurisdictions. *See Krim*, 989 F.2d at 1447-50 (subjectively determining materiality based on the point of view of either the market or a reasonable investor, and not the defendant, as in *Schaffer*). In fact, considering the information available to the defendants, rather than that available to the market, seemingly contradicts the *Schaffer* court's own analysis. *See Schaffer*, 924 F. Supp. at 1313 (indicating that the *Schaffer* court was evaluating corporate statements in the context of the "eyes of the investing public" and that dismissal should be based on whether a "reasonable investor may have relied on the predictions"). Why the *Schaffer* court would attempt to determine whether a forward-looking statement is specific enough to affect financial markets by examining what information the defendants had knowledge of is unclear. Such analysis, while valuable for determining scienter, is utterly irrelevant to a determination of materiality. *See infra* Part III.A & III.C (distilling materiality to the ability to affect market regardless of veracity).

64. 82 F.3d 1194, 1218 (1st Cir. 1996).

65. *See id.* at 1217 (citing Basic, Inc. v. Levinson, 485 U.S. 224, 236 (1988)).

66. *Id.* (footnotes and examples omitted). In *Shaw*, the court held that press releases by the chief financial officer stating that "its Alpha chip products sales [were] 'going reasonably well' and that the company 'should show progress quarter over quarter, year over year,' " were not actionable because of their patent immateriality. *Id.* at 1219. The court also found statements by the CEO "that the company 'was basically on track' "; that "DEC was a very healthy company"; and that he was "confident that DEC was pursuing the right strategy" and statements by DEC's head of European Operations that he was " 'pretty optimistic' that the company would 'be able to stabilize [its] revenue' in the first half of the calendar year 1994 and 'start to grow revenue' in the second half,' " to be immaterial as a matter of law. *Id.* The court specifically limited the applicability of the puffery doctrine to cases where "the statements [were] outside of the registration statement and prospectus." *Id.* at 1218-19. The *Shaw* court also analogized the Corporate Puffery Defense to puffery under the common law of fraud where courts would find " 'puffing' or sales talk upon which no reasonable person could rely . . . legally insufficient to support a claim." *Id.* at 1217 n.32 (examples omitted).

67. In this regard, the Contextual Standard most closely approximates the contextual inquiry applied under the Bespeaks Caution Doctrine. The Bespeaks Caution Doctrine and a contextual application of the Corporate Puffery Defense seek the same determination—how a reasonable investor would be affected by the statements considering the context in which the statement was made. *Compare* Rubenstein v. Collins, 20 F.3d 160, 167 (5th Cir. 1994) ("[T]he 'bespeaks caution' doctrine merely reflects the unremarkable proposition that statements must be analyzed in context."), *with Shaw*, 82 F.3d at 1217 (evaluating vague corporate statements in the context of the information available to the market).

the fraud-on-the-market doctrine[68] will not withstand judicial scrutiny when based on vague statements which the market recognizes as nothing more than mere corporate puffery.[69] Thus, the *Shaw* standard evaluates the statement contextually by determining whether the market viewed the information as significantly altering the total mix of information available.[70]

In *Simon v. American Power Conversion Corp.*, the First Circuit refined this contextual test.[71] The *Simon* court found the CEO's statements recognizing the company's presence in newly emerging markets, noting the company's improved manufacturing efficiencies,[72] acknowledging opportunities to expand its product line,[73] and announcing that the upcoming year was going to be a busy one[74] to be nothing more than corporate cheerleading.[75] As in *Shaw*, the First Circuit held that the statements constituted nonactionable corporate puffing under the Contextual Standard.[76] The *Simon* court, however, found that other statements cited in securities analysts' reports and a 10-Q filing could not be characterized as similar "rosy affirmations" that would be so easily dismissed by the market.[77] According to *Simon*, these statements contributed to the total mix of information available so as to influence a reasonable investor's decision and, as a result, could not be dismissed as immaterial as a matter of law.[78]

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68. For a discussion of the fraud-on-the-market theory, see *infra* notes 134-40 and accompanying text.

69. Specifically, the court stated, "[t]he market is not so easily duped, even granted that individual investors sometimes are." *Shaw*, 82 F.3d at 1218 (citing *In re* Apple Computer Sec. Litig., 886 F.2d 1104, 1114 (9th Cir. 1989); Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 515 (7th Cir. 1989)). The *Shaw* court made a clear distinction between the reasonable investor, by whom materiality must be gauged, and the market, by which claims of fraud on the market must be gauged. *See id.* (citing *In re* Verifone Sec. Litig., 784 F. Supp. 1471, 1479 (N.D. Cal. 1992)) (stating that the fraud-on-the-market theory "shifts the inquiry from whether an individual investor was fooled to whether the market as a whole was fooled").

70. *See id.* at 1217-18.

71. 945 F. Supp. 416 (D.R.I. 1996).

72. *See id.* at 428.

73. *See id.*

74. *See id.*

75. *See id.* The company released the statements in press releases, financial analysts' reports, a 10-Q filing to the SEC, and a shareholder meeting. *See id.* at 433-34.

76. *See id.* at 428-29.

77. The *Simon* court specifically stated that there could be "little doubt that reasonable investors could take information in analysts' reports into consideration when making investment decisions." *Id.* at 429. Therefore, the court determined the market would have factered the information in these reports "into the equation when setting the price of APC's stock." *Id.*

78. *See id.* In addition to the statements contained in analysts' reports and a 10-Q, the *Simon* court also considered a statement in a July 3 *Home Furnishing Network* article stating that APC had "stepped-up production in anticipation of Windows 95," *id.* at 433, as well as statements during a shareholder meeting that the company was outshipping a major competitor

III. ANALYSIS OF IMMATERIALITY OF FORWARD-LOOKING STATEMENTS AS A MATTER OF LAW

A. Materiality Under Case Law Interpreting Rule 10b-5

Since courts are dismissing private securities fraud claims because the forward-looking statements are immaterial as a matter of law, any justifiable application of the Corporate Puffery Defense must be consistent with the standard of materiality developed under securities jurisprudence. Therefore, the first paradigm under which the competing standards of the Corporate Puffery Defense will be analyzed is their consistency with the benchmarks of materiality courts developed under case law interpreting Rule 10b-5.[79] This analysis compares the three competing views of the Corporate Puffery Defense with the definition of materiality proscribed in *Basic v. Levinson* and the heightened inferences of materiality when there is a duty to speak the truth in *Virginia Bankshares v. Sandberg*.

1. The Definition of Materiality

The Supreme Court clearly articulated the standard for determining materiality of historical corporate statements in *Basic v. Levinson*.[80] In *Basic*, the plaintiffs claimed a corporate official's denial of preliminary merger negotiations constituted securities fraud.[81] The *Basic* Court considered whether the corporate statements were sufficiently material to support the claim.[82] The Court found the information to be material because a reasonable investor would view the statement as significantly altering the "total mix of information available."[83] The Court discussed the previous standard for determin-

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"by as much as 460 to 1" and that the company's "high inventory levels . . . were required to meet swelling demand." *Id.* at 432.

79. *See supra* note 7 (describing the necessary elements of securities fraud under Rule 10b-5, which was promulgated under section 10(b) of the Exchange Act).

80. 485 U.S. 224 (1988).

81. *See id.* at 225.

82. *See id.* at 230.

83. *Id.* at 231-32 (applying the materiality standard for proxy solicitation, defined in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), to the materiality requirement necessary for securities fraud claims. *TSC Industries* defined the standard to be whether "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote"). Therefore, materiality depends upon a balancing of the probability that an event will occur and the anticipated magnitude of the event, considering total company activity. *Basic*, 485 U.S. at 238 (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968) (en banc)).

ing the materiality of preliminary merger negotiations,[84] finding any method that only considered a single fact as determinative of an "inherently fact-specific finding such as materiality, must necessarily be over- or underinclusive."[85]

Just as the *Basic* Court rejected a bright line test for the materiality of preliminary merger negotiations, courts considering a motion to dismiss or a motion for summary judgment should hesitate before applying a bright line test to determine that forward-looking corporate statements should be deemed puffery. Both the Vagueness Standard and the Guarantee Standard use a bright line test, as both standards limit the judicial inquiry to the language used in the forward-looking statements and ignore the total mix of information available to the market. Conversely, the Contextual Standard of the Corporate Puffery Defense is consistent with the *Basic* philosophy of a contextual inquiry into materiality because it considers the impact of the statement on the total mix of information available to the market.[86]

Critics of the Contextual Standard may argue that the purpose of immateriality as a matter of law is to put the materiality question in the hands of the judiciary, avoiding the lengthy and costly discovery process associated with determining materiality at trial. The contextual nature of the materiality inquiry described in *Basic*, however, suggests that courts should nonetheless avoid using over-simplified bright line tests, such as Vagueness or Guarantee Standards, as the sole means by which to determine materiality as a matter of law.[87] Although courts should continue to dismiss statements that are immaterial as a matter of law, they should expand their inquiry beyond the specificity of the particular language and instead consider the language's probable effect on the market.

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84. Under a test used by the Third Circuit, preliminary merger negotiations were not considered material until the parties had reached an "agreement-in-principle" as to the price and structure of the transaction contemplated. *Basic*, 485 U.S. at 239 (citing Greenfield v. Heublin, Inc., 742 F.2d 751, 757 (3d. Cir. 1984), *cert. denied*, 469 U.S. 1215 (1985)).

85. *Id.*; Wallace v. Systems & Computer Tech. Corp., No. Civ. A. 95-CV-6303, 1997 WL 602808, at *9 (E.D. Pa. Sept. 23, 1997) ("When assessing materiality, the court should not only consider the statement or omission itself . . . but also the context in which it occurs.") (citations omitted).

86. *See supra* notes 83-85 and accompanying text (describing the contextual nature of the *Basic* holding).

87. *See infra* notes 196-204. As shown by *Shaw* and *Simon*, the Contextual Standard does not require the extensive discovery process required for a securities fraud trial. *See* Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1217 (1st Cir. 1996); Simon v. American Power Conversion Corp., 945 F. Supp. 416, 428-29 (D.R.I. 1996) (discussing securities fraud class action utilizing a contextual standard without resorting to the full blown discovery required for a trial).

Despite its insight regarding materiality, the *Basic* Court specifically declined to address the materiality requirements of forward-looking information.[88] This lack of direction from the Supreme Court has led to the aforementioned competing standards for determining the materiality of forward-looking statements among the circuits.[89] Thus, although the *Basic* decision provides insight into the need for a contextual inquiry into materiality, it does not definitively require the same analysis for forward-looking statements.[90]

2. Materiality when a Duty Exists

The vast majority of securities litigation stems from the statements of corporate officials or official corporate statements.[91] The Supreme Court addressed the inherent importance of corporate officials' statements of opinions in *Virginia Bankshares v. Sandberg*, in which the Court evaluated the Board of Directors' statements claiming that a merger plan they approved provided shareholders

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88. *Basic*, 485 U.S. at 232 n.9 (generally referring to the definitions and distinctions between hard and soft information found in Hiler, *supra* note 1); *see also* Louis Lowenstein, *Financial Transparency and Corporate Governance: You Manage what You Measure*, 96 COLUM. L. REV. 1335, 1355 (1996) (stating that the market places an "enormous emphasis" on earnings reports).

89. Although forward-looking information is often material, determining its materiality is often difficult. *See* Joel Seligman, *The SEC's Unfinished Soft Information Revolution*, 63 FORDHAM L. REV. 1953, 1977-81 (1995) (surveying differing interpretations of the actionablility of soft information among the circuits); *compare* Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993) (finding vague forward-looking statements immaterial and therefore inactionable as a matter of law), *with In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1114-15 (9th Cir. 1989) (finding predictive opinions or beliefs actionable).

90. *Basic*, 485 U.S. at 232 n.9. Some commentators, however, have suggested that courts should apply the *Basic* test to forward-looking information. *See, e.g.*, JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 71 (2d ed. 1997) (suggesting the probability/magnitude test from *Basic* should be applied to forward-looking information despite the *Basic* court's failure to explicitly so hold).

91. A few cases consider statements of analysts attributable to the corporation under the entanglement doctrine. *See, e.g.*, Rubenstein v. Collins, 20 F.3d 160, 168-69 (5th Cir. 1994) (holding corporation's statement that analysts' estimates were "realistic" enough to be actionable); Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 163 (2d Cir. 1980) (holding corporation liable for misrepresentations made by an analyst when the corporation "sufficiently entangled itself with the analysts' forecasts to render those predictions 'attributable to it' "); Schaffer v. Timberland Co., 924 F. Supp. 1298, 1314-15 (D.N.H. 1996) (finding no difference between a corporate official stating earnings would be five dollars per share and a corporate official expressing comfort with, adopting, or ratifying an analyst's statement that earnings will be five dollars per share). The scope of this Note is limited to evaluating the forward-looking statements released by the corporation's officers, directors, internal public relations departments, outside public relations firms, or other such designated representatives and, therefore, does not address the entanglement doctrine.

with a high share value.[92] The Court held that such statements by directors are material because directors have knowledge and expertise that exceed the normal investor's resources.[93] The directors' superior position magnifies their duty to act in the shareholders' interests.[94]

In *Virginia Bankshares*, the Court considered the directors' statements material although they were mere opinions.[95] This standard justifies investor or market reliance regardless of whether the corporate statements rise to the level of a guarantee. Therefore, the Guarantee Standard is utterly inconsistent with the holding and inquiry into materiality established in *Virginia Bankshares*. The Contextual Standard is more consonant with the Court's holding in *Virginia Bankshares* because it recognizes the value that investors place on any corporate official's statements where the official has superior access to corporate information. Such officials have a higher duty to speak the truth when they choose to make disclosures regarding future corporate performance.[96] Therefore, an inquiry into an authoritative statement's impact on the totality of information available to the market is superior to standards that merely examine the corporate language in the abstract. Thus, notions of materiality developed by the Supreme Court's interpretations of Rule 10b-5 in *Basic* and *Virginia Bankshares* indicate that the contextual interpretation of the Corporate Puffery Defense is superior to both the Vagueness Standard and Guarantee Standard, which limit their inquiries to bright line tests and ignore the context of statements.

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92. 501 U.S. 1083, 1090 (1991). Although the Court evaluated the reasonableness of the investor's reliance in the context of a Rule 14(a) violation of proxy statement disclosure, the standard of reliance is equally applicable to Rule 10b-5 violations. The SEC promulgated Rule 14(a), 17 C.F.R. § 240.14a-9 (1997), pursuant to section 14(a) of the Exchange Act, 15 U.S.C. § 78n(a). Rule 14(a) prohibits the use of false or misleading information in a proxy statement.

93. *See Virginia Bankshares*, 501 U.S. at 1090.

94. *See id.* at 1090-91.

95. *See id.* at 1093-94; *see also In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1428 (3d Cir. 1997) ("[S]tatement of opinion may be actionable."); Glassman v. Computervision Corp., 90 F.3d 617, 627 (1st Cir. 1996) (holding half-truths may be actionable); *In re* Donald J. Trump Casino Sec. Litig., 7 F.3d 357, 372 & n.14 (3d Cir. 1993) (holding statements of opinion are actionable). The *Virginia Bankshares* Court stated that "a statement of belief by corporate directors about a recommended course of action, or an explanation of their reasons for recommending it," would be so important that a "reasonable shareholder would consider it important in deciding how to vote." *Virginia Bankshares*, 501 U.S. at 1090-91; *see also In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir. 1989) (stating that management projections or opinions contained factual assertions that may be actionable, as investors were reasonable in relying on the directors' good faith). *But see* Barrios v. Paco Pharm. Servs., Inc., 816 F. Supp. 243, 251 (S.D.N.Y. 1993) (stating that "it is well settled in this and a number of other jurisdictions that future presentations such as contained in the [private placement memorandum] are not statements of material fact on which an investor can rely").

96. *See supra* notes 92-95 and accompanying text (describing the *Virginia Bankshares* holding).

B. Materiality Under the Commercial Common Law

Courts derived the Corporate Puffery Defense from the concept of puffery created under the commercial common law of fraud.[97] Despite some differences between commercial common law and securities law,[98] courts have found it useful to apply the puffery concept, originally developed under the commercial common law, to private securities fraud litigation.[99]

Under the commercial common law, puffing consists of general, indefinite statements[100] of the seller's opinion that the buyer should discount or ignore, as no reasonable person would rely on such

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97. The commercial common law and securities law share a common ancestry. Certain basic principles of law are prevalent in both commercial common law and securities regulation. *See* Chiarella v. United States, 445 U.S. 222, 227-28 (1980) (comparing common law fraud to securities fraud); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 192-95 (1963) (comparing commercial common law fraud to securities fraud); *see also* LOSS & SELIGMAN, *supra* note 1, at 3431-48 (comparing common law fraud to securities fraud). In spite of the recent number and breadth of cases recognizing a puffery defense, commentators continue to maintain that the applicability of the puffery doctrine is not a point of commonality between commercial common law fraud and securities fraud. *See id.* at 3434-37.

98. Courts developed the commercial common law doctrine of fraud and deceit primarily to govern the sale of tangible items. Therefore, sales of intangibles, such as securities, did not easily fit within the commercial common law. *See Capital Gains Research Bureau*, 375 U.S. at 194 (recognizing that the doctrines of fraud and deceit are ill-suited to the sale of securities); *see also* Affiliatod Uto Citizens of Utah v. United States, 406 U.S. 128, 151 (1972) (citing with approval *Capital Gains Research Bureau*, whicb statod that the securities laws replaced pbilosophy of caveat emptor with philosophy of full disclosure); B. Fennekohl & Co., 41 S.E.C. 210, 216 (1962) (noting that the "concept of 'puffing' is derived from the doctrine of *caveat emptor* and . . . can have little application to the merchandising of securities"); LOSS & SELIGMAN, *supra* note 1, at 3434-40. This inapplicability derives in part from the different price formation mechanisms of real goods and financial goods. *See* Nicholas L. Georgakopoulos, *Frauds, Markets, and Fraud-on-the-Market: The Tortured Transition of Justifiable Reliance from Deceit to Securities Fraud*, 49 U. MIAMI L. REV. 671, 677-96 (1995) (detailing the contrasting economic implications of common law deceit and securities fraud to argne for different thresholds of reliance). Furthermore, the commercial common law of fraud is based on caveat emptor, *Fennekohl*, 41 S.E.C. at 216, whereas the drafters of the securities laws explicitly shifted the focus of the markets from caveat emptor to full disclosure. *See Capital Gains Research Bureau*, 375 U.S. at 186 (citing H.R. REP. NO. 73-85, at 2 (1933)); *supra* notes 25-26. In fact, Congress drafted securities laws to protect investors where the commercial common law fraud doctrines failed to do so. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 388-89 (1983) (citing *Capital Gains Research Bureau*, 375 U.S. at 186). The recently enacted Reform Act, however, shifts away from this fundamental purpose, adding a caveat emptor element to securities regulation by providing a statutory safe harbor for forward-looking statements to balance the protections the securities laws otherwise give investors. *See* BLOOMENTHAL, *supra* note 13, at 848. In this sense, comparison between the commercial common law and securities law is perhaps even more appropriate.

99. *See supra* noto 31 (citing cases that have used the Corporate Puffery Defense to dismiss securities fraud claims as a matter of law).

100. *See* BLOOMENTHAL, *supra* note 13, at 756; *see also* Independent Order of Forestors v. Donaldson, Lufkin & Jenrette, Inc., 919 F. Supp. 149, 152 (S.D.N.Y. 1996) (implying that puffery is an expression of judgment about a thing to which both parties can be expected to have an opinion).

statements.[101] These statements include relative terms, which may mean anything the speaker or the listener wants.[102] Thus, the common law of fraud does not protect parties who rely on such vague statements, reflecting the idea that the speaker should not be penalized because of her exaggeration or the listener's disappointment.[103] In a commercial context, a buyer who relies on puffing statements assumes the risk of loss, which commercial common law defines as the difference between the seller's overstatement and a reasonable value of the item.[104] The puffery concept under the commercial common law recognizes that a statement of opinion indicates the speaker either has some doubt about the facts of which she speaks or is merely expressing personal judgment.[105] As long as the facts do not mislead the listener, the listener has no justification for relying on the speaker's judgment.[106]

In the typical commercial common law case where the speaker makes assurances of specific facts, the jury decides whether the speaker is liable for misrepresentation.[107] The judge, however, can determine that the statement lacks specificity before submitting the factual question to the jury and may dismiss the claim as inactionable puffery.[108] Such dismissal as a matter of law precludes the jury from hearing the case; therefore, no one ever determines whether the statement was intentionally false. This construct leads some commentators to characterize the puffing doctrine as "the seller's privilege to lie his head off, so long as he says nothing specific."[109]

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101. *See* BLOOMENTHAL, *supra* note 13, at 757.

102. *See* Bertram v. Reed Automobile Co., 49 S.W.2d 517, 518 (Tex. Civ. App. 1932); *see, e.g.*, Greenery Rehabilitation Group, Inc., v. Antaramian, 628 N.E.2d 1291, 1293 (Mass. App. Ct. 1994) (finding that "it would be very hard, even with the intendments favoring the plaintiffs, to raise from [the puffing statements] any implications of falsity upon which there could have been reasonable reliance").

103. *See* BLOOMENTHAL, *supra* note 13, at 755-58.

104. *See id.* at 757 (citing *Fowler v. Harper* and Mary Coate McNeely, *A Synthesis of the Law of Misrepresentation*, 22 MINN. L. REV. 939, 1004 (1938)). This loss is similar to the measure of damages in private securities litigation. *See infra* note 136 (describing the calculation of damages under the fraud-on-the-market theory).

105. Personal judgment typically includes matters such as quality, value, or authenticity. *See* KEETON ET AL., *supra* note 11, at 755; *see also* RESTATEMENT (SECOND) OF TORTS § 538 (1977) (stating that facts are material if a reasonable person would attach importance in determining his course of action).

106. *See* KEETON ET AL., *supra* note 11, at 755.

107. *See id.* at 757 n.29 (citing cases).

108. *See* LensCrafters, Inc. v. Vision World, Inc., 943 F. Supp. 1481, 1489 (D. Minn. 1996) (citing Cook, Perkiss & Liehe v. Northern Cal. Collection Serv., Inc., 911 F.2d 242, 246 (9th Cir. 1990)).

109. Castrol, Inc. v. Pennzoil Co., 987 F.2d 939, 945 (3d Cir. 1993) (quoting KEETON ET AL., *supra* note 11, at 757). While perhaps simplistic, this observation provides significant insight

The Vagueness Standard[110] of the Corporate Puffery Defense is very similar to this commercial common law theory of puffery.[111] Both doctrines support the speaker's right to lie. Unlike specific forward-looking statements, which may affect market price, clear puffing statements, by their very definition from commercial common law, do not affect the markets due to their lack of specificity.[112] Since these puffing statements do not affect the markets, the fact they were made without a reasonable basis or in bad faith is irrelevant.[113] Therefore, a factual inquiry into the corporation's basis for making the statements, or good faith, is unnecessary. Under these circumstances, judges, as a matter of law, dismiss all claims based on clear statements of puffery.[114] To do otherwise would place unwarranted restraints on the corporate officials' natural optimism.[115]

The commercial common law, however, adopts an entirely different position for specific forward-looking statements.[116] Where the speaker claims to have special knowledge of facts that would justify the creation of expectation,[117] where the parties do not have

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into evaluating the desirability of a Corporate Puffery Defense. *See infra* Part III.C (discussing the irrelevance of puffing statements on the market price of a security).

110. To the extent that the Contextual Standard considers the vagueness of the language used in the corporate statement, whether implicitly as in *Shaw*, or explicitly as in the methodology suggested in Part IV, the similiarity of the commercial common law puffery doctrine extends to the Contextual Standard as well as the Vagueness Standard.

111. *See* Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1217 n.32 (1st Cir. 1996) (viewing the Chief Financial Officer's claims in the same light as sales talk or mere puffery that is just as insufficient to support a securities fraud claim as a common law fraud claim); Simon v. American Power Conversion Corp., 945 F. Supp. 416, 426-27 (D.R.I. 1996) (drawing parallels between common law puffery and the Corporate Puffery Defense) (citing *Shaw*, 82 F.3d at 1217 n.32).

112. Thus, puffing statements may be grouped into the category of nonfundamental information that have no impact on a fundamental valuation of the company.

113. *See* Fisher v. Acuson Corp., No. 93-20477, 1995 U.S. Dist. LEXIS 19968, at *7 (N.D. Cal. Apr. 26, 1995) (holding statements are not actionable unless they "significantly alter the total mix of information available to investors").

114. *See id.*

115. That is, one should not be concerned about a market flooded with falsely optimistic, vague forward-looking statoments when an abundance of fundamental information subject to disclosure requirements exists that either supports their validity or attests to less spectacular expectations. One should be concerned only about the forward-looking corporate statements that influence the markets.

116. Where forward-looking statements are specific, the puffing doctrine will not apply and one must look to the commercial common law treatment of statements where the speaker has a duty to speak the truth. Courts hearing private securities fraud claims would be wise to follow suit.

117. *See* KEETON ET AL., *supra* note 11, at 760. Such is the case with corporate officers who have exclusive access te internal forecasts that are not disclosed to the general public. The implication is that the speaker not only does not know information to the contrary, but also knows facts that justify the forecasts. *See* Hayes Constr. Co. v. Silverthorn, 72 N.W.2d 190, 193

equal access to information,[118] or where the parties are in a special relationship of trust and confidence that justifies reliance, the common law interpretation breaks down.[119] These circumstances justify reliance on the opinion of the speaker, and courts typically will grant relief.[120] Thus, while the common law seeks to protect those who make vague statements, it does not always protect those who make predictions of future events. This treatment of forward-looking statements under commercial common law provides a useful reference point with which to compare the judicial treatment of specific forward-looking statements made by corporate officials who have a duty to speak the truth in their voluntary corporate forward-looking disclosures.[121]

In addition, the commercial common law carves out an exception to protection of statements when a duty exists between the transacting parties. Although corporate officials have no duty to disclose financial projections or forward-looking statements,[122] once they elect to disclose, they do have a duty to speak the complete truth.[123] Corporate officials not only must have a reasonable basis for making such projections, but also must present their "good faith, best estimate" when disclosing predictions.[124] The existence of this duty warrants a factual inquiry into the corporation's reasonable basis and good faith in making a statement.[125] Applying the treatment of forward-looking statements under the commercial common law of fraud to the securities context would render inquiries into the corporation's veracity a standard judicial procedure.

The Guarantee Standard of the Corporate Puffery Defense is contrary to commercial common law treatment of specific forward-looking statements. The commercial common law implies that reliance may be reasonable when the speaker has exclusive

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(Mich. 1955). In securities fraud claims, plaintiffs often allege that the corporate insiders possessed information contrary to the publicly disclosed statements.

118. *See* KEETON ET AL., *supra* note 11, at 761.

119. *See id.* at 760.

120. *See id.*

121. *See supra* notes 92-95.

122. *See* Regulation S-K, Item 303, 17 C.F.R. § 229.303 (1997) ("Registrants are encouraged, but not required, to supply forward-looking information.").

123. *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 861-62 (2d Cir. 1968) (en banc) (holding that a corporation's management has the duty to ascertain the truth of statements released to the public).

124. *See* Barondes, *supra* note 10, at 277-78. The fiduciary relationship between corporate officers and shareholders triggers this duty to disclose the truth. A corporate official's duty of disclosure is "derivative of the duties of care and loyalty." Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1166 (Del. 1995).

125. *See In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir. 1989).

information.[126] Reliance may be even more reasonable in the corporate context where the public presumes that corporate officials have knowledge of all relevant information.[127] Thus, where corporate officials have either superior access to financial information regarding the corporation or experience with the corporation, their specific predictions of the future economic performance of the corporation are material.[128] Therefore, the comparison of securities law to the commercial common law yields support for the Vagueness Standard yet rejects application of the Guarantee Standard.

C. Materiality and Modern Financial Theory

A court's determination of materiality is really a judicial proxy for a determination that the market relied on the forward-looking statement in valuing the price of a security.[129] The financial markets' interpretation of a corporation's forward-looking statement is the true test of that statement's informative value. Therefore, this modern financial theory and its application to securities jurisprudence is a critical element in analyzing whether forward-looking statements *could* have an effect on the market price of a security and are, therefore, material. An inquiry into the value of forward-looking corporate statements begins with the market's treatment of corporate information in the context of the Efficient Capital Market Hypothesis ("ECMH").[130] The ECMH, as interpreted by the Supreme Court,[131]

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126. *See supra* notes 107-24 and accompanying text (describing the standards required for fraud under the common law).

127. *See* Barondes, *supra* note 10, at 277-78.

128. *See* Langevoort, *supra* note 10, at 495. In addition, experienced corporate officials possess a history of prior disclosures upon which reasonable investors can judge the accuracy of their predictions. *See id.* at 496.

129. While the actual fundamental efficiency of the markets is unlikely to be absolute, the materiality requirements the courts use should be sufficiently similar to the definition of fundamental information to indicate an intont to protect only the market's reliance on fundamental factors. *See In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997); Ian Ayers, *Back to* Basics*: Regulating How Corporations Speak to the Market*, 77 VA. L. REV. 945, 973 n.107 (1991) (noting the similarity between concepts of materiality and fundamental information) (citing *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

An assumption of incongruity between material information and fundamental information recognizes that investers, and possibly the markets, rely on nonfundamental information. The protection of such reliance on nonfundamental information, however, could result in investment insurance, which is not the intent of the securities laws. *See* Basic v. Levinson, 485 U.S. 224, 252 (1988) (White, J., dissenting). Thus, a regulatory scheme that overprotects traders who rely on nonfundamental information perpetuatos any inefficiences present in modern securities markets.

130. *See* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 550 (1984) ("In short, the ECMH is now the context in which serious discussion of the regulation of financial markets takes place."). Legal circles quickly adopted the

states that in an open securities market, the material information regarding the company and its business determines a company's stock price.[132] Accordingly, the stock's market price will also incorporate fraudulent statements that the market is unable to distinguish from accurate statements.[133]

Due to the judicial application of the ECMH to securities fraud jurisprudence, a plaintiff alleging securities fraud need not show actual individual reliance on the corporate statements when they

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ECMH, first articulated in Eugene Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970), although it was not easily understood. *See id.* Since then, the validity, applicability, and policy implications of efficient markets has been the subject of a great deal of literature. *See, e.g.*, Daniel R. Fischel & David J. Ross, *Should the Law Prohibit "Manipulation" in Financial Markets?*, 105 HARV. L. REV. 503 (1991) (discussing the difficulties of manipulating efficient markets); Donald C. Langevoort, *Theories, Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. PA. L. REV. 851 (1992) (discussing the use of the ECMH in securities regulation); Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623 (1992) (discussing the use of ECMH in fraud-on-the-market cases and rejecting the use of the fraud-on-the-market theory as an alternative to proving reliance for securities fraud); Andrew R. Simmonds et al., *Dealing with Anomalies, Confusion and Contradiction in Fraud on the Market Securities Class Actions*, 81 KY. L.J. 123, 142-45 (1992-93) (citing empirical research criticizing ECMH).

131. Commentators continue to debate whether the Court's application of the ECMH to the fraud-on-the-market theory is entirely consistent with the financial realities of the market. *See, e.g.*, Ayers, *supra* note 129 (finding faults with Macey and Miller's 1990 application of ECMH and fraud-on-the-market to securities regulation); Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907 (1989) (reconciling the ECMH with the 1987 market crash); Jonathon R. Macey & Geoffrey P. Miller, *The Fraud-on-the-Market Theory Revisited*, 77 VA. L. REV. 1001 (1991) (discounting Ayer's application of the ECMH to securities regulation); Jonathon R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990) (discussing the misapplication of the ECMH by the courts); Newman, Jr. et al., *supra* note 39, at 583-86 (arguing that fraud on the market is valid only if courts view materiality from the standpoint of the professional investor).

132. *See Basic*, 485 U.S. at 241 (quoting Peil v. Speiser, 806 F.2d 1154, 1160-61 (3d Cir. 1986)); *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d at 1425. This view, however, assumes that markets are informationally efficient only in that the market price reflects all available material information. *See* Ayers, *supra* noto 129, at 964-68, 974-75; *see* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 694 (1984) ("So long as informed traders engage in a sufficient amount of searching for information and bargains, market prices will reflect all publicly available information."). Informational efficiency is different than fundamental efficiency, in which the market price of the stock represents the present discounted value of the corporation's expected earnings. *See* Ayers, *supra* note 129, at 970 n.97. One form of efficiency does not imply the other, as the 1987 stock market crash illustrated. *See id.* at 974 (stating that the crash showed that the market is not fundamentally efficient but that the crash did not refute that the market is informationally efficient).

133. *See* Daniel R. Fischel, *Use of Modern Finance Theory in Securities Fraud Cases Involving Actively Traded Securities*, 38 BUS. LAW. 1, 5 (1982); *see also* Roger J. Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, 25 WM. & MARY L. REV. 373, 390 (1984) ("The relative market price of the stock . . . will reflect *any* public disclosure."). Thus, the markets will price the security at the best, albeit imprecise, estimate of the present value of the future income stream of the corporation. *See* Georgakopoulos, *supra* note 98, at 713.

allege there was fraud on the market. Under this fraud-on-the-market theory, a plaintiff must show only that the statements were in fact material and that the market as a whole relied on the statements.[134] Plaintiffs using the theory allege that the corporation or its agents artificially inflated the price of the security through the disclosure of false or misleading information.[135] Despite the fact that plaintiffs may not have been aware of the false or misleading information, plaintiffs may still seek relief if they purchased the security at a fraudulently appreciated price and were injured when the stock price plummeted because of market self-correction for the misleading information.[136]

The fraud-on-the-market theory creates a rebuttable presumption of reliance, relieving plaintiffs of the burden of proving they personally relied on corporate misstatements.[137] This presumption of reliance permits investors to forego the costly verification procedures that are otherwise required under the standard reliance doctrine.[138] The defendant may rebut this presumption, however, by showing that either the plaintiff did not rely on the efficiency of the market to incorporate information,[139] or the market did not rely on the mis-

134. *See Basic*, 485 U.S. at 242-44.

135. *See id.*

136. *See id.* at 242. Contrary to Justice White's dissent in *Basic*, *see id.* at 255 (White, J., dissenting), the fraud-on-the-market theory does not justify plaintiff's reliance on the market's magic ability to determine a true value. *See* Georgakopoulos, *supra* note 98, at 715. A plaintiff's injury in this situation is measured not by the full amount of the price decrease, but instead by the extent to which loss is attributable to the misstatement. *See Basic*, 485 U.S. at 245. This damage measurement reflects the public's interest in having investors assume that a security's price does not encompass fraudulent information and is not intended to serve as an insurance policy in the truth of corporate statements or the accuracy of financial markets.

137. *See Basic*, 485 U.S. at 242-44; Langevoort, *supra* noto 10, at 889-91. Plaintiffs need only show that the corporation's misstatements induced an artificially high stock price and that plaintiffs subsequently relied on the price in deciding to purchase the security. *See id.* This construct departs from common law fraud, where misstatements injure only those whose actions were directly influenced by the statoments themselves. *See* Georgakopoulos, *supra* note 98, at 714-15. The Court's basis for this departure from the common law of fraud is the distinction between the immense volume of trading done indirectly in the modern securities market and the face-to-face transactions of the commercial common law. *See Basic*, 485 U.S. at 244 (quoting *In re* LTV Sec. Litig., 88 F.R.D. 134, 143 (N.D. Tex. 1980)).

138. *See* Fischel, *supra* note 133, at 16; *see also* GUIDO CALABRESI, THE COSTS OF ACCIDENTS 26-31 (1970) (tort liability prevents wasteful precaution efforts). The persuasiveness of these economic benefits is limited to the extent that they can be outweighed by the gross inefficiencies of meritless strike suits. *See infra* Part V (describing the judicial balancing required to apply properly the Corporate Puffery Defense from a contextual perspective).

139. *See, e.g.*, Zlotnick v. TIE Communications, 836 F.2d 818, 820-23 (3d Cir. 1988) (holding that short selling evidences disbelief in the efficiency of the markets, thereby precluding a claim of fraud on the market). For purposes of this Note this method of rebuttal is not at issue.

statement.[140] Thus, the central focus in determining the actionability of a forward-looking statement becomes whether the market relied on the statement.

Without the aid of a judicially efficient statistical model to determine mathematically the impact of the information on the market,[141] courts must attempt to decide for themselves whether the

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140. *See Basic*, 485 U.S. at 248. The Corporate Puffery Defense is consistent with this rebuttal, as it argues that the market did not rely on defendant's misstatements because they were so vague, a reasonable investor would not rely on them in setting the price of the security. *See* Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993) (stating that the market does not rely on vague, indefinite statoments of puffery). Like materiality, the presumption of reliance derived from the fraud-on-the-market theory depends on whether the statement influenced security prices. *See* Georgakopoulos, *supra* note 98, at 727.

141. At first glance, it seems logical to consider the market's determination of a corporate statement's materiality rather than requiring courts to attempt to determine a particular statement's influence on the market. *See* Joseph A. Grundfest, *Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 961, 1013 (1994) (suggesting that the SEC could require a more significant market impact for courts making a materiality determination); *see also In re* Fidelity/Micron Sec. Litig., 964 F. Supp. 539, 548 (D. Mass. 1997) ("A simple test of materiality in a fraud-on-the-market case is whether the alleged misrepresentation in fact affected the market."). Arguably, the most efficient method of determining materiality would be to determine, as scientifically as possible, whether the market actually relied on the language in question. Some commentators have argued that the use of an event-study methodology would show whether a fraudulent statement has had a significant effect on the price of a firm's security and, thus, whether the courts would be justified in presuming reliance on the material statement. *See* Jonathan R. Macey et al., *Lessons from Financial Economics: Materiality Reliance and Extending the Reach of* Basic v. Levinson, 77 VA. L. REV. 1017, 1018 (1991) (arguing for the use of event-study methodology); *see also* Mark L. Mitchell & Jeffrey M. Netter, *The Role of Financial Economics in Securities Fraud Cases: Applications at the Securities and Exchange Commission*, 49 BUS. LAW. 545, 572-84 (1994) (describing SEC enforcement of anti-fraud provisions by utilizing the event study methodology). Courts could compare statistically the price of the stock before and after the disclosure of the corporate statement to determine whether the market internalized the information and appreciated the stock price. The event-study methodology tests the new information's effect on the price of a stock for an event period and compares it with the historical deviations of the stock via a regression analysis. *See* Macey et al., *supra*, at 1030-42 (performing an event study). Any returns existing outside the statistically significant boundaries indicates that information has been incorporated into the stock price and is, therefore, material. While such an analysis could predict accurately the matoriality of statements, the analysis suffers from difficulties inherent in practical application. *See id.* at 1042-44 (describing the difficulty in determining when information reached the market); *see also id.* at 1029 (describing how other firm-specific information released at about the same time, i.e., confounding events, would corrupt the study). Furthermore, while the test is relatively simple for statisticians to administer, it still requires extensive factual inquiries into the stock's historical performance and the nature of the corporate statements, as well as the exclusion of confounding events. Courts likely will object to such a mathematically rigorous and fact-intensive test when deciding an issue as a matter of law. As a result, some courts have determined that where corporate statements precipitate an immediate price drop, a jury should determine the issue of materiality. *See, e.g., In re Fidelity/Micron*, 964 F. Supp. at 547-48 (holding that the issue of materiality is a question of fact for the jury). This approach oversimplifles the process and forces parties into litigation when disputes could be resolved more efficiently on a motion to dismiss or on summary judgment through the judicial application of the Corporato Puffery Defense using the contextual considerations forwarded in Part V. *Cf. In re Fidelity/Micron*, 964 F. Supp. at 548 (permitting

statement contains the kind of information the market would value in determining the price of a security. Since the security's market price is determined by professional and institutional investors,[142] many courts use a "professional investor" standard to determine the informative value of the corporate statement.[143] Given the importance of market professionals in adjusting the price of a security for a claim of fraud on the market, the professional investor standard seems most appropriate in determining whether a forward-looking corporate statement is sufficiently material to affect the market price of a security.

The value of rejecting securities fraud claims under either the Vagueness Standard or the Contextual Standard is especially pronounced when a plaintiff alleges a claim based on fraud on the market. Because professional investors set the market price of a security,[144] and these market professionals usually know when to discount the optimistic rhetoric of corporate officials, they will not

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the securities fraud class action to proceed to trial to detormine other factors that could have affected the stock price besides the allegedly misleading corporate statement).

142. *See* Louis Lowenstein, *Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation*, 83 COLUM. L. REV. 249, 297 (1983) (discussing professional investors' dominant role in determining market direction); Macey & Miller, *supra* note 131, at 1062 (arguing that "rivalrous competition among market professionals causes share prices to adjust to semi-strong efficiency"); Simmonds et al., *supra* note 130, at 132-34 (arguing that individual investor behavior is irrelevant to the pricing of securities because of the influence wielded by the professional and institutional investors). *See generally* Joseph Nocera, *Who Really Moves the Market?*, FORTUNE 90 (Oct. 27, 1997) (detailing how professional analysts and investors control the price of a security).

The fact that mutual funds managers and institutional investors control the vast majority of the stock market contributes greatly to professional investors' control of security pricing. *See* Simmonds et al., *supra* noto 142, at 130 ("Institutional investors and exchange member firms presently account for about 80% of the shares traded each day on the New York Stock Exchange."); Randall Smith, *Mutual Funds Have Become Dominant Buyers of Stock*, WALL ST. J. C1 (May 22, 1992) (noting increased percentage of assets in professionally managed mutual funds).

143. *See, e.g.*, *Raab*, 4 F.3d at 290 (focusing on "analysts and arbitrageurs" to assess alleged fraud on the market); *In re* Convergent Techs. Sec. Litig., 948 F.2d at 513 (denying a claim of fraud on the market where "securities analysts" knew of the risks associated with the security); *In re* Westinghouse Sec. Litig., 832 F. Supp. 948, 976 (W.D. Pa. 1993) (finding that "professional analysts are generally the first and foremost source of information to the market; their specialized ferreting activity is the primary means by which capital markets are made 'efficient,' and stock prices relatively accurato"); *In re* Verifone Sec. Litig., 784 F. Supp. 1471, 1479 (N.D. Cal. 1992) ("The professional traders analyze information about securities, and the trading activity of these knowledgable investors pushes the price of the security toward a value which reflects all publicly available information."). A necessary condition for this standard is that professional investors are following the security. In the case of thinly traded securities, which are less efficiently priced, a reliance on the impact forward-looking statements have on trained professionals is undeserved. This Note leaves the determination of how many professionals are required to provide a sufficiently liquid market to other commentators.

144. *See supra* note 142.

rely on puffing statements.[145] Since the market professionals do not rely on puffing statements in determining the stock price, any allegations by the plaintiff that the statements could have inflated share value are inconsistent with the fraud-on-the-market theory and the ECMH.[146]

The Guarantee Standard poses theoretical difficulties because of its high threshold when a plaintiff presents a fraud-on-the-market claim. While the market may not give full credibility to corporate predictions because of their inherently speculative nature, analysts could rely on such statements to a limited extent.[147] Corporate forecasts are often better than projections made by analysts themselves, and corporate officers are assumed to have superior access to corporate information.[148] Therefore, forward-looking statements that do not rise to the level of a guarantee may be material and may affect market price.[149] The market will consider a forward-looking statement's relevancy and incorporate it into the market price to the extent it is likely to come to fruition.[150] To assume that professional investors and sophisticated financial markets treat the relevance of corporate information as a binary decision based on the statement's characterization as a guarantee is simply and wholly inaccurate.

From a market-centric point of view, the most accurate method for determining the materiality of forward-looking statements is the Contextual Standard of the Corporate Puffery Defense, which explicitly considers a forward-looking statement in light of all the information available to the market. Prohibiting actionability for *all*

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145. Courts usually recognize the fact that investors will "devalue the optimism of corporate executives, who have a stake in the future success of the [corporation]." *Verifone*, 784 F. Supp. at 1481; Schaffer v. Timberland Co., 924 F. Supp. 1298, 1313 (D.N.H. 1996) (quoting the same passage from *Verifone*); *In re* Worlds of Wonder Sec. Litig., 814 F. Supp. 850, 858 n.6 (N.D. Cal. 1993) (same); *see also* Wielgos v. Commonwealth Edison Co., 892 F.2d 509, 515 (7th Cir. 1989) (noting that professional investors and analysts are capable of seeing through the predictable optimism of corporate executives). *But see* Langevoort, *supra* note 10, at 494 n.79 (stating that although "sophisticated investors bave some sense of when to doubt and when to trust," they can be deceived when their trust is misplaced).

146. *See supra* note 141 (comparing the judicial notion of materiality with market reliance).

147. *See* Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1090-91 (1991). Forward-looking statements referring to earnings are considered to be the most material of corporate inside information because they have the ability to influence market prices. *See* Langevoort, *supra* note 10, at 502 (stating that "[e]arnings forecasts are among the most material of corporate inside information precisely because they are able to influence market prices"); Gilson & Kraakman, *supra* note 130, at 564 n.47 (explaining how investors discount the introduction of new soft information by the reliability of the information).

148. *See* Basi et al., *supra* note 3, at 252 (concluding that "there is reasonable evidence that company forecasts were better than analysts' forecasts").

149. *But see* Gross v. Summa Four, Inc., 93 F.3d 987, 995 (1st Cir. 1996) (holding that "vague and loosely optimistic statements" are not materially misleading).

150. *See supra* note 145.

vague statements does not address the infinite variations of corporate statements. Consider a scenario where someone circulates speculative negative rumors about a particular aspect of a corporation's business, such as the viability of their new software. To combat these rumors, the company could disclose an overly optimistic, yet vague, statement dispelling these rumors. Investors may discount the corporate optimism, but they will likely consider the optimism when assessing the future earnings of the company. This consideration reduces the importance investors place on negative rumors and, therefore, increases the stock price. The duty of corporate officers to tell the truth to shareholders and the exclusive inside information the officers possess justify such reliance.[151] Thus, statements that do not include fundamental data could nevertheless impact the market's valuation of the stock. Deeming all facially vague statements immaterial as a matter of law is over-inclusive. A more narrow determination of whether a statement is so vague as to be immaterial as a matter of law, taking into account the context in which the statement was made, is necessary. The contextual approach of the Corporate Puffery Defense offers precisely the type of evaluation necessary to determine if the forward-looking statement sufficiently induced market reliance in spite of its vague language or failure to rise to the level of a guarantee.

D. Materiality Under the Private Securities Litigation Reform Act of 1995

Although the majority of securities fraud litigation applying the Corporate Puffery Defense will rely on traditional 10b-5 analysis,[152] the proper application of the Corporate Puffery Defense must at least be consistent with the most recent congressional amendment to the securities laws, the Reform Act. The Reform Act provides a safe harbor for certain types of forward-looking statements.[153] The first prong[154] protects forward-looking statements that are either:

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151. *See supra* text accompanying notes 92-95 (analyzing the reasonableness of investors reliance on statements made by corporate officials).

152. *See supra* note 7 for the traditional Rule 10b-5 analysis (listing requirements, including materiality, necessary for plaintiff to allege a claim of securities fraud).

153. *See supra* note 1 (quoting the types of corporate statements considered to be "forward-looking" by the Reform Act).

154. The Reform Act contains a two-pronged test. If a corporate statement does not fit within the first prong, the second prong requires plaintiffs to prove that the speaker had actual knowledge that the forward-looking statement was false and misleading. *See* 15 U.S.C.A. §§ 77z-2(c)(1)(B)(I), 78u-5(c)(1)(B)(i) (West 1997). As more corporations use limiting cautionary

(1) identified as forward-looking and accompanied by cautionary statements detailing important factors that could cause actual results to differ materially from those in the statement;[155] or (2) immaterial.[156]

Despite the fact that the Reform Act provides a statutory safe harbor to protect statements that are immaterial, the Reform Act does not define "immateriality."[157] In order to take advantage of the immateriality provision in the Reform Act, defendants must look to definitions of materiality previously developed in cases interpreting Rule 10b-5.[158]

The rejection of securities fraud claims based on facially vague forward-looking corporate statements meshes seamlessly with the Reform Act's safe harbors. Once a court determines that a statement

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statements in public documents filed with the SEC, fewer statements made in such disclosures will be actionable under private securities fraud claims. Corporate officials are less likely, however, to use cautionary statements in sound bites to the media or securities analysts. These agents will increasingly rely upon the Corporate Puffery Defense, under the materiality provision of the first prong, to dismiss claims of securities fraud. This Note does not discuss the ramifications of the heightened pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure on private securities fraud class actions. For a more in-depth analysis of this tepic, see William S. Feinstein, *Securities Fraud: Pleading Securities Fraud with Particularity—Federal Rule of Civil Procedure 9(b) in the Rule 10b-5 Context:* Kowal v. MCI Communications Corporation, 63 GEO. WASH. L. REV. 851 (1995); Olson et al., *supra* note 4, at 1115-17 (discussing tlie pleading requirement of scienter).

155. *See* 15 U.S.C.A. §§ 77z-2(c)(1)(A)(i), 78u-5(c)(1)(A)(i). When making oral corporate statements te analysts or the press, the officers could meet the first prong of the safe harbor by stating, for example:

> I would like to make a number of forward-looking statements and to call your attention te tlie fact that with respect to each one that the actual results could differ substantially and materially from what we have projected. We have filed with the Securities Exchange Commission as item 5 of Form 8-K [or in the case of the annual meeting these statements appear in our annual report to shareholders] under date of _____ and you can readily obtain additional information concerning important factors that could cause the actual results to differ materially from what we have predicted. That having been said, we expect ____, ____, and ____ to happen within the forthcoming year.

BLOOMENTHAL, *supra* note 178, at 887. Perhaps not surprisingly, CEOs are reluctant to protect themselves with such verbiage in sound bites and conference calls.

156. *See* 15 U.S.C.A. §§ 77z-2(c)(1)(A)(ii), 78u-5(c)(1)(A)(ii). The legislative history of the Reform Act indicates that tlie drafters of the Reform Act intended to encourage the continued use of the Corporate Puffery Defense under the immateriality provision of the first prong. Senator Domenici stated "[optimistic opinions] or puffing has no effect on a company's share price and courts should continue to quickly dismiss cases based on these types of statements." 141 CONG. REC. S17970 (daily ed. Dec. 5, 1995) (statement of Senator Domenici). Senator Hatch agreed, stating that "[s]ome companies have faced damaging lawsuits merely on the basis of vague but optimistic projections that the company would do well even though it was clear that tlie prediction was speculative and future oriented. The safe harbor provision sensibly addresses those problems." 141 CONG. REC. S19054 (daily ed. Dec. 21, 1995) (statement of Senator Hatch).

157. *See* 15 U.S.C.A. §§ 77z-2(i), 78u (not explicitly defining "materiality" for purposes of the statute).

158. *See* Pitt et al., *supra* note 5, at 852; *supra* Part III.A (discussing cases interpreting materiality in the context of 10b-5 actions).

is immaterial, the statement falls within the immateriality provision of the Reform Act's safe harbor, and the plaintiff's claims against the corporation are not actionable.

Wholesale protection of forward-looking statements that fail to rise to the level of a guarantee, however, would expand the immateriality provision so as to render the other provisions of the safe harbor meaningless. Congress enacted the Reform Act to protect only certain forward-looking statements.[159] If only forward-looking statements that constitute a guarantee were material, virtually all forward-looking statements would be protected. No reason would exist either to include meaningful cautionary language[160] or to prove the defendant's actual knowledge that the statement was false or misleading.[161] As Congress could not have intended to afford protection for such a broad range of statements, courts should reject the Guarantee Standard.

E. Materiality Policy Considerations

The proper application of the Corporate Puffery Defense achieves two policy objectives: limiting investor strike suits and encouraging corporate disclosure. In the face of a growing number of securities fraud class action suits,[162] some courts recognized the potential effect of the Corporate Puffery Defense would be to eliminate a large number of frivolous strike suits at a preliminary stage.[163] Courts that properly apply the Corporate Puffery Defense effectively counter the abusive inefficiencies of these suits[164] by

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159. The Reform Act protects forward-looking statements that are either accompanied by adequate cautionary language or immaterial. *See supra* notes 1, 5, 155-56 and accompanying text.

160. *See supra* note 155 and accompanying text (discussing the meaningful cautionary language provision of the first prong of the Reform Act safe harbor).

161. *See supra* note 154 (discussing the second prong of the Reform Act safe harbor).

162. *See* Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 220 & n.14 (4th Cir. 1994) (noting that "the mere existence of an unresolved lawsuit has settlement value to the plaintiff" in securities fraud cases).

163. *See id.* at 220 (quoting and applying *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 742-43 (1975) (recognizing that the need to eliminate the settlement value of an unresolved lawsuit and reduce the threat of extensive discovery and avoid disruption of normal business practice justifies the elimination of claims at an early stage)); *see also* Lasker v. New York State Elec. & Gas Corp., 85 F.3d 55, 59 (2d Cir. 1996) (dismissing Lasker's claims of securities fraud on summary judgment).

164. *See supra* note 6 (discussing the abuses of private securities litigation). The expected cost of a private securities fraud defense more often determines the settlement value than do the merits of the claims. *See* S. REP. NO. 104-98, at 9 (1995); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 499-501 (1991).

finding claims based on questionable language worthy of dismissal as a matter of law. However, judicious use of this methodology is necessary to ensure the goals of securities disclosure are met and that fraud is not perpetuated on the investing public.

Vague statements derive their uncertainty from the speaker. When one opines that a corporation will have a good year, the listener reasonably should believe such a statement lacks the certainty on which to base an investment decision.[165] When uncertain forward-looking statements contain specific data, however, the receiver of the information introduces the uncertainty element when evaluating how to rely on the statement.[166] To the extent that these forward-looking statements may reasonably influence an investor's valuation of the stock, such statements do not deserve the same fact-blind blanket protection contextually vague statements receive.

Judicial application of the Corporate Puffery Defense under a contextual interpretation is a useful way to effectively, yet fairly, screen investor strike suits.[167] Claims alleging market reliance on contextually vague corporate statements likely are not worthy of the expensive discovery process.[168] Dismissing these claims early in the litigation process diminishes the damaging effect on the corporation and the courts, effectively fulfilling the first policy objective of the Corporate Puffery Defense.

The second policy objective the Corporate Puffery Defense achieves is the protection of corporate speech.[169] An efficient market economy must have efficient capital allocation through which entrepreneurs can receive the needed capital for projects the market

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165. The listener could interpret this statement in numerous ways. Listeners would likely not be influenced when adjusting their valuation of the security because of the lack of fundamental information in the statement. *See* Stransky v. Cummins Engine Co., 51 F.3d 1329, 1334-35 (7th Cir. 1995) (finding that a press release's mention of "cost curves," without more, was subject to multiple interpretations).

166. *See* Gilson & Kraakman, *supra* note 130, at 564 n.47 (explaining how investors discount the introduction of new soft information by the reliability of the information).

167. *See* Steven B. Rosenfeld, *"Immateriality as a Matter of Law": An Effective Curb on Securities Fraud Litigation*, 28 STANDARD & POOR'S REV. SEC. & COMMODITIES REG. 169, 169 (Oct. 11, 1995) (discussing the judicial and corporate efficiency of dismissing investor strike suits by finding immateriality as a matter of law).

168. *See supra* note 6 (discussing the lack of merit in many private securities class actions).

169. As Senator Bennett noted in the debate overriding the President's veto of the Reform Act:

> In the name of protecting the investor, we are depriving the investor of the very best guesses so labeled, estimates so labeled, conjectures so labeled, of the people who know the most about the company. We are asking the investor to fly even more blind than they would be if they had those guesses.

141 CONG. REC. S19049 (daily ed. Dec. 21 1995).

determines sufficiently promising.[170] The Corporate Puffery Defense permits entrepreneurs to discuss their opinions openly with the possessors of capital. The drafters of the Reform Act specifically designed the safe harbor to encourage corporate officers to provide the market with forward-looking information.[171] Excessive liability for forward-looking information deters entrepreneurs from discussing their prospects,[172] which denies profitable ventures to the market and withholds useful goods and services from the public.[173]

At some point, however, forward-looking statements contain language so specific they induce a revaluation of the corporation's stock price. Although courts should not hold corporations liable *every* time predictions fail to materialize,[174] they should impose liability when the forward-looking statements affect the market and the corporation acted without reasonable basis or good faith when releasing the statements.[175] For example, a court should not shield from liability a corporation that inflates the market price by publicly predicting specific revenue growth if the speaker knew such performance would be difficult to achieve. When corporations release statements that have the ability to influence the market price of their stock, a jury should resolve the truthfulness of the statements. Should such information be fraudulent, protecting the statements would no longer serve the public interest.[176]

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170. *See* Grace Pownall et al., *The Stock Price Effects of Alternative Types of Management Earnings Forecasts*, 68 ACCT. REV. 896 (1993) (examining the stock price effects of alternative types of management earnings forecasts).

171. *See* H.R. CONF. REP. NO. 104-369, at 43 (1995) (discussing the purpose of the safe harbor provision).

172. *See* Raab v. General Physics Corp., 4 F.3d 286, 290 (4th Cir. 1993) (noting that excessive liability "would put companies in a whipsaw"); Ayers, *supra* note 132, at 954 (describing the problem of inefficient silencing when corporations refuse to speak to the public to avoid inefficient lawsuits). This silencing deprives the markets of useful information. *See id.* Theoretically, markets should be unaffected by the absence of vague puffing statements.

173. The Supreme Court discussed the dangers of setting the materiality threshold too low and subjecting corporations to liability for insignificant statements in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976).

174. *See* Serabian v. Amoskeag Bank Shares, Inc., 24 F.3d 357, 361 (1st Cir. 1994) (holding that "optimistic predictions about the future that prove to be off the mark" were not actionable); Pommer v. Medtest Corp., 961 F.2d 620, 623 (7th Cir. 1992) ("The securities laws approach matters from an ex ante perspective: just as a statement true when made does not become fraudulent because things unexpectedly go wrong, so a statement materially false when made does not become acceptable because it happens to come true.").

175. That is, courts should hold forward-looking statements to the appropriate standards of Rule 175, Rule 3b-6, and the standards for private litigation set forth in the Reform Act. *See supra* Part III.D (describing the standards of private securities fraud litigation).

176. However, "[t]he securities laws were not enacted to protect sophisticated businessmen from their own errors of judgment." Hirsch v. du Pont, 553 F.2d 750, 763 (2d Cir. 1977); *see also* IIT v. Vencap, Ltd., 519 F.2d 1001, 1011 (2d Cir. 1975) (stressing that a memorandum discuss-

The fundamental purpose of the securities laws and their system of mandatory disclosure is to protect investors by eliminating fraud in the purchase and sale of securities.[177] The Reform Act, however, shifts away from this fundamental purpose, adding a *caveat emptor* element to securities regulation by providing a statutory safe harbor for forward-looking statements to balance the protections the securities laws otherwise give investors.[178] To create the proper balance, courts must walk a fine line and consider the context in which these statements were made before determining materiality. Courts should keep these policy objectives in mind when contextually evaluating the distinction between actionable fraudulent statements and mere puffery.

IV. SYNOPSIS

Crystal balls cannot foretell the future of the corporate world. Similarly, no one can guarantee the future performance of a corporation. As a result, a standard requiring forward-looking corporate statements to rise to the level of a guarantee[179] to be actionable implicitly prevents securities fraud claims on almost any forward-looking statement.[180] Dismissing all securities fraud claims failing to measure up to this elusive standard, as the Fourth Circuit does, is inconsistent

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ing potential returns on a capital investment was not likely to mislead a sophisticated investor). While business leaders might mistakenly divulge an overly specific projection without the necessary cautionary statements required to obtain statutory protection, such instances are rare. Most specific projections are intentional and can be eliminated only by an absolute ban on all communication except properly disclosed financial projections. *See, e.g.*, *Vengeance or Growth?*, WALL ST. J., Nov. 26, 1991, at A14 (describing how Oracle Systems Corp. refused to discuss forward-looking information with analysts after being sued for securities fraud 19 times in 1990).

177. *See* SEC v. Ralston Purina Co., 346 U.S. 119, 124 (1953) (finding that Congress created the Securities Act to protect investors by encouraging corporations to disclose information "necessary to [make] informed investment decisions"); H.R. REP. NO. 73-85, at 3-4 (1933) (stating that Congress intended the Securities Act to provide investors with facts essential to estimate the value of securities).

178. *See* BLOOMENTHAL, *supra* note 13, at 848.

179. Although some circuits have adopted the Guarantee Standard, few courts have attempted to define "guarantee." *See supra* notes 49, 53 for a discussion of cases employing the guarantee standard.

180. Although the Guarantee Standard does not place all forward-looking statements beyond the reach of the securities laws, *see supra* text accompanying note 49 (discussing cases that imply that only statements not rising to the level of a guarantee are immaterial and therefore cannot serve as the basis of a claim of securities fraud), realistically, virtually no forward-looking statements would rise to the level of a guarantee.

with: (1) prior decisions evaluating materiality under Rule 10b-5;[181] (2) modern financial theory;[182] (3) the commercial common law;[183] (4) the Reform Act;[184] and (5) the policy rationales underlying the Corporate Puffery Defense.[185] Despite the obvious efficiencies gained by dismissing claims based on forward-looking statements,[186] adopting a per se rule permits corporations to affect the market price of their stock with forward-looking statements regardless of their veracity, good faith, or reasonable basis. Such wholesale protection of fraudulent corporate statements is inconsistent with the goals of the securities laws, the Corporate Puffery Defense, or public policy. Thus, courts should overrule and reject the line of cases supporting the Guarantee Standard.[187]

At some point, forward-looking corporate statements are so facially vague and uninformative that a reasonable investor would never rely on the information to make an investment decision. Like a falling tree that no one hears, facially vague statements in sophisticated markets have no effect on stock price because no one would reasonably rely on them. Such statements are so vague and indefinite that they cannot support an action for securities fraud. The dismissal of such securities fraud claims based on facially vague statements is justified by the following considerations: (1) consistency with the commercial common law doctrine of puffery; (2) consistency with

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181. This Contextual Standard is consistent with *Basic* in that it evaluates whether the corporate statements have altered the total mix of information made available.

182. This Contextual Standard still permits a fact finder to evaluate the good faith and reasonable basis of corporate disclosures once the plaintiff proves that the statements were material enough to affect the reasonable investor's investment decision. *See supra* note 154 (describing the second prong of the Reform Act's Safe Harbor).

183. This contextual definition mirrors the common law doctrine of puffery by effectively permitting the speaker to lie so long as nothing specific is said. *See supra* Part III.B.

184. Compared to the Vagueness Standard and the Guarantee Standard, the Contextual Standard provides a more holistic inquiry into which statements should be judicially determined to be "immaterial" according to the Reform Act. *See supra* note 154 (describing the "immateriality prong" of the Reform Act).

185. This Contextual Standard permits courts and corporations to dismiss private securities fraud strike suits at an early stage before an expensive and time-consuming discovery occurs. It also protects the corporation's ability to release information to the public by recognizing its ability to state opinions as to future events without incurring liability if the prediction fails te materialize. *See supra* Part III.E.

186. Such inefficiencies include the aggregate effect on the economy from the defendant-corporation's high costs of discovery and litigation of a securities fraud class action, which are detailed *supra* note 6.

187. *See, e.g.*, Herman v. Legent Corp., No. 94-1445, 1995 U.S. App. LEXIS 5568, at *14 (4th Cir. Mar. 20, 1995) (holding that forward-looking statements that do not constitute a guarantee are immaterial as a matter of law); Hillson Partners Ltd. Partnership v. Adage, Inc., 42 F.3d 204, 211-12 (4th Cir. 1994) (same); Malone v. Microdyne Corp., 26 F.3d 471, 479 (4th Cir. 1994) (same); Raab v. General Physics Corp., 4 F.3d 286, 289-90 (4th Cir. 1993) (same).

modern financial theory and the fraud-on-the-market theory; (3) consistency with the safe harbor provisions of the Reform Act; and (4) effectiveness in screening securities fraud strike suits. These justifications provide a compelling rationale for the continued use of the Corporate Puffery Defense to dismiss securities fraud claims when they are based on vague forward-looking statements.

Establishing that courts should apply the Corporate Puffery Defense in certain circumstances is only half the battle, however. Establishing how courts should determine when forward-looking corporate statements are sufficiently vague and immaterial to warrant dismissal as a matter of law under the Corporate Puffery Defense is substantially more difficult. Providing a practical methodology to govern the application of the defense is essential to the efficacious application of the Corporate Puffery Defense. A contextual application of the Corporate Puffery Defense achieves the desirable results of protecting corporate statements that are so vague, they have no market impact. The contextual application of the Corporate Puffery Defense provides a more accurate method of determining which statements are sufficiently immaterial, and thus is logically consistent with the traditional notions of materiality previously articulated by the Supreme Court, and mirrors the contextual method used by commercial common law to find statements immaterial as a matter of law. These benefits should deter courts from overprotecting both forward-looking statements that fail to rise to the level of a guarantee and facially vague statements by adopting per se immateriality as a matter of law.[188] In the absence of a foolproof method to determine materiality of forward-looking statements,[189] courts should consider the context in which the statements were made. Despite the potential judicial difficulties in applying such a test,[190] a contextual evaluation may be the only

188. *See supra* note 30 and accompanying text (citing *Raab*, *Searls*, *San Leandro*, and *Lasker* as cases utilizing both the Vagueness Standard and the Guarantee Standard of the Corporate Puffery Defense).

189. *See supra* note 141 and accompanying text (describing the difficulties of judicial application of the event-study methodology to determine the materiality of forward-looking statements on summary judgment).

190. Contextual application of the Corporate Puffery Defense by the judiciary will place greater burdens on the plaintiffs, who will have to plead that the statements were material in the context of the total mix of information available to the market in their well-pleaded complaint. *See* FED. R. CIV. P. 9(b) (requiring plaintiffs to plead with particularity in fraud cases); *see, e.g.*, Gilford Partners, L.P. v. Sensormatic Elec. Corp., No. 96 C 4072, 1997 WL 757495, at *15 (N.D. Ill. Nov. 24, 1997) (requiring plaintiff to plead with particularity claims that defendant's forward-looking statements were materially misleading in light of the information available to the market regarding Sensormatics performance). This type of contextual approach may also require more evaluation by courts, as they will have to weigh the impact of the

effective method of analyzing whether vague forward-looking corporate statements influence the market.

V. CONTEXTUAL METHODOLOGY OF THE CORPORATE PUFFERY DEFENSE

This Note proposes that the proper application of the Corporate Puffery Defense requires a two step process: (1) evaluating the forward-looking statement in the abstract to identify the statement as puffery, and (2) considering the context in which the statement was made.[191]

First, as a threshold issue, a court should analyze the forward-looking statement independent of the context in which the company made the statement to determine whether it was so vague and indeterminate that no reasonable investor would rely on it when valuing the price of a security. Sufficiently vague statements would create a rebuttable presumption that the forward-looking statements are immaterial as a matter of law.[192] When deciding whether a forward-looking statement meets this test, the absence of fundamental

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forward-looking statements in light of the total mix of information available to the market, rather than merely deciding that the language used by the corporation looks vague. Although such analysis requires more judicial fact-finding to determine the context in which the corporate statement was made, the high possibility that some vague forward-looking statements may influence a security's market price warrants such judicial inquiry on motion to dismiss or on summary judgment.

If, however, the *Shaw* and *Simon* cases in the First Circuit using the contextual method, and the cases that consider the Bespeaks Caution Doctrine evidence the judicial feasibility of a contextual approach, the author remains confident that all parties could handle the task. In any event, such a determination on summary judgment is certainly more efficient than a full jury trial on all five elements of securities fraud. *See supra* note 7 (setting forth the required elements of establishing securities fraud under Rule 10b-5).

191. Before considering the Corporate Puffery Defense, a court will determine whether the statement contains adequate cautionary language to satisfy either the first prong of the Reform Act safe harbor or the judicially crafted Bespeaks Caution Doctrine. *See supra* note 155 and accompanying text (describing the bounds of the first provision of the first prong of the Reform Act safe harbor). If the forward-looking statement is found immaterial under either route, the judicial inquiry ends and the securities fraud claims are dismissed either on motion to dismiss or on summary judgment. If the corporate statement fails to contain adequate cautionary language, the court should then use the contextual application of the Corporate Puffery Defense.

Although the Corporate Puffery Defense is theoretically sound when applied to either a motion to dismiss or a motion for summary judgment, the defendant should use the defense on a motion to dismiss to maximize the efficiency of avoiding a costly discovery process. Otherwise, the plaintiff has the opportunity to make a motion pursuant to F.R.C.P. 5b(f) to seek discovery on the issues addressed in the motion.

192. Plaintiffs could overcome this presumption by showing facts related to the information available to the market as contained in plaintiff's well-pleaded complaint.

information provides evidence that the statement does not affect the future income streams and, therefore, provides a presumption of immateriality.[193] Corporate statements are relevant to the extent that they provide some information about the corporation's future income stream.[194] Any statement that includes such information is important to the market in setting a security's value.[195] Unlike the Guarantee Standard,[196] this method would find some forward-looking statements to contain adequately specific predictions that could justifiably serve as the basis of a securities fraud claim.[197] If the forward-looking statement is specific enough to be material, the puffing inquiry ends. Thus, the first step of the proper application of the Corporate Puffery Defense mirrors the approach by *Raab* and its progeny.[198] A court should not end its inquiry with the Vagueness Standard found in the *Raab* analysis,[199] however, as this could include otherwise vague statements that do influence the market price of a security. The first step in the contextual application of the Corporate Puffery Defense will merely identify puffing statements. If the forward-looking statement meets the vagueness threshold, the court will move to the second step of the puffing analysis.

A court's second step should analyze the forward-looking statement in the context of the total mix of information available to the market. Such an analysis mirrors the approach used by the courts in *Shaw* and *Simon*.[200] This contextual analysis requires a consideration

193. *See* Langevoort, *supra* note 10, at 502 (stating that earnings estimates are some of the most material statements made by a corporation); *supra* text accompanying notes 129-33 (discussing the market's reliance on fundamental information). Statements can contain information that would affect a specific risk without including financial projections. In this respect, the exclusion of fundamental information must be weighed accordingly.

194. *See* Barondes, *supra* note 10, at 276.

195. *See id.*

196. *See supra* Part II.B.

197. *See, e.g.*, Gilford Partners, L.P. v. Sensormatic Elec. Corp., No. 96 C 4072, 1997 WL 757495, at *14 (N.D. Ill. Nov. 24, 1997) (finding that defendant's statements were made with sufficient specificity to escape puffery classification and warrant procession of plaintiff's claims to trial); Simon v. American Power Conversion Corp., 945 F. Supp. 416, 428-29 (D.R.I. 1996) (same).

198. *See supra* Part II.A.

199. Under the Corporate Puffery Defense methodology advocated by this Note, finding vagueness under the *Raab* approach merely creates a presumption, rebuttable by the plaintiff, that the forward-looking corporate statement is immaterial as a matter of law, rather than allowing the courts to determine prematurely the per se immateriality of such vague language as advocated by the Vagueness Standard.

200. *See supra* Part II.C. The Contextual Standard recommended here differs from the Contextual Standard the court applied in *Schaffer*, where the court analyzed the Corporate Puffery Defense based upon the information available to *defendants*, a subjective test, rather than upon the information available to the *markets*, an objective test.

of the forward-looking statement's impact on the total mix of information available to the market.[201]

Additional information available to the market may impact the corporate statement's materiality. A corporation's forward-looking statement is likely to affect a security's market price when corporate estimates coincide with the third-party information available to the market. Conversely, when corporate estimates are inconsistent with projections available elsewhere, truth on the market exists, and the conflicting information discounts the excessively optimistic statements of the corporation, lessening the impact on market price.[202] Courts should also consider the source of the information to be another important element in the determination of materiality, although most private securities fraud claims are based on official corporate sources such as officers, directors, internal public relations departments, outside public relations firms, or other such designated representatives.[203]

The vagueness of the language has an impact on the materiality of the statement to the extent that the statement does not affect an investor's risk assessment or estimations of the corporation's future financial performance.[204] Where the statement adds information not otherwise available to the market and would influence the market price of a security, the court will find the statement material and permit the securities fraud claim to proceed to trial.

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201. *See supra* note 83 and accompanying text (describing the Supreme Court's *Basic* holding that materiality should be determined in light of the total mix of information available to the market).

202. *See In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1116 (9th Cir. 1989) (failing to hold Apple Computer liable for optimistic statements when the market had sufficient information from press sources to undermine any positive effect the corporate statements may have had). Strict construction of this factor may result in bias against companies agreeing with analysts and the press; however, the bias may be justified, as investors do consider information coinciding with market estimates more reliable than statements to the contrary.

203. *See, e.g.*, Grossman v. Novell, Inc., 120 F.3d 1112, 1121 (10th Cir. 1997) (considering the context in which allegedly misleading statements were made); *supra* note 31 (listing cases that focus on the vague language of corporate representatives).

204. *See, e.g.*, Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1218-19 (1st Cir. 1996) (finding that the statements would not have affected a reasonable investor's investment decision and, thus, were not actionable); *In re* Royal Appliance Sec. Litig., No. 94-3284, 1995 U.S. App. LEXIS 24626, at *7 (6th Cir. Aug. 15, 1995) (same); Searls v. Glasser, 64 F.3d 1061, 1066 (7th Cir. 1995) (same); Raab v. General Physics Corp., 4 F.3d 286, 289-90 (4th Cir. 1993) (same); Simon v. American Power Conversion Corp., 945 F. Supp. 416, 428-29 (D.R.I. 1996) (same); Schaffer v. Timberland Co., 924 F. Supp. 1298, 1314 (D.N.H. 1996) (noting that vague statoments are not actionable).

VI. CONCLUSION

Contemporary financial markets compel corporations to make forward-looking statements predicting future performance. Unfortunately, so long as uncertainty remains a fixture in the corporate landscape, some of these forward-looking statements will inevitably fail to materialize. When the discrepancies between these statements and the corporation's actual performance induce significant reductions in the market's valuation of the company's stock, shareholders likely will file a private securities litigation class action suit. To prove such a claim, the shareholders must show that these forward-looking statements were material, otherwise their claims will be dismissed on motion to dismiss or on summary judgment.

After analyzing the methods employed by different courts to determine the immateriality of forward-looking statements on summary judgment, this Note concludes that some forward-looking statements will be so vague that the market will not rely on them. Whether these forward-looking statements rise to the level of a guarantee is irrelevant to this determination of immateriality as a matter of law. Furthermore, not all vague statements are per se immaterial as a matter of law; thus, courts should also consider such vague statements in the context of the information available to the markets. Courts should dismiss securities fraud claims based on such contextually immaterial puffing statements to save all parties from enduring the lengthy and expensive litigation process.

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