

THE PROBLEM OF MEANINGFUL LANGUAGE: SAFE HARBOR PROTECTION IN SECURITIES CLASS ACTION SUITS AFTER *ASHER V. BAXTER*

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INTRODUCTION

In any class action involving securities fraud, one of two negative consequences will inevitably follow: more fraud or more extortion.¹ If the court blocks a class of plaintiffs from conducting the discovery required to substantiate their allegations of fraud, a potentially meritorious suit will fail. On the other hand, if the court permits the plaintiff to conduct expensive discovery, the courts will encourage future “strike suits”² that extract unde-

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¹ See *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 264 (2d Cir. 1993) (noting that the central tension in securities class action suits is between the goals of allowing the victims of securities fraud to pursue a potentially meritorious claim and deterring expensive litigation in a losing suit).

² A strike suit is defined as a suit that is “often based on no valid claim, brought either for nuisance value or as leverage to obtain a favorable or inflated settlement.” BLACK’S LAW DICTIONARY 1448 (7th ed. 1999). The classic strike suit typically follows after corporate disclosure paints a rosy picture. Soon

served settlements from deep-pocketed defendants.³ How to strike the optimal minimization of either danger—without stifling corporate disclosure of vital investor information from potential corporate defendants—has been a fundamental question with which legislators, courts, and scholars have struggled.⁴

In *Asher v. Baxter International Inc.*,⁵ the Seventh Circuit weighed in. For the first time, the court, in a decision written by Judge Frank Easterbrook, interpreted the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (PSLRA or Reform Act).⁶ As discussed below, this decision split the circuit courts.⁷

Among the PSLRA's provisions aimed at curbing nuisance litigation related to strike suits were immunizations⁸ for companies that attach "meaningful cautionary statements"⁹ to any forward-looking statements¹⁰. In case corporate promises of future performance go unfulfilled, the PSLRA's safe harbors can protect a company from liability. The *Asher* decision, which turned on a new interpretation of the "meaningfully cautionary statements" requirement, bent the contours of this safe harbor into a new and previously unknown shape.¹¹

The PSLRA case law now features two competing interpretations, one broad and one narrow, of the standard under which companies can claim

afterwards, the firm reveals that the corporate situation is no longer as flawless as it might have seemed, causing a precipitous drop in stock prices. Plaintiffs, in a race to the courthouse, file suit alleging that company statements were either misleading or deceptive. See also Milt Policzer, *They've Cornered the Market: A Few Firms Dominate the Derivative-Suit Arena*, NAT'L L.J., Apr. 27, 1992, at 1 (detailing a study of forty-six class actions and reporting that roughly 25% of plaintiffs filed within one day of any corporate disclosure of negative news and, furthermore, almost 70% within one week).

³ A notorious example of this type of lawsuit is that detailed in *In re Philip Morris Sec. Litig.*, 872 F. Supp. 97, 98 (S.D.N.Y. 1995). The court noted that the first securities class action suits were filed less than five hours after Philip Morris announced that it expected profits to fall by 40%.

⁴ See, e.g., James D. Cox, *The Social Meaning of Shareholder Suits*, 65 BROOK. L. REV. 3 (1999); Geoffrey P. Miller, *Payment of Expenses in Securities Class Actions: Ethical Dilemmas, Class Counsel, and Congressional Intent*, 22 REV. LITIG. 557 (2003); E. Norman Veasey, *The Role of Corporate Litigation in the Twenty-First Century*, 25 DEL. J. CORP. L. 131 (2000).

⁵ 377 F.3d 727 (7th Cir. 2004).

⁶ Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified in various sections of the Securities Act of 1933, 15 U.S.C. § 77a (1996), and the Securities and Exchange Act of 1934, 15 U.S.C. § 78a (1996)).

⁷ See *Harris v. Ivax Corp.*, 182 F.3d 799 (11th Cir. 1999) (affirming a dismissal under the safe harbor provision of the PSLRA); *Helwig v. Vencor, Inc.*, 251 F.3d 540 (6th Cir. 2001) (en banc) (adopting the *Harris* rule).

⁸ The PSLRA's safe harbors really involve three distinct types of safe harbors. For an excellent discussion, see Joel Seligman, *The Private Securities Reform Act of 1995*, 38 ARIZ. L. REV. 717, 733 (1996).

⁹ 15 U.S.C. §§ 77z-2(a), 78u-5(a) (2000).

¹⁰ See 15 U.S.C. § 78u-5c(4)(I)(1)(A) (2000) (defining a forward-looking statement, in part, as "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").

¹¹ 377 F.3d 727, 734–35 (7th Cir. 2004).

safe harbor protections.¹² Before *Asher*, companies that warned investors even generally of “significant” corporate dangers—whether those dangers were realized or not—entered into the safe harbor.¹³ In *Asher*, however, the court restricted the statute’s seemingly broad protection: If investors could raise even the “possibility” that important corporate dangers were omitted from the cautionary language, safe harbor protection was eliminated.¹⁴

Coming from one of the most important business-law judges of the 20th century,¹⁵ Judge Easterbrook’s rejection of the majority standard is bound to have major consequences for corporate disclosure around the country;¹⁶ the decision augurs a deepening circuit split.¹⁷ The additional ambiguity results in higher stakes, since a number of circuits in which elevated numbers of securities class action suits are typically filed have not yet interpreted the provision.¹⁸

The injection of additional uncertainty into the law makes any corporate disclosure to the public fraught with greater risks of liability.¹⁹ The additional ambiguity will likely give rise to two major issues. First, courts and companies will struggle with the problem of how to interpret *Asher* in order to safely identify the important risk factors that must accompany predictions about future earnings. Second, given the high-stakes liability that may follow the release of information to the public, companies must now

¹² See discussion *infra* Part II.A.

¹³ *Ehlert v. Singer*, 245 F.3d 1313 (11th Cir. 2001); *Harris v. Ivax Corp.*, 182 F.3d 799, 807 (11th Cir. 1999) (noting that “when an investor has been warned of risks of a significance similar to that actually realized, she is sufficiently on notice of the danger of the investment to make an intelligent decision about it according to her own preferences for risk and reward”); see also *Helwig v. Vencor, Inc.*, 251 F.3d 540, 559 (6th Cir. 2001) (adopting the Eleventh Circuit’s standard for “meaningful cautionary statements”).

¹⁴ 377 F.3d at 734–35.

¹⁵ Mitu Gulati, Jeffrey J. Rachlinski & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773, 796 (2004) (identifying Judges Easterbrook and Friendly as standing “among the most prominent business-law judges of the past century”).

¹⁶ Phyllis Plitch, ‘Safe Harbor’ May Offer No Protection, WALL ST. J., Sept. 8, 2004, at C3 (noting that lawyers expect Judge Easterbrook’s reputation to carry weight within the business world).

¹⁷ Judge Easterbrook has written several important securities law cases, including *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509 (7th Cir. 1989), *Pommer v. Medtest Corp.*, 961 F.2d 620 (7th Cir. 1992), and *Jordan v. Duff and Phelps, Inc.*, 815 F.2d 429 (7th Cir. 1987). Historically, his opinions have been influential with other courts. For example, fraud-by-hindsight cases rely heavily on his articulation of the doctrine. See Gulati, Rachlinski & Langevoort, *supra* note 15, at 798–99.

¹⁸ The Second Circuit is important because of the high concentration of financial services firms, the Ninth Circuit is important because of the high concentration of technology firms that have traditionally been the target of “strike suits,” and the Fourth Circuit is notable because of its growing number of high technology companies. For greater detail on where securities class actions are filed, see Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 942–47.

¹⁹ See FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 302 (1991) (noting that firms cannot know until well after the moment of disclosure whether or not the information was sufficient, proper, and within the boundaries of the law).

determine whether the legal uncertainty surrounding corporate disclosure is enough to entirely junk the practice of making forward-looking statements.

This Note evaluates *Asher*'s implications for corporate liability arising from forward-looking statements. It traces the legislation's history, details the different circuit standards, and locates the source of the circuit split in Judge Easterbrook's divergent interpretation of the Reform Act's statutory language.²⁰ This Note further argues that *Asher* was wrongly decided because the court failed to follow the legislature's express intent. In addition, this Note argues that the policy implications of *Asher* fail to show any clear upside. *Asher* risks stifling corporate disclosure without creating any incentives for companies to improve the quality of cautionary statements.

This Note proceeds as follows. Part I reviews the PSLRA and the legislative battle that preceded and followed President Clinton's initial veto. In particular, Part I analyzes the little-discussed relationship between the presidential veto, the safe harbor provisions, and Congress's success in overriding the veto. This discussion will lay the foundation for a criticism of Judge Easterbrook's trivialization of the PSLRA's statutory language and his rejection of the statute's legislative history as a tool in resolving the statutory ambiguity.

Part II summarizes the case law interpreting the safe harbor provision and concludes that Judge Easterbrook's unusual decision fails to follow the legislative history, the statutory language, or the case law. Part II.A reviews what used to be the leading case, *Harris v. Ivax*,²¹ and Part II.B details *Asher v. Baxter*.²² Part II.C analyzes the *Asher* decision, highlighting Judge Easterbrook's inaccurate account of the Reform Act's legislative history and explaining the obscure meta-rule upon which Judge Easterbrook relied when construing the statute.

Part III sketches out the informational signals between companies and the marketplace, and examines how *Asher* affects the clarity or noise of those signals. Part III also describes the danger of judicial error in attempting to amplify or filter those signals.

Finally, this Note concludes that the decision was made without any apparent basis in empirical data, case law, congressional intent, or statutory language.

²⁰ See discussion *infra* Part II.

²¹ 182 F.3d 799 (11th Cir. 1999).

²² 377 F.3d 727 (7th Cir. 2004).

I. A HISTORY OF THE PSLRA

A. *The Perceived Need for Securities Litigation Reform*

Congress designed the Reform Act to promote the increased disclosure of company information to the markets.²³ This information makes it easier for investors to evaluate the desirability of their potential investments, and helps companies pursue investors and raise capital, thereby facilitating the process by which investors and companies transact with each other.²⁴ By protecting this disclosure, Congress hoped to encourage high-quality companies to tell the marketplace about their probabilities of future profits.

But, for companies issuing forward-looking projections, the disclosures could carry enormous potential costs. Even if such information could help investors and companies, the additional information has the potential to increase a company's liability. In the late 1980s and early 1990s, companies began to defend against a perceived increase in the number of class action securities suits.²⁵ It was further thought that, whether such class action suits had merit or not, investors calculated the enormous potential costs of the litigation and the possibility of a negative outcome into the stock price, and severely punished companies as soon as news of a complaint hit the market.²⁶

The abusive litigation was also thought to restrict the "robustness and candor of disclosure,"²⁷ thereby threatening the amount of information that investors could use to assess the future value of their investments.²⁸ When

²³ See S. REP. NO. 104-98, at 5 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 684 ("S.240 is intended to encourage the voluntary disclosure of information by issuers.").

²⁴ See EASTERBROOK & FISCHER, *supra* note 19, at 279–80.

²⁵ See, e.g., H.R. REP. NO. 98-355, at 6 (1983) ("In recent years, the securities markets have grown dramatically in size and complexity, while Commission enforcement resources have declined."). However, this belief has been widely attacked and debunked. See, e.g., JOHN C. COFFEE, JR. & JOEL SELIGMAN, *SECURITIES REGULATION* 1218 (9th ed. 2003) ("[T]he claim that the volume of securities litigation was dramatically accelerating has proven least tenable.").

²⁶ See Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497 (1991). This hypothesis "captured the attention of both scholars and legislators." Marilyn F. Johnson, Karen K. Nelson & A.C. Pritchard, *Do the Merits Matter More? Class Actions Under the Private Securities Litigation Reform Act* (John M. Olin Ctr. for Law & Econ., Univ. of Mich. Law Sch., Working Paper No. 02-011, 2002), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=349500. A hot academic debate followed, and Professor Alexander's hypothesis was discredited. See, e.g., Joel Seligman, *The Merits Do Matter: A Comment on Professor Grundfest's "Disimplying Private Rights of Action Under the Federal Securities Laws: The Commission's Authority"*, 108 HARV. L. REV. 438, 453 (1994) (attacking Professor Alexander's sample size of six as statistically insignificant).

²⁷ See H.R. REP. NO. 104-369, at 42–43 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730, 741–42 (Statement of Managers—The "Private Securities Litigation Reform Act of 1995") [hereinafter Statement of Managers].

²⁸ There is a potential danger that a vicious cycle could develop, as successful litigation encourages other potential plaintiffs to seek out opportunities to file other lawsuits. Combined with the dynamics discussed *infra* note 39, incentives encourage increasing numbers of weak lawsuits, thus encouraging

capital markets reflect information efficiently, “[u]nderstanding a company’s own assessment of its future potential would be among the most valuable information . . . investors could have about a firm.”²⁹ As widely noted, investors want to know what a company will do tomorrow, not what it did yesterday.³⁰

Spurred on by stories of strike suits³¹ and the “muzzling”³² of corporate America, Congress enacted the controversial PSLRA. Included among the provisions aimed at deterring litigation abuses are: (1) the safe harbor provision;³³ (2) heightened pleading standards for securities class actions;³⁴ and, importantly, (3) a provision requiring courts to stay discovery during a summary judgment motion involving a covered forward-looking statement.³⁵

Because discovery is both expensive for companies and burdensome on management employees and other personnel, special emphasis was placed on protecting companies against discovery.³⁶ Protection from discovery compares to armor in war.³⁷ Typically, discovery battles are decided by attrition, and the enormous expenditures in both time and money make fighting a securities fraud suit—rather than quickly settling a case—difficult to justify.³⁸ Moreover, even if a company can easily bear discovery costs, the “bet-the-company” stakes that typify securities class actions can

the problem of rent-seeking behavior. Because more plaintiffs would individually benefit from engaging in litigation that generates social waste for everyone, this rent-seeking would generate other lawsuits and further discourage corporate disclosure. See DAVID D. FRIEDMAN, *LAW’S ORDER: WHAT ECONOMICS HAS TO DO WITH LAW AND WHY IT MATTERS* 32–35 (2000).

²⁹ Statement of Managers, *supra* note 27, at 43; see also Daniel R. Fischel, *Efficient Capital Markets, the Crash, and the Fraud on the Market Theory*, 74 CORNELL L. REV. 907, 917–22 (1989).

³⁰ *E.g.*, *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 514 (7th Cir. 1989) (“Investors value securities because of beliefs about how firms will do tomorrow, not because of how they did yesterday.”).

³¹ See COFFEE & SELIGMAN, *supra* note 25, at 1217–18 (citing, *inter alia*, the perception of an epidemic of meritless securities class actions that profited plaintiffs’ lawyers at the expense of class members).

³² Statement of Managers, *supra* note 27, at 42–43 (“Fear that inaccurate projections will trigger the filing of securities class action lawsuit [sic] has muzzled corporate management.”).

³³ 15 U.S.C. § 78u-5(c)(1)(A)(i) (2004).

³⁴ *Id.* § 78u-4(b)(2).

³⁵ *Id.* § 78u-4(b)(3).

³⁶ Statement of Managers, *supra* note 27, at 37 (stating that the provision allowing for the stay on discovery was designed to prevent “fishing expedition” lawsuits that forced “innocent parties to settle frivolous securities class actions”).

³⁷ See Frank H. Easterbrook, *Discovery as Abuse*, 69 B.U. L. REV. 635 (1989) (comparing discovery to trench warfare in World War I).

³⁸ Up to 80% of total litigation costs can be attributed to discovery. S. REP. NO. 104-98, at 14 (1995), reprinted in 1995 U.S.C.C.A.N. 679, 693 (quoting *Securities Litigation Reform Proposals: Hearing on S. 240, S. 667 and H.R. 1058 Before the Subcomm. on Sec. of the S. Comm. on Banking, Housing, and Urban Affairs*, 104th Cong. 52 n.17 (1995) (statement of J. Carter Beese, Jr., Chairman, Capital Markets Regulatory Reform Project, former Chairman of the Securities and Exchange Commission, Center for Strategic and International Studies) (internal citations omitted)).

make settlement a foregone conclusion—even when the action lacks merit.³⁹ These dynamics were thought to create both a strong incentive to settle meritless cases⁴⁰ and a disincentive to release company information that might serve as grounds for future liability.⁴¹ In this way, opportunistic plaintiffs squeezed corporate efforts to raise capital and investor efforts to generate wealth.

The hearings that led to the Reform Act's passage included war stories⁴² from the private sector that worried Congress; it was widely believed that the merits of these strike suits were weak compared to the settlement value.⁴³ Congress believed that the essential problem with securities litigation was the “muzzle” imposed by the bullying actions filed by the plaintiff's bar.⁴⁴ In seeking to adopt an especially protective safe harbor, the legislative history shows Congress's intent clearly: Tear away this muzzle.⁴⁵

B. The Legislative History of the PSLRA

On January 4, 1995, as a component of the Republican Party's “Contract with America,” the Common Sense Legal Reforms Act of 1995 was introduced in the House of Representatives.⁴⁶ The proposal was impressive in the scope of its protections for corporate disclosure.⁴⁷ The proposed bill

³⁹ A company that faces a 10% chance of losing a \$500 million case will discount the possible award by the probability of losing, and settle the case for an amount less than \$50 million. See, e.g., Richard Craswell, *Deterrence and Damages: The Multiplier Principle and its Alternatives*, 97 MICH. L. REV. 2185, 2186–87 (1999) (calculating the probability of a certain event by multiplying the probability of the event's occurrence by the stakes of the event).

⁴⁰ See, e.g., David Rosenberg & Steven Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3, 3–4 (1985).

⁴¹ See, e.g., *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Sec. of the S. Comm. on Banking, Housing & Urban Affairs*, 103d Cong. 3 (1993) (statement of Sen. Riegle, Member, S. Comm. on Banking, Housing & Urban Affairs) (noting securities litigation “raises the cost of capital formation and [puts] our firms often at a competitive disadvantage”); *id.* at 12 (statement of Edward R. McCracken, President, Silicon Graphics, Inc.) (criticizing such litigation as “an uncontrolled tax on innovation”).

⁴² See, e.g., *supra* notes 38, 41 and accompanying text.

⁴³ The belief gained traction after the publication of a controversial article by Stanford Law School Professor Janet Cooper Alexander. See Alexander, *supra* note 26 (arguing that the strength of the case was largely irrelevant to the amount of the settlement). To see why the merits are thought to matter, see Seligman, *supra* note 26.

⁴⁴ Richard H. Walker, David M. Levine & Adam C. Pritchard, *The New Securities Class Action: Federal Obstacles, State Detours*, 39 ARIZ. L. REV. 641, 642 (1997) (“A brief review of the legislative history makes clear . . . that Congress did take sides, crediting the arguments of critics who asserted that plaintiffs' lawyers were the central problem with private securities litigation.”).

⁴⁵ Statement of Managers, *supra* note 27, at 42–45 (“The Conference Committee has adopted a statutory ‘safe harbor’ to enhance market efficiency by encouraging companies to disclose forward-looking information.”).

⁴⁶ H.R. 10, 104th Cong. (1995).

⁴⁷ See *id.*

contained rules forcing the loser to pay legal costs,⁴⁸ shielded almost completely any forward-looking statements,⁴⁹ and included scienter standards that were higher than required by any of the courts at the time.⁵⁰

1. Initial Conflict with the SEC.—The proposal, as well as its later iterations, provoked strong opposition.⁵¹ Criticizing one version⁵² as “so broad and inflexible that it may compromise investor protection and market efficiency,”⁵³ the then-Chairman of the Securities and Exchange Commission (SEC), Arthur Levitt, was widely known to disagree with the initial formulation of the safe harbor provisions.⁵⁴

Moreover, the proposed bill encroached on SEC rulemaking. The SEC was considering an expansion of the existing safe harbor rule⁵⁵ at the time the proposed bill was introduced.⁵⁶ However, the SEC’s proposed safe harbor was not seen as offering sufficient protection against strike suits.⁵⁷ Although the SEC lobbied Congress to defer to the Commission’s expertise, it had only limited success.⁵⁸ Congress moved forward, aggressively expanding safe harbor protections past the likely limits that the SEC would have drawn.⁵⁹

Nevertheless, sustained SEC efforts to limit these protections had some effect.⁶⁰ Subsequent iterations of the safe harbor provisions featured what

⁴⁸ See *id.* The bill featured the “English” system, which awarded “reasonable attorneys’ fees to the prevailing party in any private action under the Exchange Act.” John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW. 335, 348 (1996).

⁴⁹ See H.R. 10. The bill eliminated secondary liability as well as liability for recklessness in private actions under Section 10(b). Avery, *supra* note 48, at 348.

⁵⁰ See H.R. 10. The bill required “actual knowledge of and reliance on a misstatement . . . which would have effectively eliminated fraud-on-the-market claims.” Avery, *supra* note 48, at 348.

⁵¹ E.g., Dominic Bencivenga, *Securities Litigation: Experts Question New Law’s Ability to Reform*, N.Y. L.J., Nov. 30, 1995, at 5 (citing criticism from prominent securities lawyers, including the Association of the Bar of the City of New York’s Securities Regulation and Federal Courts committees and former Columbia Law School Professor and current Securities and Exchange Commissioner Harvey Goldschmid).

⁵² H.R. 1058, 104th Cong. (1995).

⁵³ 141 CONG. REC. 17,234 (1995).

⁵⁴ See, e.g., Barbara Moses & Rachel K. Jeck, *Securities Litigation Reform*, REV. OF SEC. & COMMODITIES REG., Feb. 22, 1995, at 31 (“SEC Chairman Arthur Levitt (who was apparently not invited to testify during the initial subcommittee hearings) . . . warned in a speech that the GOP was about to throw the baby out along with the bathwater.”).

⁵⁵ 17 C.F.R. § 230.175 (1998) (Rule 175).

⁵⁶ Avery, *supra* note 48, at 354.

⁵⁷ Steven J. Spencer, Note, *Has Congress Learned its Lesson? A Plain Meaning Analysis of the Private Securities Litigation Reform Act*, 71 ST. JOHN’S L. REV. 99, 110 (1997).

⁵⁸ Carl W. Schneider & Jay A. Dubow, *Forward-Looking Information—Navigating in the Safe Harbor*, 51 BUS. LAW. 1071, 1084 (1996).

⁵⁹ *Id.* (noting that the Contract with America philosophy motivated Congress to take up legislative proposals that were “far beyond” the protections that the SEC would likely adopt).

⁶⁰ *Id.* (“[T]he final version contains many exclusions and other changes advocated by the [SEC].”).

Chairman Levitt termed a “workable balance”⁶¹ between encouraging disclosure and preventing abuse. Chairman Levitt emphasized the need “of legitimate businesses to have a mechanism for early dismissal of frivolous lawsuits” and “a viable safe harbor [that] . . . excludes the greatest opportunities for harm to investors.”⁶² As a result of these modifications, the SEC shifted its support in favor of the legislation in November of that year.⁶³ This support was widely seen as a reliable indicator that the President would support the bill.⁶⁴

2. *The Conference Report, the Floor Debates, and the Act Passes.*—

Produced and adopted after nearly five months of negotiations, the Conference Report was subsequently filed on November 28.⁶⁵ House and Senate conferees framed the report with a strong denouncement of four problems targeted by the bill:

(1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer’s stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent.⁶⁶

Addressing the safe harbor provisions, the report laid out two prongs.⁶⁷ The first prong, itself operating in two parts, protected (i) statements that are identified as forward-looking statements if (ii) accompanied by sufficient cautionary language.⁶⁸ The second prong, which is outside of the scope of this Note, protected the defendant so long as the plaintiff failed to prove that the defendant acted with actual knowledge.⁶⁹ The Conference Report also included instructions for interpreting the first prong, stating that “[t]he cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those

⁶¹ 141 CONG. REC. 35,240 (1995) (letter from Arthur Levitt to Senator Alfonse D’Amato).

⁶² *Id.*

⁶³ *Id.* But see *id.* at 17,935 (letter from Arthur Levitt to the Los Angeles Times stating that “[t]he article is wrong in reporting that I now support the litigation reform bill”).

⁶⁴ Bencivenga, *supra* note 51, at 5; cf. John C. Coffee, Jr., *Safe Harbor for Forward-Looking Statements*, N.Y. L.J., Nov. 30, 1995, at 5 (“Only those who also believe in the tooth fairy still expect a presidential veto of the Private Securities Litigation Reform Act of 1995.”).

⁶⁵ 141 CONG. REC. 34,745 (1995).

⁶⁶ Statement of Managers, *supra* note 27, at 31.

⁶⁷ *Id.* at 43.

⁶⁸ *Id.*

⁶⁹ *Id.*

projected in the forward-looking statement, such as, for example, information about the issuer's business."⁷⁰ Although the Conference Committee failed to define specific cautionary statements that would qualify for the safe harbor, it did include guidance for courts in the judicial analysis of what constitutes a "meaningful cautionary statemen[t]":

'Important' factors means the stated factors identified in the cautionary statement must be relevant to the projection and must be of a nature that the factor or factors *could* actually affect whether the forward-looking statement is realized.

The Conference Committee expects that the cautionary statements identify important factors that could cause results to differ materially—but not all factors. *Failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor.* The Conference Committee specified that the cautionary statements identify "important" factors to provide guidance to issuers and *not to provide an opportunity for plaintiff counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made.*⁷¹

This language indicates that the safe harbor should protect defendants from discovery, even when the factors that caused the forward-looking statements to go amiss were not originally included in the cautionary language.

On December 5, 1995, the Senate considered the passage of the final version of the bill. The debate—both for and against⁷²—on all four of the Conference Report's goals⁷³ was considerable. Notable in the debate were comments by one of the Senators who originally introduced the bill, Senator Pete Domenici (R-NM). Envisioning the future interpretation of the first prong of the safe harbor provisions, he stated,

Courts should not read the word important to mean that plaintiffs are entitled to large-scale discovery on the issue of which factors the company believed were important. Courts should simply look at the four corners of the predictive statement, as well as the information about the company already in the market, and determine whether investors should have relied on the predictive statement.⁷⁴

Senator Domenici's explication was important because, when analyzing the legislative history, courts give greater weight to the statements made by a

⁷⁰ *Id.*

⁷¹ *Id.* at 43–44 (emphasis added).

⁷² *E.g.*, 141 CONG. REC. 35,243 (1995) (statement of Sen. D'Amato) ("Projections by corporate insiders will be protected no matter how unreasonable, no matter how misleading, no matter how fraudulent, if accompanied by boilerplate, cautionary language.").

⁷³ *See supra* note 66 and accompanying text.

⁷⁴ 141 CONG. REC. 35,276 (1995) (statement by Sen. Domenici).

bill's sponsors.⁷⁵ Following the debate on the floor, the Senate passed the bill sixty-five votes to thirty.⁷⁶

On December 6, the very next day, the House of Representatives considered the passage of the House Conference Report.⁷⁷ Debate on the safe harbor provisions was heated. For example, Representative Dingell (D-MI) called the passage of the bill “the most scandalous and outrageous abuse of the legislative and conference process that I have ever seen in this institution.”⁷⁸ Representative Dingell’s strong language failed to persuade his colleagues: The House passed the conference bill in a veto-proof vote of 320 to 102.⁷⁹ After digesting some twelve congressional hearings and testimony that was transcribed in some 5,000 pages, Congress sent the bill to the President.⁸⁰

3. *The President Vetoes the PSLRA for its Legislative History, and Congress Overrides the Veto.*—Because Congress was in session, the President had ten days to veto the bill.⁸¹ With less than one hour to pass before the bill would automatically become law, President Clinton, in a surprise to many,⁸² delivered a veto on December 19.⁸³ Curiously, in his veto message, the President stated his support for the legislation’s goals, as well as the statutory language.⁸⁴ Instead, writing that the bill “will have the effect of closing the courthouse door on investors who have legitimate claims,”⁸⁵ the President objected to language in the Statement of Managers, further stating:

[W]hile I support the language of the Conference Report providing a “safe harbor” for companies that include meaningful cautionary statements in their projections of earnings, the Statement of Managers—which will be used by courts as a guide to the intent of the Congress with regard to the meaning of the bill—attempts to weaken the cautionary language that the bill itself requires.⁸⁶

⁷⁵ See *infra* text accompanying note 89; see also *infra* Part I.C.

⁷⁶ 141 CONG. REC. 35,304 (1995).

⁷⁷ *Id.* at 35,556.

⁷⁸ *Id.*

⁷⁹ *Id.* at 35,571.

⁸⁰ *Id.* at 35,259 (statement of Sen. Dodd).

⁸¹ U.S. CONST. art I, § 7.

⁸² Anne Kates Smith, *Some Call it Securities Reform*, U.S. NEWS & WORLD REP., Nov. 13, 1995, at 117 (noting that “Washington insiders say a veto is possible but unlikely”).

⁸³ 141 CONG. REC. 37,797–98 (1995).

⁸⁴ *Id.* at 37,797 (“I support these goals. Indeed, I made clear my willingness to support the bill passed by the Senate with appropriate “safe harbor” language, even though it did not include certain provisions that I favor—such as enhanced provisions with respect to joint and several liability, aider and abettor liability, and statute of limitations.”).

⁸⁵ *Id.*

⁸⁶ *Id.* at 37,798 (1995); see also *infra* notes 125–26 and accompanying text.

Although it did not specify what exactly was objectionable in the Conference Report language,⁸⁷ the President's veto message was extraordinary because it vetoed the Reform Act on the basis of the statute's legislative history rather than its language.⁸⁸ Although the Statement of Managers is often considered the most important piece of legislative history because it contains the views of its sponsors,⁸⁹ "[a] statement of managers is not law, everyone knows that."⁹⁰

The override was almost immediate. Only thirteen hours after the veto, after hearing many of the same arguments regarding the safe harbor provisions,⁹¹ the House voted to override by a margin of 319 to 100.⁹² All 230 Republicans voted to override, as well as 89 of 188 Democrats.⁹³

Two days later, the Senate took up the matter. The Senate also voted to override in a vote of sixty-eight to thirty.⁹⁴ Forty-eight Republican senators out of fifty-two and twenty Democratic senators out of forty-six voted to override.⁹⁵ As a result, on December 22, the PSLRA became law.⁹⁶

C. Analysis

The use of legislative history is sometimes disparaged with the cliché that it is "the equivalent of entering a crowded cocktail party and looking over the heads of the guests for one's friends,"⁹⁷ but many judges and scholars agree that an act's legislative history should be given great weight.⁹⁸ As

⁸⁷ 141 CONG. REC. 37,798 (1995).

⁸⁸ *Id.* at 38,214 (1995) (statement of Sen. Hatch) ("Now, the Constitution gives the President the authority to veto legislation, but nowhere does it give the President authority to veto legislative history. I think a veto on the grounds of legislative history in this case is extreme, especially in light of the clear language of the bill.").

⁸⁹ The Statement of Managers explains the conference committee's actions. George A. Costello, *Average Voting Members and other "Benign Fictions": The Relative Reliability of Committee Reports, Floor Debates, and Other Sources of Legislative History*, 1990 DUKE L.J. 39, 42 ("Statements by sponsors or drafters are most persuasive, views of other witnesses seldom carry much weight, and fears of opponents usually are dismissed as unreliable.").

⁹⁰ 141 CONG. REC. 38,205 (1995) (statement of Sen. Domenici).

⁹¹ *See, e.g., id.* at 37,798–806.

⁹² *Id.* at 37,807.

⁹³ *Id.*

⁹⁴ *Id.* at 38,354.

⁹⁵ *Id.*

⁹⁶ *See id.* at 37,807 (showing the voting roll for the override vote in the House); *id.* at 38,354 (showing the voting roll for the override vote in the Senate).

⁹⁷ *Conroy v. Aniskoff*, 507 U.S. 511, 519 (1993) (Scalia, J., concurring in the judgment) (noting that support in contrary positions can be found in most legislative histories).

⁹⁸ WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY & ELIZABETH GARRETT, *CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 947 (3d ed. 2001) (noting the consensus that committee reports in particular should be considered authoritative because "the collective statement by the members of the subgroup will represent the best-informed thought about what the proposed legislation is doing").

stated by Justice Breyer, “[t]o take from the courts the power to refer to legislative history . . . is to cut an essential channel for communications . . . a channel that runs from those affected by a law’s implementation, through courts and legislators, to those involved in the law’s creation.”⁹⁹

The Supreme Court has repeatedly relied on legislative history as an authoritative source on congressional intent.¹⁰⁰ Moreover, empirical evidence in the scholarship corpus bears out the proposition that an act’s legislative history significantly influences decisions by the courts.¹⁰¹ Of the various legislative histories, including conference committee reports, congressional hearings, and congressional debates, conference committee reports have been shown to be the most influential form, with congressional debates following closely behind.¹⁰²

Moreover, courts are free to consider the relevance of other forms of legislative history.¹⁰³ For example, the Supreme Court has, in the past, found the statements made by the sponsors of legislation important.¹⁰⁴ It has also examined the presidential veto message and subsequent overrides for helpful inferences.¹⁰⁵ Although, historically, there have been comparatively few cases where the Court has used a presidential veto to deduce leg-

⁹⁹ Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. CAL. L. REV. 845, 856 (1992).

¹⁰⁰ See, e.g., *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 610 n.4 (1991) (8-1 decision) (rejecting Justice Scalia’s “New Textualism”); *Garcia v. United States*, 469 U.S. 70, 76 (1984) (“[T]he authoritative source for finding the Legislature’s intent lies in the Committee Reports on the bill which ‘represent[t] the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation.’” (quoting *Zuber v. Allen*, 396 U.S. 168, 186 (1969))). But see Michael H. Koby, *The Supreme Court’s Declining Reliance on Legislative History: The Impact of Justice Scalia’s Critique*, 36 HARV. J. ON LEGIS. 369 (1999) (showing that citations in Supreme Court opinions to legislative history declined between 1980 and 1998).

¹⁰¹ See, e.g., ESKRIDGE, FRICKEY & GARRETT, *supra* note 98, at 957 (“Especially after the appointment of Justice Breyer (a big fan of legislative history), the Supreme Court has relied on legislative materials more often in the late 1990s and first part of the new century.” (citing Jane Schacter, *The Confounding Common Law Originalism in Recent Supreme Court Statutory Interpretation: Implications for the Legislative History Debate and Beyond*, 51 STAN. L. REV. 1 (1998); Charles Tiefer, *The Reconceptualization of Legislative History in the Supreme Court*, 2000 WIS. L. REV. 205)).

¹⁰² See Joseph A. Grundfest & A.C. Pritchard, *Statutes with Multiple Personality Disorders: The Value of Ambiguity in Statutory Design and Interpretation*, 54 STAN. L. REV. 627, 643 (2002) (citing Patricia M. Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term*, 68 IOWA L. REV. 195 (1983); Jorge L. Carrol & Andrew R. Brann, *The U.S. Supreme Court and the Use of Legislative Histories: A Statistical Analysis*, 22 JURIMETRICS J. 294 (1982); Nicholas S. Zeppos, *The Use of Authority in Statutory Interpretation: An Empirical Analysis*, 70 TEX. L. REV. 1073 (1992).

¹⁰³ Grundfest & Pritchard, *supra* note 102, at 644.

¹⁰⁴ *N. Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 526–27 (1982); *Nat’l Woodwork Mfgs. Ass’n v. NLRB*, 386 U.S. 612, 640 (1982).

¹⁰⁵ See *NLRB v. Robbins Tire & Rubber Co.*, 437 U.S. 214, 235 (1978).

islative intent, case law shows that, in situations where courts face difficult statutory interpretation questions, its use has been embraced.¹⁰⁶

1. *Consistent Signals of Legislative Intent in the Safe Harbor Provision.*—In interpreting the PSLRA, its legislative history has great explanatory power. As the product of years of congressional hearings and negotiations among legislators, the House Conference Report impounded the dynamics and concerns of many of its participants. To be sure, these very dynamics create some interpretational difficulties since the Reform Act's opponents may have blown up the consequences of the statute's language, just as supporters may have soft-pedaled their positions.¹⁰⁷ Nevertheless, one thing is clear: Not only did the report, which largely appears to be a product of bipartisan concerns, pass by substantial margins in both houses of Congress after considerable debate, but the legislation was promulgated over a presidential veto—the first override of President Clinton's administration.¹⁰⁸ The support that the PSLRA received through the legislative process evinces strong congressional support of the four problems targeted in the Statement of Managers.¹⁰⁹

The congressional support for interpreting broader protection in the safe harbor provisions is similarly clear. The House Conference Report,¹¹⁰ the congressional floor debates, and the override all bolster the contention that Congress intended for courts to interpret that language broadly. The analysis of all of these sources, particularly the veto override,¹¹¹ reveal a single, clear, and consistent message of the legislature's intent.¹¹²

2. *The Legislature's Explicit Instructions.*—First, and most explicitly, the legislature states its intent. The House Conference Report includes at least three express instructions. First, courts are to distinguish between boilerplate and cautionary language.¹¹³ Second, courts are to look for “important” factors that could cause actual results to differ from projected re-

¹⁰⁶ See Kathryn Marie Dessayer, Note, *The First Word: The President's Place in "Legislative History,"* 89 MICH. L. REV. 399, 412–17 (1990).

¹⁰⁷ But see Costello *supra* note 89, at 41–42 (noting that the fears of opponents are unhelpful in determining the legislative intent).

¹⁰⁸ See, e.g., Harvey L. Pitt, Karl A. Groskaufmanis, David B. Hardison & Dixie L. Johnson, *Promises Made, Promises Kept: The Practical Implications of the Private Securities Litigation Reform Act of 1995*, 33 SAN DIEGO L. REV. 845, 846 (1996).

¹⁰⁹ See *supra* note 66 and accompanying text.

¹¹⁰ See *supra* notes 52–67 and accompanying text.

¹¹¹ Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 541 (1947) (“If the purpose of construction is the ascertainment of meaning, nothing that is logically relevant should be excluded.”).

¹¹² Breyer, *supra* note 99, at 856–60 (arguing that courts should turn to a statute's legislative history to “choose among reasonable interpretations of a politically controversial statute”).

¹¹³ Statement of Managers, *supra* note 27, at 43 (stating that cautionary language must “convey substantive information about factors that realistically could cause results to differ materially from those projected in the forward-looking statement”).

sults.¹¹⁴ And, third, courts are to be wary of plaintiffs seeking to use the “meaningful cautionary” language as an opportunity to win discovery.¹¹⁵ By expounding in the House Conference Report on the principles that courts should use when reviewing a claim, Congress’s intent is made clear: Examine the forward-looking projections and the information on the market to see if an investor should have properly relied on the disclosures.¹¹⁶

3. *The Floor Debates.*—Second, the congressional debates also provide useful insight into the legislative intent, as the statements made during the floor debates are crucial to understanding and clarifying vague provisions.¹¹⁷ This is particularly true with the statements of sponsors, whose intentions and preferences were initially written into the legislation and, furthermore, who must assume the responsibility of explaining the statute’s design to the rest of the legislature.¹¹⁸ Thus, statements made by Senator Domenici, one of the Reform Act’s sponsors,¹¹⁹ explaining that courts should tend to restrict plaintiff’s access to discovery, should have greater persuasive value for courts interpreting the safe harbor provisions.¹²⁰

4. *Implications of the Veto Override.*—Third, Professors Grundfest and Pritchard have suggested that most of the Reform Act’s ambiguous and contradictory legislative history was limited to the scienter requirement in the second prong of the safe harbor provision¹²¹—a prong that operates in the disjunctive from the cautionary language requirement. If the legislature’s agreement to disagree over the Reform Act’s language was largely limited to the second prong,¹²² the override of the presidential veto suggests

¹¹⁴ *Id.* (“[C]autionary statements identify important factors that could cause results to differ materially—but not all factors.”).

¹¹⁵ *Id.* at 44 (stating that the identification of “important factors” is “not to provide an opportunity for plaintiff counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made”).

¹¹⁶ See *supra* note 74 and accompanying text.

¹¹⁷ Abner J. Mikva, *A Reply to Judge Starr’s Observations*, 1987 DUKE L.J. 380 (“[T]he real problem is that we start out with 435 prima donnas in the House and 100 prima donnas in the Senate, and the name of the game is to get them to agree on a single set of words.”).

¹¹⁸ See William N. Eskridge, *Textualism, the Unknown Ideal?*, 96 MICH. L. REV. 1509, 1559 (1998) (“Reading the legislative history puts the judge better in touch with the values, vocabulary, and policy choices of the authors of the statute—just as *The Federalist* does for the framers of the Constitution.”).

¹¹⁹ See *supra* text accompanying note 74.

¹²⁰ One analysis argues that the Reform Act might not have been enacted without the assurances of Senators Domenici and Dodd. Grundfest & Pritchard, *supra* note 102, at 658.

¹²¹ See *supra* text accompanying notes 67–69.

¹²² See Grundfest & Pritchard, *supra* note 102, at 666 (arguing that the crucial ambiguity in the statute is located in the scienter prong of the safe harbor provision, stating that “the legislation would not have been enacted but for the legislative agreement to disagree over the interpretation of the [scienter prong]”). By concluding that the legislative disagreement—both internally within Congress and externally to the other branches of government—was exclusive to the scienter prong, Professors Grundfest and Pritchard imply that congressional consensus existed over the cautionary language prong. See *id.*; see also *infra* note 131 and accompanying text.

that congressional and presidential consensus had coalesced around a single interpretation of the meaning of the “cautionary language” prong. The behavior of the actors in the aftermath of the veto shows that both the legislative branch and the executive branch agreed that the safe harbor should provide wider protections for defendants.

This analysis begins with the debates following the override. Because the veto message focuses on the section of the bill to which the President most objects, that section of the bill is also the focus of the congressional veto-override debates.¹²³ If the presidential veto message and the veto-override debates reveal that both Congress and the President agree on the President’s interpretation of the statute, then that very agreement tightly restricts the range of plausible court interpretations of congressional intent.¹²⁴ Put another way, if the veto-override debates accept the President’s interpretation of the bill, then courts can infer that both Congress and the President agree on the statute’s proper interpretation. Such an agreement can guide courts on how broadly or narrowly to interpret the scope of the safe harbor provision.

In the case of the PSLRA’s safe harbor, at least one commentator¹²⁵ believes that the President’s criticism of the safe harbor language was directed at the portion of the House Conference Report that reads:

The Conference Committee expects that the cautionary statements identify important factors that could cause results to differ materially—but not all factors. Failure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor.¹²⁶

Vetoing the bill partly because of the concern that courts would construe the PSLRA in a way that would “weaken the cautionary language” required of companies,¹²⁷ the President presupposed that courts would interpret the statutory language that requires “meaningful cautionary statements”¹²⁸ in a way that makes it easier for companies to find admission to the safe harbor. This presupposition reveals his belief that the statute’s language would be interpreted broadly, since a broad interpretation would permit a weaker standard when evaluating cautionary language and the “important factors that could cause actual results to diverge from predicted forecasts.”¹²⁹

¹²³ See Dessayer, *supra* note 106, at 412 n.72.

¹²⁴ *Id.* (citing *United States v. Cong. of Indus. Orgs.*, 335 U.S. 106, 139 (1948) (Rutledge, J., concurring in the judgment) (“In the debate preliminary to the overriding of the veto, none of the legislators in charge of the measure gave any indication that they differed with the President’s interpretation.”)).

¹²⁵ Avery, *supra* note 48, at 357.

¹²⁶ Statement of Managers, *supra* note 27, at 44.

¹²⁷ 141 CONG. REC. 37,798 (1995) (veto message from President Clinton).

¹²⁸ 15 U.S.C. §§ 77z-2(c)(1)(A)(i), 78u-5(c)(1)(A)(i) (2000).

¹²⁹ *Id.*

Congress agreed. During the veto-override debates, for example, Senator Chris Dodd (D-Conn.), another sponsor of the bill, summarized both the Reform Act's legislative path and the President's veto message.¹³⁰ In doing so, he emphasized the common ground that the legislation shared with almost all of the President's goals in reforming litigation. Senator Dodd characterized the President's veto as a disagreement over 11 words out of 12,000 and, furthermore, an agreement on all major issues, including the safe harbor.¹³¹ Senator Domenici additionally emphasized the harmony between the executive and legislative branches, noting the President's focus on the Reform Act's pleading standard rather than the safe harbor provision, as well as the SEC's support for the statute's safe harbor language.¹³²

In combination, President Clinton's veto message, Senator Dodd's explication and affirmation of the executive and legislature's shared position, and Congress's subsequent override suggest that Congress agreed with the President's interpretation of the cautionary language provision, but enacted the legislation anyway. The consensus and subsequent enactment reveals how Congress intended for the courts to interpret the "meaningful cautionary statements" provision: permissively.

II. CASE LAW INTERPRETING THE "MEANINGFUL CAUTIONARY STATEMENTS" PROVISION OF THE SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS

Due, perhaps, to a perception by the plaintiff's bar that the modest language in the House Conference Report "tilt[ed] the balance in securities litigation in favor of the defendant at virtually every juncture,"¹³³ the case law interpreting the "meaningful cautionary statements" provision has remained relatively undeveloped.¹³⁴ Part II.A begins by setting forth what was formerly the leading case, *Harris v. Ivax Corp.*¹³⁵ Then, Part II.B analyzes Judge Easterbrook's opinion in *Asher v. Baxter International Inc.*¹³⁶ Part II.C criticizes Judge Easterbrook's opinion by highlighting his disingenuous characterization of the statute, and explains the obscure meta-rule on which the Judge may have relied to interpret the PSLRA.

¹³⁰ 141 CONG. REC. 38,326.

¹³¹ *Id.* ("[Disagreement with the President] has come down to a pleading standards disappointment and a disagreement over Rule 11.").

¹³² *Id.* at 38,323.

¹³³ John C. Coffee, Jr., *The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Yet Sung*, 51 BUS. LAW. 975, 995 (1996).

¹³⁴ After the passage of the PSLRA, securities fraud suits were increasingly filed in state court in order to avoid the PSLRA's obstacles. See Walker, Levine & Pritchard, *supra* note 44, at 643-44 ("It has been reported that 40% of the securities class actions filed in the first ten months of 1996 were filed in state courts, compared to slightly more than 20% during 1995.").

¹³⁵ 182 F.3d 799 (11th Cir. 1999).

¹³⁶ 377 F.3d 727 (7th Cir. 2004).

A. *The Eleventh Circuit*

1. *Harris v. Ivax Corp.*—Three press releases set into motion the facts underlying *Harris v. Ivax Corp.*,¹³⁷ a securities fraud class action suit. The first press release, issued on August 2, 1996, recognized Ivax's business difficulties in the generic drug manufacturing sector, and included forward-looking statements on corporate strategy from its chief executive officer, who stated that Ivax had "taken a hard look at our U.S. generic drug business . . . [before] institut[ing] actions to enhance the profitability of our U.S. generics business."¹³⁸ The press release concluded with the optimistic statement that:

[T]he U.S. market for generic drugs doubled over the last three years to more than \$6 billion, and industry experts generally expect it to double yet again over the next three to five years. Only a limited number of companies are positioned to meaningfully participate in this rapidly growing market and, among them, IVAX is certainly very well positioned.¹³⁹

Ivax stock rose.¹⁴⁰

The second press release, issued on September 30, the last day of the third quarter, announced that Ivax anticipated a \$43 million dollar loss for the quarter.¹⁴¹ This press release also contained a list of cautionary factors that looked both forward and backward, all of which had the potential to impact Ivax's business going forward.¹⁴² Over the course of the two press releases, italicized statements warned of "additional competition,"¹⁴³ "purchasing decisions by existing and potential customers,"¹⁴⁴ "the number and timing of product introductions,"¹⁴⁵ "the volume and product mix of sales,"¹⁴⁶ and "FDA approval,"¹⁴⁷ as well as other warnings.

It was the third press release that carried the really bad news.¹⁴⁸ On November 11, Ivax announced a \$179 million loss in the third quarter, the bulk of which resulted from a \$104 million reduction in the accounting of goodwill.¹⁴⁹ Common shares of the stock fell over twenty percent to a new

¹³⁷ See *Harris*, 182 F.3d at 802. The first two press releases are reprinted as appendices to the opinion at 808–14.

¹³⁸ *Id.* at 809 (quoting Ivax CEO Phillip Frost).

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 802.

¹⁴¹ *Id.*

¹⁴² See *id.*

¹⁴³ *Id.* at 810.

¹⁴⁴ *Id.*

¹⁴⁵ *Id.*

¹⁴⁶ *Id.* at 813.

¹⁴⁷ *Id.* at 814.

¹⁴⁸ See *id.* at 801.

¹⁴⁹ *Id.* at 802. "Goodwill" is a business's reputation, patronage, and other intangible assets that are considered when appraising the business. BLACK'S LAW DICTIONARY 715 (8th ed. 2004).

fifty-two week low.¹⁵⁰ As a result, plaintiffs filed a class action claiming fraud and material omission.¹⁵¹ Examining the cautionary language that accompanied the corporate disclosure, the Eleventh Circuit held that Ivax was entitled to protection under the safe harbor.¹⁵²

2. *Analysis.*—*Harris* was an important PSLRA decision for four reasons. First, the court applied the statute to the press releases to determine whether the statements were forward-looking in nature.¹⁵³ Relying on legislative history to conclude that the PSLRA safe harbor was intended to “loosen the ‘muzzling effect’ of potential liability for forward-looking statements,” the court held that the press releases were forward-looking and, thus, within the protection of the safe harbor.¹⁵⁴

Second, following the instructions in the House Conference Report, the court asked whether the cautionary language contained within Ivax’s press releases was merely boilerplate.¹⁵⁵ Concluding that Ivax’s cautionary language was “detailed and informative . . . tell[ing] the reader in detail what kind of misfortunes could befall the company and what the effect could be,” the court held that the cautionary statements were meaningful and not boilerplate.¹⁵⁶

The third reason for the importance of the *Harris* decision was that the court tackled the question of whether, to be meaningful, cautionary language must mention the specific factor that causes the corporate promise to break. The *Harris* court highlighted the statute’s failure to require a listing of *all* the important factors that could cause actual results to differ from projections.¹⁵⁷ Again, tellingly, the court depended on the House Conference Report, which specified that a “[f]ailure to include the particular factor that ultimately causes the forward-looking statement not to come true will not mean that the statement is not protected by the safe harbor.”¹⁵⁸ As a result, the court concluded that “meaningful cautionary statements” did not require the inclusion of the factor that ultimately caused actual results to miss forward-looking projections.¹⁵⁹

Finally, the court created a standard for what sufficiently constitutes “meaningful cautionary language”: “In short, when an investor has been warned of risks of a significance similar to that actually realized, she is sufficiently on notice of the danger of the investment to make an intelligent

¹⁵⁰ *Harris v. Ivax Corp.*, 998 F. Supp. 1449, 1452 (S.D. Fla. 1998).

¹⁵¹ *Harris*, 182 F.3d at 802.

¹⁵² *Id.* at 807.

¹⁵³ *Id.* at 804–06.

¹⁵⁴ *Id.* at 806–07.

¹⁵⁵ *Id.* at 807.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* (quoting Statement of Managers, *supra* note 27, at 44) (internal quotation marks omitted).

¹⁵⁹ *Id.*

decision about it according to her own preferences for risk and reward.”¹⁶⁰ The standard requiring that a company warn investors of significant dangers that are similar to those actually realized was subsequently adopted by the Sixth Circuit in *Helwig v. Vencor*.¹⁶¹ Thus, under both *Harris* and *Helwig*, as long as a company warned the markets of a significant business danger that was similar in scope to the actual danger that came to pass, the company could receive safe harbor protection even if the cautionary language failed to identify “significant” or “principal” dangers. The *Harris* standard remained the unquestioned rule until *Asher v. Baxter* was handed down five years later.

B. The Seventh Circuit

1. *Asher v. Baxter International Inc.—Harris and Asher v. Baxter International Inc.*¹⁶² tell similar corporate stories. Baxter, a large healthcare company, presented a rosy profit picture in press releases, oral statements, and SEC filings, at various times in late 2001 and early 2002.¹⁶³ However, the profit projections, which carried cautionary statements identifying risk factors such as problems with several of its major medical products,¹⁶⁴ “new plant start-ups,”¹⁶⁵ and economic conditions,¹⁶⁶ failed to materialize when

¹⁶⁰ *Id.*

¹⁶¹ 251 F.3d 540, 559 (6th Cir. 2001) (citing *Harris*, 182 F.3d at 807).

¹⁶² 377 F.3d 727 (7th Cir. 2004). The opinion, written by Judge Frank Easterbrook, was joined by Judges Daniel A. Manion and Ilana Diamond Rovner.

¹⁶³ *See id.* at 728.

¹⁶⁴ *See id.* at 730. In October 2001, a line of Baxter-manufactured products, six models of kidney dialysis filters, were linked to a series of patient deaths. *See, e.g.*, Bruce Japsen, *Croatia Health Chief Resigns; Points to Baxter Dialyzers*, CHI. TRIB., Oct. 24, 2001, at N3.

¹⁶⁵ *Asher*, 377 F.3d at 730. The cautionary language that the court examined reads, in part:

Many factors could affect the company’s actual results, causing results to differ materially, from those expressed in any such forward-looking statements, [including] interest rates; technological advances in the medical field; economic conditions; *demand and market acceptance risks for new and existing products*, technologies and health care services; the impact of competitive products and pricing; *manufacturing capacity*; *new plant start-ups*; global regulatory, trade and tax policies; *regulatory, legal or other developments relating to the company’s Series A, AF, and AX dialyzers*; continued price competition; *product development risks, including technological difficulties*; ability to enforce patents; actions of regulatory bodies and other government authorities; reimbursement policies of government agencies; commercialization factors; results of product testing; and other factors described in this report or in the company’s other filings with the Securities and Exchange Commission. *Additionally, as discussed in Item 3—“Legal Proceedings,” upon the resolution of certain legal matters, the company may incur charges in excess of presently established reserves. Any such change could have a material adverse effect on the company’s results of operations or cash flows in the period in which it is recorded.* Currency fluctuations are also a significant variable for global companies, especially fluctuations in local currencies where hedging opportunities are unreasonably expensive or unavailable. *If the United States dollar strengthens significantly against most foreign currencies, the company’s ability to realize projected growth rates in its sales and net earnings outside the United States could be negatively impacted.* The company believes that its expectations with respect to forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of its business operations, but there can be no assurance that the actual results or performance of the company will conform to any future results or performance expressed or implied by such forward-looking statements.

the company announced its second quarter financial results for 2002.¹⁶⁷ Baxter issued a disappointing earnings report, its stock price fell from \$43 to \$32 a share, and angry investors filed lawsuits arguing that the projections were riddled with material omissions and merely boilerplate cautions.¹⁶⁸

The lower court dismissed the complaint,¹⁶⁹ relying on both the guidance included in the House Conference Report¹⁷⁰ and the *Harris* court's "meaningful cautionary statements" analysis.¹⁷¹ It concluded that Baxter's warning statements opened up access to the PSLRA's safe harbor.

2. *Asher's Central Tension*.—The Seventh Circuit, however, reversed and revived the case.¹⁷² In the unanimous opinion, Judge Easterbrook isolated the fundamental issue as the problem that the statutory requirement for "meaningful cautionary statements" was too vague to be meaningful itself.¹⁷³ Judge Easterbrook explained the problem, noting that, on the one hand, the statute could not demand clairvoyance in requiring that cautionary statements identify the exact danger that would ultimately come to pass. If that were the case, he reasoned, the safe harbor would be useless because such an impossible requirement would not provide any safety at all.¹⁷⁴

On the other hand, if an unforeseen danger is realized and the cautionary statement, in hindsight, failed to warn investors of that risk, then it is always possible to claim plausibly that the cautionary language was fatally deficient in meeting the statutory requirement that the "important factors that could cause actual results to differ materially" were properly identified.¹⁷⁵ Allowing a company the safe harbor would thus seem to violate the statute's language. As Judge Easterbrook characterized the dilemma, either result is incompatible with possible interpretations of the statutory language.¹⁷⁶

Id. at 729–30 (emphasis added to indicate Baxter-specific factors).

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at 728.

¹⁶⁸ *See id.*

¹⁶⁹ *Asher v. Baxter Int'l, Inc.*, No. 02-C-5608, 2003 WL 21825498, at *16 (N.D. Ill. July 24, 2003) (holding that "Baxter's cautionary statements are sufficiently tailored to the forward-looking projections").

¹⁷⁰ *See id.* at *11.

¹⁷¹ *See id.* at *15–16.

¹⁷² *Asher*, 377 F.3d at 735.

¹⁷³ *Id.* at 729 ("[A] word such as 'meaningful' resists a concrete rendition and thus makes administration of the safe harbor difficult if not impossible.").

¹⁷⁴ *Id.*

¹⁷⁵ *Id.* (internal quotation marks omitted).

¹⁷⁶ *See id.* ("A safe harbor matters only when the firm's disclosures . . . are false or misleadingly incomplete; yet whenever that condition is satisfied, one can complain that the cautionary statement must have been inadequate. The safe harbor loses its function.")

When the legislation is insufficiently specific, how is a court to fill in the gaps? The move made by Judge Easterbrook was to dismiss the statute's language as a compromise between legislators which lacked both the letter and the "spirit"¹⁷⁷ of a law, thus making it impossible for a court to follow.¹⁷⁸ Judge Easterbrook then found that Baxter's warnings were not boilerplate—but not exactly cautionary either.¹⁷⁹ The dilemma this presents is important. Judge Easterbrook identified the cautionary warnings that, in an ideal world, would be of most help to investors, including the financial calculations behind the projections or the release of Baxter's confidence intervals in those projections. However, he never explained why Baxter's warnings failed to meet the statutory minimum.¹⁸⁰ Instead, he reasoned that Baxter's warnings were problematic because, even as business conditions changed, Baxter never modified the wording.¹⁸¹ This "raise[d] the possibility—no greater confidence is possible before discovery—that Baxter omitted important variables from the cautionary language."¹⁸² Thus, as far as the court could know, Baxter failed to mention any of the "principal" risk factors.¹⁸³ Judge Easterbrook then instructed the district court to order discovery to determine whether or not Baxter's cautionary statements addressed the major risks for investors.¹⁸⁴

C. Analysis

1. *Asher's Inaccuracies in Discussing the PSLRA's Legislative History.*—Judge Easterbrook's opinion is remarkable for at least four reasons. First, the opinion's account of the PSLRA's "compromise" is factually incorrect on at least two counts: Judge Easterbrook characterized the safe harbor provision as a compromise between legislators, but it is more accurately characterized as the result of a compromise with the SEC.¹⁸⁵

¹⁷⁷ See generally Frank H. Easterbrook, *Statutes' Domains*, 50 U. CHI. L. REV. 533, 541–43 (1983) (elaborating on the "spirit" of legislation and legislatures).

¹⁷⁸ *Asher*, 377 F.3d at 732–33 ("[T]he statutory language . . . is the result of a compromise between legislators who did not want any safe harbor (or, indeed any new legislation), and those who wanted a safe harbor along the lines of the old Rule 175 . . . that did not require any cautionary statement but just required the projection to have a reasonable basis. As is often the situation, a compromise enabled the bill to pass but lacks much content; it does not encode a principle on which political forces agree as much as it signifies conflict about both the scope and the wisdom of the safe harbor. Compromises of this kind lack spirit.").

¹⁷⁹ *Id.* at 733–34.

¹⁸⁰ See *id.*

¹⁸¹ *Id.* at 734–35.

¹⁸² *Id.* at 734.

¹⁸³ *Id.*

¹⁸⁴ *Id.* at 735.

¹⁸⁵ Allan Horwich, *Is There a Breach in the Breakwater of the Statutory Safe Harbor for Forward-Looking Statements*, WALL ST. LAW., Sept. 2004, at 20; see also 3C HAROLD S. BLOOMENTAL &

Second, Judge Easterbrook declared that such a compromise “does not encode a principle on which political forces agreed as much as it signifies conflict about both the scope and the wisdom of the safe harbor.”¹⁸⁶ However, the bill was promulgated by a supermajority of legislators over the President’s veto.¹⁸⁷ So, to the contrary, the PSLRA’s very passage seems to indicate just that: Political forces agreed, and then encoded just such an interpretation into the statute. As discussed above in Part I.C, the message that Congress and the President encoded was that courts would interpret the safe harbor provision broadly to increase protection from discovery.

Next, beyond the misleading account of the supposed compromise, the opinion includes no mention of the Reform Act’s actual legislative history.¹⁸⁸ As one of the “co-parents” of New Textualism¹⁸⁹ and a self-described “notorious opponent of legislative history,”¹⁹⁰ Judge Easterbrook’s skepticism about the use of legislative history should come as no surprise.¹⁹¹ However, having framed the language of the safe harbor provision as the product of an unholy alliance involving hidden maneuverings and strategic compromises,¹⁹² Judge Easterbrook’s subsequent dodge of the legislative history’s import is curious.¹⁹³

2. *Asher’s Interpretation Relies on a Different Meta-Rule.*—What did he use instead? The answer may be that, instead of relying on the express guidance set down in the Conference Report or any of the other

SAMUEL WOLFF, *SECURITIES AND FEDERAL CORPORATE LAW* § 15:22.10 (2d ed. Supp. 2004); *supra* note 63.

¹⁸⁶ *Asher*, 377 F.3d at 733.

¹⁸⁷ In the original opinion, Judge Easterbrook wrote that the veto would be successful unless Congress “accepted provisos agreeable to the SEC; as the legislature lacked the votes to override a veto, a deal was struck that could not have carried in the absence of the threat to sink the whole package.” *Compare* Horwich, *supra* note 185, at 20, with *Asher*, 377 F.3d at 733.

¹⁸⁸ *See Asher*, 377 F.3d at 733.

¹⁸⁹ ESKRIDGE, FRICKEY & GARRETT, *supra* note 98, at 954 (noting that Judge Easterbrook and Justice Scalia are the parents of the New Textualism that doubts the trustworthiness of legislative history).

¹⁹⁰ Frank H. Easterbrook, *Text, History, and Structure in Statutory Interpretation*, 17 HARV. J.L. & PUB. POL’Y 61, 62 (1994).

¹⁹¹ *See, e.g., In re Sinclair*, 870 F.2d 1340, 1343 (7th Cir. 1989) (Easterbrook, J.) (“One may say . . . that legislative history is a poor guide to legislators’ intent because it is written by the staff rather than by members of Congress, because it is often losers’ history (‘If you can’t get your proposal into the bill, at least write the legislative history to make it look as if you’d prevailed’), because it becomes a crutch (‘There’s no need for us to vote on the amendment if we can write a little legislative history’), because it complicates the task of execution and obedience (neither judges nor those whose conduct is supposed to be influenced by the law can know what to do without delving into legislative recesses, a costly and uncertain process).” *But cf.* Paul F. Campos, *The Chaotic Pseudotext*, 94 MICH. L. REV. 2178, 2194–95 (1996) (arguing that Judge Easterbrook’s “catalogue of pitfalls” are ordinary problems that affect any interpretative inquiry).

¹⁹² *See supra* note 178 and accompanying text.

¹⁹³ *See generally* Grundfest & Pritchard, *supra* note 102 (analyzing the scienter standard of the PSLRA under a game theory model); Campos, *supra* note 191 (examining the limitations of New Textualism).

sources of legislative history detailed above, Judge Easterbrook followed his own meta-rule.¹⁹⁴ By structuring the decision around the problem that “meaningful” is not itself meaningful,¹⁹⁵ Judge Easterbrook highlighted the textual ambiguity that the legislature left in the statute’s language. Then, rather than rely on traditional methods of statutory interpretation, Judge Easterbrook may have interpreted this ambiguity as a congressional signal for the judiciary to resolve the remaining ambiguity¹⁹⁶: Since the statute could not be enacted with greater specificity, Congress implicitly signaled to the courts that the judiciary had wide discretion in resolving the ambiguity in the language.¹⁹⁷ Reliance on this meta-rule for legislative intent is problematic, however, where, as here, the legislative history provides more direct evidence of the legislature’s preferences in how the courts should interpret the statutory language.

3. *The Case Law Does Not Support the Asher Standard.*—The third remarkable feature of Judge Easterbrook’s opinion is the finding that Baxter’s cautionary language was neither boilerplate nor meaningful.¹⁹⁸ Although Judge Easterbrook cites *Harris* for the proposition that boilerplate is insufficient cautionary language, the opinion contains no mention of the *Harris* court’s interpretation of the “meaningful cautionary statements” standard.¹⁹⁹ Interestingly, it appears that Baxter’s cautionary statements warned of dangers at least as effectively as did Ivax’s. By warning of such potential problems as currency fluctuation and manufacturing capacity²⁰⁰—problems that actually contributed to Baxter’s missing Wall Street expectations²⁰¹—Baxter seems to have pointed to dangers at least as important as those Ivax warned of when it alerted its customers to increased competition and high inventory.²⁰² However, without citing to *Harris* or, for that matter, any other authority, Judge Easterbrook abruptly concluded that Baxter’s language was insufficient for admission to the safe harbor as a matter of law.²⁰³

¹⁹⁴ Cf. *Brown & Root, Inc. v. Donovan*, 747 F.2d 1029, 1035–36 (5th Cir. 1984) (interpreting a highly detailed act as a meta-signal to leave Congress’s statutory structure alone).

¹⁹⁵ See *supra* note 173 and accompanying text.

¹⁹⁶ See generally Easterbrook, *supra* note 177.

¹⁹⁷ See *id.* at 552.

¹⁹⁸ See *supra* note 179 and accompanying text.

¹⁹⁹ See *Asher v. Baxter Int’l, Inc.*, 377 F.3d 727, 732 (7th Cir. 2004).

²⁰⁰ See *supra* note 165 (quoting Baxter’s 2001 Form 10-K, which advised that “[c]urrency fluctuations are also a significant variable” and the potential importance of the company’s “manufacturing capacity”).

²⁰¹ See Baxter Int’l, Q-2 2002 Baxter International Earnings Conference Call (Jul. 18, 2002) (blaming foreign currency volatility for a significant negative impact on product sales, and its manufacturing capacity for lower-than-expected sales growth).

²⁰² See *Harris v. Ivax Corp.*, 182 F.3d 799, 808–09, 810 (11th Cir. 1999).

²⁰³ See *Asher*, 377 F.3d at 734.

4. *The Statutory Language Does Not Support the Asher Standard.*—

Fourth, opening the door to discovery upon the mere “possibility” that “principal” risk factors were omitted from Baxter’s cautionary statements appears to be at odds with the statute’s requirement.²⁰⁴ Nowhere does the statute require that companies must disclose the “principal or important” factors.²⁰⁵ The statute merely requires that companies “identify *important* factors that *could* cause actual results to differ materially from those in the forward-looking statement.”²⁰⁶ Requiring a company to identify the “principal” risks appears to impose a higher standard on companies seeking protection in the safe harbor.²⁰⁷

5. *The Legislative History Does Not Support the Asher Standard.*—

Furthermore, easing access to discovery contradicts the intent specified by the House Conference Report, which states that “[t]he Conference Committee specified that the cautionary statements identify ‘important’ factors to provide guidance to issuers and not to provide an opportunity for plaintiff counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made.”²⁰⁸ Since the PSLRA was enacted to target opportunistic discovery, the *Asher* standard fails to serve this legislative goal.

6. *The Asher Court Could Have Applied a Different Provision.*—

Finally, even if the *Asher* court was concerned about shutting the courthouse to a potentially meritorious claim by closing off discovery, the PSLRA permits either party to make a motion for discovery while a motion to dismiss is pending.²⁰⁹ If Judge Easterbrook were looking for a statutory anchor for his decision to order discovery, the provision that expressly permits particularized discovery would have been a logical choice.²¹⁰ Yet Judge Easterbrook made no mention of this provision. This suggests judi-

²⁰⁴ *Id.*

²⁰⁵ *See, e.g.*, 15 U.S.C. §§ 77z-2, 78u-5 (2000).

²⁰⁶ *Id.* (emphasis added).

²⁰⁷ Horwich, *supra* note 185, at 22 (noting the different meanings of “important” and “principal”).

²⁰⁸ Statement of Managers, *supra* note 27, at 44.

²⁰⁹ 15 U.S.C. § 7z-1(b)(1) (2000) (“In general. In any private action arising under this subchapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds, upon the motion of any party, that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.”).

²¹⁰ The provision governing stays of discovery highlights a tension between the PSLRA’s statutory language and its legislative history. Presumably, plaintiffs can get discovery into whether a defendant’s cautionary language sufficiently identified important factors. This would seem to contradict the legislative history of the first prong of the safe harbor, which repeatedly evinces congressional intent to reduce defendant’s exposure to expensive discovery. For the Ninth Circuit’s analysis, see *SG Cowen Securities Corporation v. United States District Court*, 189 F.3d 909, 912 (9th Cir. 1999). *See also* BLOOMENTAL & WOLFF, *supra* note 185, at § 15:22.10. However, given Judge Easterbrook’s “notorious” opposition to the use of legislative history, see *supra* note 190, this would assumedly not cause him any difficulties.

cial disingenuousness—i.e., that Judge Easterbrook substituted a policy preference for the statute’s language. This apparent policy preference, however, reopens the danger that companies will be vulnerable to opportunistic discovery.

Judge Easterbrook has written that “[w]hen the text [of a statute] has no answer, a court should not put one there on the basis of legislative reports . . . or economics! Instead the interpreter should go to some other source of rules, including . . . common law”²¹¹ Declining to fasten his decision to the text, the legislative reports, or the common law (and relying in part on a factually misleading account of the legislative history), Judge Easterbrook may have turned to economics to replace the statute’s language.²¹² Possible answers to whether the economics of the *Asher* decision net a gain or a loss are set out in the next Part.

III. INCREASED DISCLOSURE OR INCREASED FRAUD?

The PSLRA has been both credited with delivering vital information to shareholders about a firm’s future outlook,²¹³ and simultaneously disparaged with charges of helping to vaporize trillions of dollars of shareholder wealth.²¹⁴ This Part examines this tension between the benefits from increased corporate disclosure and the resulting costs when companies mislead investors.

A. *The Lemon Problem*

Both fraud and the deficiency of information reduce efficiency.²¹⁵ What is known as the “lemon problem”²¹⁶ arises when too much fraud exists in the market: low-quality companies attract too much investor wealth and high-quality companies keep good investments off the market because investors would be uncertain of their quality.²¹⁷ Like a used car market that is

²¹¹ Easterbrook, *supra* note 190, at 68.

²¹² See *infra* text accompanying notes 242–245.

²¹³ See Marilyn F. Johnson, Ron Kasznik & Karen K. Nelson, *The Impact of Securities Litigation Reform on the Disclosure of Forward-Looking Information by High Technology Firms*, J. ACCT. RES. 297, 298 (2001).

²¹⁴ William S. Lerach, *Plundering America: How American Investors Got Taken for Trillions by Corporate Insiders: The Rise of the New Corporate Kleptocracy*, 8 STAN. J.L. BUS. & FIN. 69, 102–03 (2002); see also, e.g., Editorial, *License to Steal; In Securities “Reform” a Senate Bill Bars Lawsuits Against Many Who Bilk Investors. How Does This Help the Economy?*, MIAMI HERALD, June 26, 1995, at 8A (“Go ahead, lie about the future . . . you can fleece investors in any way that your imagination allows.”).

²¹⁵ Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 673 (1984) (noting further that “[a] world with fraud, or without adequate truthful information, is a world with too little investment, and in the wrong things to boot”).

²¹⁶ See generally George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970).

²¹⁷ See EASTERBROOK & FISCHEL, *supra* note 19, at 280.

choked with lemons, too many consumers purchase cars that should not be bought, while owners of reliable used cars are not selling as many as they should. The difficulty in identifying lemons deters transactions that would improve everyone's welfare.

Of course, even in a market full of lemons, high-quality sellers can distinguish their wares from those of their competitors. To continue with the classic example, the high-quality seller can offer a warranty on the car in order to signal that it is not a lemon.²¹⁸

However, the utility of the extra information only goes so far. A dealer of lemons can mimic high-quality sellers with additional disclosures of information and promises the buyer may be unlikely or unable to verify.²¹⁹ If the marketplace cannot quiet such mimicry by low-quality sellers, the perceptible differences between the high-quality and the low-quality sellers shrink again. This shrinkage imposes additional inefficiencies on investors, like sorting through informational noise and investment substitutions.²²⁰ For the buyers and the investors, greater search costs result, as more time and resources must be invested in vetting the extra information to determine what is truly important.²²¹

If left unchecked, the situation may eventually lead the seller of high-quality assets to stop releasing information, and to remove high-quality assets from the marketplace.²²² A company's costs rise as it increases corporate disclosure with more guarantees or the bases of profit projections. As required disclosures become more revealing, the extra information starts to help competitors of the seller more than potential buyers of the assets.²²³

B. Should the Courts Regulate Corporate Disclosure?

The question of regulating the level of corporate disclosure is an issue of comparative advantage. Should the courts determine the amount of corporate information that is released, or should the marketplace?

A safe harbor protects against the problem of informational oversupply by subjecting corporate disclosure to marketplace incentives. By permitting companies to decide the appropriate level of corporate disclosure, the safe harbor incentivizes companies to make forward-looking predictions so long as corporate advantages can be secured.²²⁴ This leaves the interpretation of

²¹⁸ See Akerlof, *supra* note 216, at 499.

²¹⁹ See EASTERBROOK & FISCHEL, *supra* note 19, at 280–81.

²²⁰ See generally *Asher v. Baxter Int'l Inc.*, 377 F.3d 727 (7th Cir. 2004).

²²¹ See EASTERBROOK & FISCHEL, *supra* note 19, at 311.

²²² See *id.*

²²³ See *Asher*, 377 F.3d at 733, 734; *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 514 (7th Cir. 1989) (Easterbrook, J.).

²²⁴ See Easterbrook & Fischel, *supra* note 215, at 703.

corporate predictions largely up to the market, which is typically less susceptible to errors in evaluating such information than the courts.²²⁵

The desirability of this result depends to some degree on the protectiveness of the safe harbor.²²⁶ The more protective the safe harbor, the easier it becomes for low-quality sellers to imitate high-quality sellers.²²⁷ At first blush, this appears problematic, but legal rules that permit this imitation may nevertheless be the preferable outcome. There is a high potential for judicial error in evaluating the liability of companies for forward-looking statements.²²⁸ Consequently, the net losses that result when courts are quick to impose penalties for inadequate forward-looking statements may be greater than net losses that trace back to legal rules that are more protective of corporate disclosure. In addition to the theoretical difficulties in determining whether a more protective regime is more efficient than a less protective regime, empirical studies suggest that a more protective regime increases corporate disclosure from high-quality sellers: motivated by reputational factors like honesty and altruism, high-quality companies increased disclosure after the Reform Act was enacted.²²⁹

C. Asher and the Lemon Problem

This, however, was before the corporate scandals. In the post-PSLRA period, numerous earnings restatements have caused losses measured in the billions, if not trillions of dollars.²³⁰ Now, after the Enron and Arthur Andersen debacles, the PSLRA has repeatedly come under fire.²³¹ Criticized, for example, as the “ultimate in special-interest legislation,”²³² the PSLRA

²²⁵ See, e.g., Eric Talley, *Disclosure Norms*, 149 U. PA. L. REV. 1955, 1959 (2001). Easterbrook and Fischel further argue that the securities regulation system is at its most efficient when verifying issuer-specific historical facts. See Easterbrook & Fischel, *supra* note 215, at 703. However, other commentators have argued that verifying historical facts also contributes to the problem, as one of the difficulties with the rules governing disclosure is judicial expertise and hindsight bias. See, e.g., Jeffrey J. Rachlinski, *A Positive Psychological Theory of Judging in Hindsight*, 65 U. CHI. L. REV. 571, 572–76 (1998).

²²⁶ See, e.g., Talley, *supra* note 225, at 1981–83.

²²⁷ *Id.* at 1982 (noting that a protective safe harbor increases the “universe of signals a defendant may send without fear of liability”).

²²⁸ *Id.* at 1983 (“[C]onsistent with the common wisdom, I argue that the risk of judicial error, if sufficiently large, probably supports a less interventionist approach by courts, all else held constant.”).

²²⁹ Marilyn F. Johnson, Ron Kasznik & Karen K. Nelson, *Shareholder Wealth Effects of the Private Securities Litigation Reform Act of 1995*, 5 REV. ACCT. STUD. 217 (2000) (arguing that evidence showed that shareholders of companies that were most likely to be sued benefited from the PSLRA, but that firms that were likely to be the targets of meritorious lawsuits benefited less).

²³⁰ See, e.g., Stephen Labaton, *Now Who, Exactly, Got Us Into This?*, N.Y. TIMES, Feb. 3, 2002, at C1; Lerach, *supra* note 214, at 79.

²³¹ See, e.g., Charles Murdock, *Problem No. 2: Corporate Leaders Lied to Themselves*, CHI. TRIB., Oct. 13, 2002, at C1; Dave Murray & Joe Mahr, *How a Foe of Reform Changed His Tune*, PITT. POST-GAZETTE, Dec. 7, 2003, at A-1.

²³² Labaton, *supra* note 230, at C6 (quoting James D. Cox, a professor of corporate law and securities regulation at Duke University).

has been publicly questioned by its key supporters, including one of its original sponsors, Senator Chris Dodd.²³³ The resulting business and regulatory environment has triggered an increase in a company's risk in being targeted—either privately by plaintiffs or publicly by the SEC—for securities infractions.²³⁴ Have the scandals revealed a lemon problem?

1. *Targeting Obfuscation* . . .—The *Asher* holding specifically targets increasing search costs, citing the problem of boilerplate warnings.²³⁵ In permitting discovery against Baxter to proceed, Judge Easterbrook leaned on the fact that Baxter's cautionary statements remained the same even as the business environment that Baxter faced continued to change, thereby suggesting that Baxter omitted the important cautionary factors.²³⁶ This reflects a larger problem as well. A year after the passage of the PSLRA, then-Chairman Arthur Levitt of the SEC criticized the quality of companies' cautionary language, saying, “[R]ather than taking advantage of the new safe harbor to communicate forecasts more clearly, companies are using even more boilerplate, in the form of cautionary language. It appears that the legal requirements of the safe harbor are being ‘over-lawyered.’”²³⁷ *Asher* encourages issuers to revise cautionary language continually, thus reducing the amount of time required to sift through disclosures in order to discover the truly important information.

In this way, the decision may help the market factor any publicly-disclosed information into the price of the company's securities. Additionally, it will allow high-quality companies to distinguish more easily their higher-quality securities, and to do so at a lower cost. Explicating several specific ways in which high-quality companies can safely disclose forward-looking information, such as revealing the confidence factors associated with the projection, *Asher* gives companies at least a few concrete ways with which to alert investors of the value of its assets.

2. . . . *But at What Cost?*—Yet, weighing against this benefit are several negatives, including the new uncertainty that this circuit split brings to the law. This uncertainty may lead to a chill in corporate disclosure until the new contours of the safe harbor are clarified. After *Asher* was handed

²³³ *Id.* (including then-SEC Chairman Harvey Pitt and Representative Oxley, two strong supporters of the legislation before its enactment, as among those who now question its applicability in a post-Enron business environment).

²³⁴ See, e.g., John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. REV. 301 (2004).

²³⁵ See *Asher v. Baxter Int'l Inc.*, 377 F.3d 727, 733 (7th Cir. 2004) (citing examples of boilerplate that are insufficient cautionary language: “Statements along the lines of ‘all businesses are risky’ or ‘the future lies ahead’ come to nothing other than caveat emptor (which isn’t enough) . . .”).

²³⁶ *Id.* at 734–35.

²³⁷ Arthur Levitt, Chairman, U.S. Sec. & Exch. Comm’n, Remarks at the Securities Regulation Institute: Corporate Finance in the Information Age (Jan. 23, 1997), available at <http://www.sec.gov/news/speech/speecharchive/1997/spch135.txt>.

down, large law firms released numerous publications for clients that warned of the potential liability of public disclosure.²³⁸

Moreover, the holding is unlikely to dissuade low-quality companies from releasing valuable information on their future outlook. Although low-quality companies will either go silent or else issue more cautionary statements, the uncertainty in the law is likely to cause high-quality companies to do the same. The problem of distinguishing between high-quality and low-quality companies will still exist, but *Asher* may leave the market with less public information to consider.

3. “*Hard Questions Have No Right Answers.*”²³⁹—The main problem with the result in *Asher* is that the best result is unclear, and largely empirical. The Reform Act reduced the cost for issuers in defending class action securities suits,²⁴⁰ but the individual impact of the safe harbor on shareholder losses cannot reliably be isolated and measured, although it is assumed to be large.²⁴¹ Despite this empirical uncertainty, as well as the large possibility of judicial error, the *Asher* court took it upon itself to resolve the statutory ambiguity on the basis of policy, rather than the statute’s language, the common law, or the legislative history.

CONCLUSION

Having explored the issues both surrounding and embedded within the PSLRA’s safe harbor provisions and *Asher v. Baxter*,²⁴² this Note now returns to the dilemma posed at the beginning. Is the inevitable negative consequence of the *Asher* decision going to be the encouragement of fraud, or of litigation?²⁴³ Certainly, in almost every single way, this decision will help future plaintiffs.

By lowering the standard under which plaintiffs can open the door to expensive discovery, the decision makes it easier for plaintiffs to survive the pleadings stage, exposing companies to greater liability for forward-looking statements.²⁴⁴ Judge Easterbrook’s decision rejected the overwhelming goals that carried the PSLRA through its legislative battles until its enactment over the President’s veto. This decision is at odds with the Reform Act’s language, its legislative history, and with the precedents in the other circuits.

²³⁸ See, e.g., Memorandum from Skadden, Arps, Slate, Meagher & Flom, Forward-Looking Statement Safe Harbor Considerations in Light of *Asher v. Baxter* (Apr. 2005), http://www.skadden.com/content/Publications/Publications1020_0.pdf.

²³⁹ Easterbrook, *supra* note 190, at 68.

²⁴⁰ Stephen J. Choi & A.C. Pritchard, *Behavioral Economics and the SEC*, 56 STAN. L. REV. 1, 38 (2003).

²⁴¹ See, e.g., Coffee, *supra* note 234, at 320.

²⁴² 377 F.3d 727 (7th Cir. 2004).

²⁴³ See *supra* text accompanying note 1.

²⁴⁴ See *supra* Part 1.B–C.

Furthermore, the decision is almost certain to trigger higher levels of litigation activity. Since most class action securities litigation is currently oriented to—or, rather, lost in—the thicket surrounding the scienter prong, plaintiffs' lawyers in search of an opening to discovery will shift the focus of litigation to the safe harbor prong. Given Judge Easterbrook's national stature as a securities law scholar and a respected professor,²⁴⁵ the decision will almost certainly increase safe harbor litigation across the country.

In conclusion, the *Asher* decision needlessly sapped the statutory language of meaning with a disingenuous account of the legislative history. *Asher* is a naked substitution of Judge Easterbrook's policy preference over the statute's language, the legislative history, and the accumulated body of law.

²⁴⁵ See *supra* note 15 and accompanying text.

