Cooley

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On June 30, 2010, the Ninth Circuit decided *In re Cutera Securities Litigation,* an important case clarifying and strengthening the "safe harbor" for forward-looking statements issued by public companies. The court made it clear that if a company provides sufficient cautionary language surrounding the forward-looking statements, the statements cannot form the basis for a securities fraud claim, regardless of the alleged state of mind of the defendants.

Introduction

Prior to Congress's enactment of the Private Securities Litigation Reform Act (PSLRA) in 1995, it was relatively easy for shareholders to pursue fraud claims under the federal securities laws, based on little more than generalized allegations that defendants had recklessly or knowingly issued false statements. This problem was particularly acute in relation to projections; if the hoped-for results did not materialize, it was easy for investors to allege that the projection had been made recklessly, and it was difficult for defendants to persuade courts to dismiss these cases at an early stage.

The PSLRA "safe harbor"

One of the key innovations of the PSLRA was the creation of a statutory "safe harbor" for forward-looking statements. The safe harbor contains three separate tests, stated disjunctively; if any one of the test is met, the statement cannot give rise to liability. Under the first test, a forward-looking statement is protected if it is "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." Under the second test, the statement is protected if it is immaterial. Under the third test, it is protected if the plaintiff is unable to prove that the statement was made with actual knowledge that it was false.

Following the enactment of the PSLRA, most of the cases and commentary focused on the first test, as companies and their advisors grappled with how to craft "meaningful cautionary statements" that would immunize their disclosures from fraud claims. It soon became clear, for example, that mere boilerplate would not suffice. Companies need to craft cautionary language that is specific to the particular risk, and must be alert to the need to change the language when the nature of the risks changes.

The Court's holding

Cutera, however, focused on a different question: if a forward-looking statement is material, and the cautionary statements are sufficient to bring it under the safe harbor, can a plaintiff nonetheless defeat the safe harbor (and avoid an early dismissal of her claims) by making sufficiently strong allegations that the defendant actually knew the forward-looking statement was false? The Court answered this question with a resounding "No." It reached this conclusion from the statutory language itself: because the three tests had been set forth disjunctively, the satisfaction of any one of them required the complaint to be dismissed.

A brief discussion of the facts of the case suggests how important this result is. In January 2007, Cutera, Inc., which sells medical lasers, announced its 2006 fourth-quarter and annual financial results, and 2007 first quarter and yearly financial projections, via press release and conference call. At that time, the company stated that it was realigning its sales organization because while its senior sales force had generally been successful, the junior sales force had not been as productive as hoped. It also warned that its ability to compete and perform in the future depended on the selling ability of its sales force, and that failure to attract and retain sales and marketing personnel would materially harm its ability to compete and to grow. Three months later, in May 2007, Cutera announced that it had failed to meet its first-quarter revenue projections, explaining that the causes of the shortfall included the unsuccessful implementation of a sales program and unusually high sales employee turnover.

In their attempt to sustain their complaint, the plaintiffs presented evidence attributed to "confidential witnesses" suggesting that the company had been aware in January of problems within the sales force. The court held, however, that because of the Company's specific statements about past problems with the sales force, and its affirmative warnings about its dependence on the future performance of the sales force, the evidence offered by the plaintiffs was not enough to take the first-quarter projections outside the safe harbor. In other words, because the company had used sufficient cautionary language, the case could be decided solely under the first of the three "safe harbor" tests, and *the defendants' state of mind of was irrelevant.*

Other federal appeals courts had already reached this conclusion, but in the Ninth Circuit (which covers nine Western States including California), the answer was unclear. In fact, in a 2003 case, the Ninth Circuit hinted in a footnote that "a strong inference of actual knowledge" could take a forward-looking statement outside of the safe harbor, no matter what cautionary language had been used. The court in *Cutera,* however, dismissed that suggestion as "dicta" and specifically criticized several lower-court cases that had followed it.

Conclusion

The PSLRA's "safe harbor" contains strong protections for companies that pay careful attention to the language surrounding their statements about the future. The *Cutera* case is one more welcome sign that the statutory language has some teeth, and that companies that craft strong forward-looking disclosures can obtain a measure of lawsuit protection.

Key Contacts

Koji Fukumura San Diego	kfukumura@cooley.com +1 858 550 6008
Alan Levine New York	alevine@cooley.com +1 212 479 6260