No. 17-1056

IN THE

Supreme Court of the United States

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

Petitioners,

v.

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

Respondents.

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

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether or in what circumstances a defendant must admit that *non*-forward-looking statements are false or misleading, in order to be protected by the Private Securities Litigation Reform Act of 1995 ("Reform Act") safe harbor for *forward*-looking statements.

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INTEREST OF *AMICUS CURIAE*

The Washington Legal Foundation ("WLF") is a nonprofit, public-interest law firm and policy center with supporters in all fifty states.[1] WLF devotes a substantial portion of its resources to defending free enterprise, individual rights, limited government, and the rule of law. To that end, WLF has appeared before this and other federal courts in numerous cases related to the proper scope of the federal securities laws. *See, e.g.*, *Cyan, Inc.* v. *Beaver Cty. Emps. Ret. Fund*, 583 U.S. __ (2018); *Omnicare, Inc.* v. *Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318 (2015); *Tellabs, Inc.* v. *Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007); *Dura Pharm., Inc.* v. *Broudo*, 544 U.S. 336 (2005).

WLF agrees with petitioners that this Court should resolve the conflict among the circuits on how to apply the Reform Act's safe harbor for forward-looking statements ("Safe Harbor"). WLF submits this brief to emphasize just how often courts misapply and avoid the Safe Harbor, and to urge the Court to use this opportunity to harmonize the Safe Harbor standard with the standards for falsity and scienter this Court established in *Omnicare* and *Tellabs*.

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[1] Pursuant to Supreme Court Rule 37.6, WLF states that no counsel for a party authored this brief in whole or in part; and that no person or entity, other than WLF and its counsel, made a monetary contribution intended to fund the preparation and submission of this brief. More than ten days before filing this brief, WLF notified counsel for respondents of its intent to file. All parties have consented to the filing; blanket consents are on file with the Clerk.

STATEMENT OF THE CASE

This is an alleged securities class action challenging statements by Quality Systems, Inc. ("QSI") about its current and future performance. QSI's forecasts of its future performance were accompanied by cautionary language that identified risks and uncertainties. Pet. App. at 32a–33a, 46a–48a. Respondents' complaint identified ten statements they believed to be false or misleading. These included forward-looking statements about future revenue, earnings, and sales; non-forward-looking statements about current operations and results; and "mixed statements" involving both forward-looking and non-forward-looking assertions. *Id.* at 1a, 19a–20a, 28a–30a, 32a.

The district court granted petitioners' motion to dismiss. *Id.* at 43a–50a. The court found that QSI's forward-looking statements fell within the Safe Harbor because they were accompanied by meaningful cautionary language and respondents had not alleged petitioners knew they were false. *Id.* at 46a–49a. In finding QSI's cautionary language meaningful, the district court emphasized that QSI identified specific risk factors unique to QSI's business, unlike the generic, boilerplate language courts often find lacking. The court dismissed the non-forward-looking statements as puffery. *Id.* at 47a–48a.

The Ninth Circuit reversed. Rejecting the district court's finding of puffery, the court held respondents adequately alleged that the non-forward-looking statements were misleading, and that respondents had sufficiently alleged scienter. *Id.* at 20a–27a. In addressing the forward-looking statements, the Ninth Circuit announced a new rule: whenever a plaintiff adequately alleges that a non-forward-looking statement is false, the Safe Harbor will not apply unless

defendants' cautionary language admits that falsity. *Id.* at 27a–34a.

Applying its new rule, the Ninth Circuit held that QSI's cautionary language was not meaningful because it accompanied materially false and misleading non-forward-looking statements not identified as false in QSI's disclosures. *Id.* at 32a–34a. The court reversed the dismissal based on "mixed statements," but upheld the dismissal of the standalone forward-looking statements. *Id.* It nevertheless found the selfsame cautionary language that did not protect the mixed statements *sufficient* to protect the standalone statements. *Id.* at 32a–33a.

SUMMARY OF THE ARGUMENT

The Reform Act was no small legislative accomplishment. Given the notorious litigation abuses that Congress determined had injured investors—including routine, reflexive lawsuits whenever a company did not achieve its publicly disclosed projections—Congress passed the Reform Act to protect companies from frivolous claims and encourage them to disclose forward-looking information.

The statute's centerpiece was the Safe Harbor. Other features of the Reform Act, including provisions specifying the method for choosing lead counsel and the imposition of heightened pleading standards, were also important reforms. But contemporary commentators agreed that "by far the most important provision for public companies [was] the new safe harbor for forward-looking information." Boris Feldman, *Informing the Investor, Stifling the Shareholder Suit*, The Recorder (California), Jan. 3, 1996, at 6.

The Safe Harbor protects a material projection if it is *either*:

> (1) accompanied by meaningful cautionary statements disclosing important risk factors that could cause the prediction not to be realized, *or*
>
> (2) made without actual knowledge of its falsity.

15 U.S.C. § 78u-5(c)(1) (emphasis added).[2]

The Safe Harbor's text and legislative history reveal that Congress meant these two prongs to be disjunctive, so that even a knowingly false (and material) forward-looking statement is not actionable if it is accompanied by "meaningful cautionary statements." Although the Senate bill preceding the Conference Committee's final version joined the two prongs with the conjunctive "and," the Conference Committee's final version changed the Senate version's "and" to an "or" and called the "actual knowledge" prong an "alternative analysis." Congress's intent was clear.

Yet courts have balked at interpreting and applying the statute precisely the way Congress wrote it. And though the plaintiffs' bar itself well recognized the breadth of the protection Congress provided, it has fostered the impression that the Safe Harbor marks a return to *caveat emptor*. For example, leading plaintiffs' securities lawyer William Lerach once said in an interview:

> Q: You actually have called it the Corporate License to Steal Act.

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[2] The Safe Harbor has a third prong, immateriality, which is not directly at issue here.

> A: "License to Lie." The safe harbor is actually a license to lie.

Lori Calabro, *I Told You So*, CFO Magazine, Sept. 1, 2002, at 67.

To get around the broad protections Congress intended with the Safe Harbor, courts have either committed serious legal errors—as the Ninth Circuit did here—or ignored the statute altogether by deciding motions to dismiss on other grounds. Because of this judicial antipathy to the statute's broad protections, the Safe Harbor has failed to protect forward-looking statements as Congress intended.

The Ninth Circuit's decision takes this propensity for error and avoidance to a new extreme. It invents a new rule—found nowhere in the statute or this Court's jurisprudence—that a company must admit the falsity of non-forward looking statements accompanying a forward-looking statement to obtain Safe-Harbor protection. If the Court lets the decision below stand, a plaintiff could easily plead around the Safe Harbor by challenging an accompanying non-forward looking statement—a litigation stratagem that would effectively end Safe Harbor protection in the Ninth Circuit.

The Ninth Circuit's new rule conflicts with this Court's securities jurisprudence. Its myopic focus on a false present-tense statement conflicts with the direction in *Omnicare* and *Tellabs* that courts evaluate a challenged forward-looking statement in the full context of the record properly before the court—not just the sliver the Ninth Circuit selected. Nor does its new rule require an allegation that the false non-forward looking statement was made with scienter or caused the plaintiff's loss—thus eliminating the essential elements of loss-causation, established in

Dura, and scienter, reiterated in *Tellabs*. Moreover, the Ninth Circuit's decision conflicts with Safe Harbor decisions in other circuits, a conflict petitioners have well detailed. Pet. Br. at 13, 21.

While WLF agrees that the petition should be granted, its proposed approach to applying the Safe Harbor differs somewhat from petitioners' focus on the language of the company's cautionary statements. WLF advances a standard that evaluates the meaningfulness of cautionary statements within the broader context of relevant disclosures, consistent with the direction in *Omnicare* and *Tellabs* that courts evaluate falsity and scienter allegations within the full context of information the court may consider on a motion to dismiss. Consistent with this analysis, courts should determine whether the company meaningfully disclosed its risks based on an objective review of the challenged forward-looking statements, by considering not only the warnings specifically given in the cautionary statements themselves, but also other information relevant to the forward-looking statements. WLF's standard, like QSI's, demonstrates that the Ninth Circuit's decision is incorrect.

The standard WLF advances is consistent with Congress's intent and would likely assuage the uneasiness some courts have expressed with applying the Safe Harbor as written. If courts are instructed to look at the company's disclosures through a broader prism, they will be more willing to apply the Safe Harbor as Congress intended. And if courts consider the full context of cautionary statements, companies will be more willing to disclose their projections more frequently—as Congress intended—and to amplify those projections with meaningful cautionary language that will help investors.

REASONS FOR GRANTING THE PETITION

I. THE PETITION PRESENTS AN IMPORTANT, RECURRING, AND UNRESOLVED QUESTION OF FEDERAL LAW.

A. The Safe Harbor Is an Integral Part of Securities Regulation.

The Safe Harbor does vital work. It operates separate and apart from the elements of the claims to which it applies—principally, claims under Section 10(b) of the Securities Exchange Act of 1934 and Section 11 of the Securities Act of 1933. Even a false forward-looking statement made with scienter—judged under the falsity and scienter elements of Section 10(b)—is still not actionable if the Safe Harbor applies. This feature may seem like *caveat emptor*—based on a warning, it can deprive investors of a recovery in some cases in which they relied on false statements.

But Congress was well aware of this possibility when it enacted the Safe Harbor's "meaningful cautionary statements" and "actual knowledge" prongs in the disjunctive rather than the conjunctive. Its overriding concern was that companies not be deterred from providing forward-looking information. Citing the testimony of former SEC Commissioner Richard Breeden, the Conference Committee noted that forward-looking information is "among the most valuable information shareholders and potential investors have about a firm." H.R. Rep. No. 104-369, at 43 (1995) (Conf. Rep.), *reprinted in* 1995 U.S.C.C.A.N. 730.

Yet Congress discovered that many companies opted not to disclose forward-looking information because of liability risks. The Committee also cited Mr. Breeden's

concerns about the "chilling effect" of litigation on corporate disclosure; a study showing reluctance to disclose projections; and anecdotal evidence that corporate counsel routinely advised companies to say as little as possible, "so as to provide no grist for the litigation mill." *Id*. at 42–43 (citation omitted). Congress found that "the investing public and the entire U.S. economy have been injured by the unwillingness * * * of issuers to discuss publicly their future prospects, because of fear of baseless and extortionate securities lawsuits." *Id.* at 31–32.

To address those concerns and promote greater disclosure of forward-looking information, Congress created a rule that reduced the risk of liability via the Safe Harbor.

B. How the Safe Harbor Works.

Under the Safe Harbor's first prong, designated forward-looking statements accompanied by "meaningful cautionary statements" are not actionable. *Id*. at 43. Congress intended to set an *objective* standard: "Courts should not examine the state of mind of the person making the statement" but rather should "examine only the cautionary statement accompanying the forward-looking statement." *Id*. at 44.

As the Conference Committee emphasized, the first prong has real teeth—"boilerplate warnings will not suffice"; nor will a "cautionary statement that misstates historical facts." *Id.* at 43–44. Rather, "[t]he cautionary statements must convey substantive information about factors that realistically could cause results to differ materially from those projected in

the forward-looking statement, such as, for example, information about the issuer's business." *Id.* at 43. Moreover, such cautionary statements "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." *Id.* at 43–44.

At the same time, Congress recognized that companies cannot perfectly predict the future, stressing that "important factors" does *not* mean "all factors." *Id.* at 44. In particular, "[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." *Id*. The Committee stated that the Safe Harbor was not intended "to provide an opportunity for plaintiff [*sic*] counsel to conduct discovery on what factors were known to the issuer at the time the forward-looking statement was made." *Id.*

The Safe Harbor's second prong—protecting forward-looking statements made without "actual knowledge" that they were false or misleading—was intended as an "alternative analysis." The Senate bill preceding the Conference Committee's final version was a *conjunctive* scienter requirement—to fall within the Safe Harbor, a forward-looking statement had to be *both* (1) accompanied by meaningful cautionary statements *and* (2) made without a purpose and actual intent to mislead. *See* S. 240, 104th Cong. § 105 (1995) (as passed by the Senate June 28, 1995), *reprinted in* 141 Cong. Rec. 17,444, 17,447–48. Congress's ultimate decision to make the two prongs *disjunctive* manifests its clear intent to make the first prong an unambiguous, independent, and objective standard.

C. The Ninth Circuit and Other Lower Courts Have Improperly Circumvented the Safe Harbor Through Error and Avoidance.

Yet many courts have struggled against the *caveat-emptor* feel of the Safe Harbor's disjunctive structure: that a company may *intentionally* make false or misleading forward-looking statements so long as they are accompanied by "meaningful" cautionary statements identifying "important" risk factors. That disjunctive structure led the First Circuit to describe the Safe Harbor as a "curious statute, which grants (within limits) a license to defraud." *In re Stone & Webster, Inc. Sec. Litig.*, 414 F.3d 187, 212 (1st Cir. 2005).

1. Circumvention Through Judicial Error.

Judicial discomfort with this purported "license to defraud" has led many courts to interpret and apply the Safe Harbor in a manner inconsistent with the plain language of the statute and Congress's intent.

For example, in *Asher* v. *Baxter Int'l, Inc.*, 377 F.3d 727, 734 (7th Cir. 2004), the Seventh Circuit thoughtfully examined the legislative history but then proceeded to insert the word "the" before "important" in the phrase "identifying important factors," contrary to Congress's clear intent that "not all factors" must be identified. *See* H.R. Conf. Rep. No. 104-369, at 44. Compounding this error, the court held that plaintiffs were entitled to discovery into whether "the items mentioned in Baxter's cautionary language were those that at the time were the (or any of the) 'important' sources of variance." *Asher*, 377 F.3d at 734. He noted that Baxter's "cautionary language remained fixed

even as the risks changed," so it was unclear without discovery whether "Baxter omitted important variables from the cautionary language." *Id*. That holding contravenes Congress's intent that the "important" requirement never open the door to discovery. *See* H.R. Rep. No. 104-369, at 44.

Another way courts have misinterpreted the Safe Harbor is to read a scienter requirement into the first prong, converting the disjunctive "or" into a conjunctive "and." Despite concerns about a "license to defraud," every Circuit to consider the issue has correctly interpreted the plain text of the Safe Harbor as setting forth disjunctive requirements—that is, "or" means "or." *See OFI Asset Mgmt.* v. *Cooper Tire & Rubber*, 834 F.3d 481, 502 (3d Cir. 2016); *IBEW Local 98 Pension Fund* v. *Best Buy Co., Inc.*, 818 F.3d 775, 778 n.2 (8th Cir. 2016); *In re Cutera Sec. Litig.*, 610 F.3d 1103, 1111–12 (9th Cir. 2010); *Slayton* v. *Am. Express Co.*, 604 F.3d 758, 766 (2d Cir. 2010); *Edward J. Goodman Life Income Trust* v. *Jabil Circuit, Inc.*, 594 F.3d 783, 794–95 (11th Cir. 2010); *In re Stone & Webster*, 414 F.3d at 195; *Southland Sec. Corp.* v. *INSpire Ins. Sols., Inc.*, 365 F.3d 353, 371 (5th Cir. 2004); *Helwig* v. *Vencor, Inc.*, 251 F.3d 540, 548 (6th Cir. 2001) (en banc), *overruled on other grounds by Tellabs, Inc.*, 551 U.S. at 314). Nevertheless, many district courts have interpreted the "meaningful" requirement in a manner that effectively turns "or" into "and" by holding that actual knowledge of the forward-looking statement's falsity means the cautionary language can never be meaningful. *See, e.g.*, *In re Genworth Fin. Inc. Sec. Litig.*, 103 F. Supp. 3d 759, 790 (E.D. Va. 2016); *City of Ann Arbor Emps.' Ret. Sys.* v. *Sonoco Prods. Co.*, 827 F. Supp. 2d 559, 576 (D.S.C. 2011); *Freudenberg* v. *E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 193–94 (S.D.N.Y. 2010); *In re*

SeeBeyond Techs. Corp. Sec. Litig., 266 F. Supp. 2d 1150, 1163–67 (C.D. Cal. 2003).

Despite previously holding that "or" means "or," *see In re Cutera*, 610 F.3d at 1112–13, the Ninth Circuit's decision here essentially nullified that earlier holding—no doubt driven by the perceived danger of a "license to defraud" that the First Circuit explicitly voiced. The appeals court announced a new, bright-line rule for "mixed" statements—that is, "[w]here a forward-looking statement is accompanied by a non-forward-looking factual statement that supports [it]"—that would essentially eviscerate the first prong of the Safe Harbor in most cases. Pet. App. 27a.

The Ninth Circuit's analysis conflicts with the plain statutory language in two distinct ways. First, like *Asher*, the court focused on the absence of cautionary language regarding a *particular* "important factor," which essentially reads "the" into the statute before the words "important factors." But not *all* important factors must be disclosed; even the failure to disclose the actual factor that causes the projections to be inaccurate is not necessarily fatal. *See* H.R. Rep. No. 104-369, at 44; *Harris* v. *Ivax*, 182 F.3d 799, 807 (11th Cir. 1999).

Second, the Ninth Circuit's categorical rule provides that cautionary language cannot be "meaningful" absent an admission of falsity that related statements of present or past facts are false or misleading—even if the company did not know they were. By not even considering scienter in evaluating cautionary statements, the rule creates strict liability for companies who inadvertently misstate present or historical facts in connection with a forward-looking statement.

The Ninth Circuit's rule effectively swallows the entirety of the Safe Harbor's first prong. Companies routinely provide earnings guidance on quarterly analyst calls, during which they also discuss past results and current facts about the business, often in response to direct questions from analysts. Under the Ninth Circuit's rule, such projections might be considered "mixed" statements, and therefore any misstatement about the present or past state of the business would nullify the first prong of the Safe Harbor for the projections. The practical consequence will likely be the very problem Congress sought to avoid: companies will be hesitant to disclose earnings projections and other information about future business prospects.[3]

2. Circumvention Through Judicial Avoidance.

Disagreement with the Safe Harbor has also spawned judicial avoidance. Judges often treat the Safe Harbor as a secondary consideration or avoid it entirely. Over the first ten years of the Reform Act, "[d]ozens of Reform Act motions to dismiss premised in part on the safe harbor came and went without courts addressing the issue. Often, courts dismissed the complaints on other grounds or ignored the issue altogether." Douglas Clark, *How Safe is the Safe Harbor?*, Wilson Sonsini Goodrich & Rosati Client

[3] Staying silent bears its own risks. For example, Item 303 of Regulation S-K requires an issuer to disclose "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact * * *." 17 C.F.R. § 229.303(a)(3)(ii). This Court was set to resolve a circuit split over whether Item 303 can give rise to claims under Section 10(b) before the parties settled. *Leidos, Inc.* v. *Indiana Pub. Ret. Sys.*, *cert granted*, No. 16-581 (March 27, 2017).

Alert, at 1 (June 2005), https://www.wsgr.com/publications/pdfsearch/clientalert_safeharbor.pdf.

Starting in 2005, courts began to apply the Safe Harbor more frequently but then often criticized and worked around it through the types of legal gymnastics discussed above. This phenomenon raises the question of whether the safe harbor is really safe. *See, e.g.*, Lyle Roberts & Noelle Francis, *Is the PSLRA's Safe Harbor Becoming a Safe Puddle?*, PLI's Securities Litigation & Enforcement Institute 2008, No. 14673 (June 2008).

Today, Safe-Harbor jurisprudence is at best unpredictable. Some courts get it right, and some get it wrong—as the Ninth Circuit's decision shows—and some still work around it. *See, e.g.*, *Williams* v. *Globus Med., Inc.*, 869 F.3d 235, 245–46 (3d Cir. 2017) (using safe harbor as a fallback basis to affirm dismissal of forward-looking statements); *IBEW Local No. 58 Annuity Fund* v. *EveryWare Glob., Inc.*, 849 F.3d 325, 328, n.2 (6th Cir. 2017) (affirming dismissal of forward-looking statements on scienter grounds); *Ganem* v. *InVivo Therapeutics Holding Corp.*, 845 F.3d 447, 454 n. 5 (1st Cir. 2017) (affirming dismissal of challenge to forward-looking statements on falsity grounds); *Tongue* v. *Sanofi*, 816 F.3d 199, 211–14 (2d Cir. 2016) (affirming dismissal of challenge to forward-looking statements under *Omnicare*). This makes the Safe Harbor an uncertain basis for seeking dismissal, relegating it to a fallback argument.

D. Lower Courts Require the Certainty of Harmonious Standards.

QSI argues for a standard under the Safe Harbor's first prong that focuses primarily on the cautionary language at issue. Pet. Br. at 25–27. WLF agrees with

QSI's analysis of the conflict among lower court decisions, *id.* at 13–21, and believes QSI's proposed standard for prong one of the Safe Harbor would benefit public companies and investors. QSI's interpretation is plainly superior to the Ninth Circuit's erroneous holding below.

But other standards would conform with Congress's intent as well. Following a detailed discussion of the conflict the Ninth Circuit has created with this Court's securities decisions, WLF suggests a different standard—one that would both avoid conflict and harmonize the Safe Harbor with this Court's rulings, avoid the *caveat-emptor* concern that causes so many courts to stretch to avoid applying the Safe harbor as written, and incentivize companies to better warn investors about their risks.

II. THE LOWER COURTS' MUDDLED SAFE HARBOR DECISIONS UNDERMINE THIS COURT'S SECURITIES JURISPRUDENCE.

It is critical to the viability of the Safe Harbor and the system of securities litigation to give the statute the distinct meaning and emphasis Congress intended. Relegating the Safe Harbor to a fallback causes conflict and confusion.

The decision below illustrates this problem. To avoid applying the Safe Harbor as written, the Ninth Circuit made three rulings that conflict with this Court's securities decisions:

First, it held that QSI's cautions were not "meaningful" because QSI made accompanying false non-forward looking statements. This is directly at odds with the command in *Omnicare* and *Tellabs* that courts examine the full context of challenged statements—not just the sliver the Ninth Circuit directed—to

determine if they are misleading or made with knowledge.[4] 135 S. Ct. at 1330; 551 U.S. at 322–23.

Second, the Ninth Circuit permitted the claim to proceed despite failing to analyze whether, when, and how the false statement accompanying the challenged forward-looking statement must be revealed as false for loss-causation purposes under *Dura*, 544 U.S. at 342–46.

If the earnings projection is what causes the loss, and the false statement is not shown to be false until later or does not negatively impact the stock price, *Dura* dictates that the plaintiffs have failed to state a claim. If the stock price does not drop once the statement of historical fact is revealed to be false, the statement is not actionable. Yet, the Ninth Circuit's new rule simply does not take account of such factors.

Third, the Ninth Circuit eliminated protection of the Safe Harbor's second prong by erroneously relying on *Tellabs* to support its conclusion that the complaint plead "actual knowledge" that the challenged projections were false. After finding scienter with respect to non-forward-looking statements based on *Tellabs*, the court concluded "[i]t necessarily follows that they

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[4] *Omnicare* held that whether a statement of opinion (and by clear implication, a statement of fact) was misleading "always depends on context." 135 S. Ct. at 1330. This requires courts to consider not only the challenged statements and its context, but also other publicly available information, including industry customs and practices. *Id.* This is an objective inquiry. *Id.* at 1327. While *Omnicare* arose under Section 11, lower courts have held that its analysis applies to claims under Section 10(b). *See Sanofi*, 816 F.3d at 209–10; *City of Dearborn Heights Act 345 Police & Fire Ret. Sys.* v. *Align Tech., Inc.*, 856 F.3d 605, 616 (9th Cir. 2017).

also had actual knowledge that their forward-looking statements were false or misleading." Pet. App. 34a.

The court's conclusion skips an analytic step. The Ninth Circuit's scienter standard is "deliberate recklessness," *id.* at 23a, a lower standard than "actual knowledge," and the Ninth Circuit decision employed *Tellabs's* collective analysis to determine that an individual defendant "knew *adverse information* about the state of QSI's sales he was not sharing with the general public." *Id.* at 26a (emphasis added). But knowing adverse information, while relevant, is not the same as knowing the challenged forward-looking statement is false. The Ninth Circuit failed to engage in this necessary further analysis. *See Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 48 n.14 (2011) (recognizing the Safe Harbor's "actual knowledge" standard).

III. THE COURT SHOULD SEIZE THIS OPPORTUNITY TO HARMONIZE THE SAFE HARBOR WITH ITS SECURITIES-LAW DECISIONS.

The Court should use this case to resolve the conflict between the decision below and this Court's jurisprudence and provide the lower courts with much-needed guidance on the proper application of the Safe Harbor. The Court should grant review and adopt a standard that emphasizes an objective, context-based approach to what constitutes "meaningful cautionary statements" consistent with the Court's decisions in *Omnicare* and *Tellabs*.

This standard would create more certainty and improve corporate disclosure. The more consistently courts apply the Safe Harbor, the safer companies will feel disclosing their projections, consistent with

Congressional intent. A context-based standard would also incentivize companies to disclose their real risks in a straightforward way, to ensure they meet the Court's standard for judging meaningfulness. The result will be disclosure of more forward-looking statements and the accompanying risks.

A. Looking at Meaningfulness Through a Broader Prism.

The standard WLF proposes flows from the D.C. Circuit's decision in *In re Harman Int'l Indus., Inc. Sec. Litig.*, 791 F.3d 90 (D.C. Cir. 2015), *cert. denied*, 136 S. Ct. 1167 (2016). While *Harman*'s analysis is uneven, as petitioners note, Pet. Br. at 17, WLF agrees with the court's focus on the objective content and quality of the cautionary language.

In *Harman*, the court turned to a tried and true source—the dictionary—to support an objective standard under the Safe Harbor's first prong. The court observed that "meaningful" means "significant" or of "useful quality or purpose," and that "important" likewise means something "of great significance or value." *Harman*, 791 F.3d at 101 (citations omitted). Building on those definitions, the court ruled that the first prong of the Safe Harbor required cautionary language "that is tailored to a particular company's status at a particular time" as well as to "the [particular] forward-looking statement that it accompanies." *Id.* at 101–02. *Harman*'s focus on the objective *content* and *quality* of the cautionary language—rather than the speaker's state of mind—coheres with congressional intent. *See* H.R. Rep. No. 104-369, at 43–44. *Harman*'s objective standard thus avoids the improperly subjective focus espoused by *Asher* and mimicked by the Ninth Circuit below.

Such a standard is also workable for company management seeking to provide guidance to investors—the Safe Harbor's animating purpose. The *Harman* standard would require a company to disclose what are essentially "the real risks." *See* Clark, *supra*, at 3. While the "real risks" cannot be identified in the abstract, they have objective characteristics consistent with the *Harman* standard: (1) "they change all the time, so if the safe harbor risks don't change over time, they are not real risks"; (2) they are specific to the particular forward-looking statement to which they apply; *i.e.*, "the same risks that apply to a statement concerning financial projections don't apply to a statement concerning the release of a new product"; and (3) they "are rarely, if ever, vague." *Id.* And, most importantly, "[a]ll companies face real risks," and the company itself is in the best position to identify and disclose them. *Id.* Tailored, detailed discussion of challenges demonstrates an effort on the part of the company to identify the "real risks." But that is *not* to say that courts should inquire into company management's state of mind—no company is perfectly prescient, and a company's failure to identify a risk that ultimately materializes does not mean that its other detailed disclosures of risks were neither "meaningful" nor "important."

B. Using Context, Courts Can Evaluate Cautionary Statements Objectively.

But how can we know if a company has actually identified the "real risks" without a subjective inquiry? That is the question posed (but not satisfactorily answered) by the Second Circuit in *Slayton*. *Slayton* correctly observed that "the Conference Report makes quite plain that [Congress] does not want courts to inquire into a defendant's state of mind." 604 F.3d at

771. Yet the court lamented that it could not assess whether the cautionary language identified "important" factors without "some reference by which to judge what the realistic factors were at the time the statement was made." *Id.* The court reasoned that the most "sensible reference" required "an inquiry into what the defendants knew" at the time the statements were made. *Id.*

Faced with contrary statutory language and Congressional intent, the court implored Congress to provide "further direction on how to resolve this tension," asking, "[m]ay an issuer be protected by the meaningful cautionary language prong of the safe harbor even where his cautionary statement omitted a major risk that he knew about at the time he made the statement?" *Id.* at 772.

The petition offers this Court an excellent opportunity to address the Second Circuit's question and the concerns that have motivated talented judges to simply get the Safe Harbor wrong. A subjective inquiry is not required.

This Court regularly uses the overall objective context of a statement to make complex assessments of its import—even on motions to dismiss. For example, in *Omnicare*, the Court considered when a statement of opinion can be actionable as a false or misleading statement. The Court explained that whether a statement of opinion is "false" turns on whether the speaker actually holds the opinion—a subjective inquiry. *Omnicare*, 135 S. Ct. at 1326. Yet in most cases—including *Omnicare*—investors also allege that statements were "misleading" because they omitted facts that undermine them. *See id.* at 1327. That, the Court held, is an "objective" inquiry that "depends on

the perspective of a reasonable investor." *Id.* And importantly, "whether an omission makes an expression of opinion misleading always depends on context." *Id.* at 1330. The Court observed that investors review a company's statement, "whether of fact or of opinion, in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information," and "tak[ing] into account the customs and practices of the relevant industry." *Id.* A plaintiff must show that a statement is objectively misleading in light of this "full context." *Id.*

Even in an area as plainly subjective as scienter, courts rely on objective cues to make judgments at the pleading stage in the absence of direct evidence of a defendant's state of mind. In *Tellabs*, the Court held that to determine whether a securities fraud plaintiff has alleged facts giving rise to a "strong inference" of scienter as required by the Reform Act, "courts must consider the complaint in its entirety, as well as other sources courts ordinarily examine when ruling on Rule 12(b)(6) motions to dismiss, in particular, documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." 551 U.S. at 322. "The inquiry * * * is whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard." *Id.* at 322–23 (emphasis in original).

Courts can likewise look to the objective context of cautionary statements to determine whether they are "meaningful" and disclose "important" risk factors. How closely tailored are the risk factors to the forward-looking statements they support? Are they particular to this company, or could they apply to

anyone? Have the risk factors applied to forward-looking statements evolved over time as the overall risk factors facing the business—as disclosed in the company's annual and quarterly reports, press releases, and other public information incorporated into the complaint or subject to judicial notice—have changed? Do the risk factors address additional historical facts that have recently been disclosed in public filings? In short, does it appear that the company has made a genuine effort to identify the "real risks," as opposed to simply issuing boilerplate cautions? Those questions can be answered *without* inquiring into company management's state of mind. Context provides an objective basis to evaluate cautionary language on a motion to dismiss.

C. This Case Is an Excellent Vehicle for Clarifying the Meaning of "Meaningful Cautionary Statements."

Under either QSI's or WLF's standard, the cautionary statements at issue here were "meaningful." WLF's standard, however, looks beyond the standard risk factors to other risk information QSI provided to investors.

In reaching its conclusion that QSI's cautionary language was not meaningful, the Ninth Circuit restricted itself to one thing: the one paragraph statement provided by QSI at the start of the calls and presentations during which it "misled" investors. Pet. App. 32a–33a, 46a–48a. WLF agrees with QSI that these cautions *were* meaningful, as they warned investors of important factors including uncertain sales cycles and rates of product acceptance. But those warnings were not QSI's only cautions. Pet. App. 29a–30a. For example, on the May 9, 2012, conference call

identified in the complaint, QSI warned investors about market volatility:

> [I]t doesn't take much of a blip to have a pretty big swing in a quarter-to-quarter result. * * * So if something just fluctuates a little bit on a quarter-to-quarter basis, you're going to see shifts in revenue, a good quarter and a bad quarter. It just isn't linear, as much as we'd all like to see that.

Declaration of Katherine A. Rykken in Support of Defendants' Motion to Dismiss Amended Complaint, at 738, *In re Quality Sys., Inc. Secs. Litig.*, 60 F. Supp. 3d 1095 (C.D. Cal. 2015) (No. 13-1818) (Robert Baird Conference, May 9, 2012). Then on a June 9, 2011 call, QSI gave warnings about pipeline estimates:

> [I]t's a judgment call on many cases about is it greater than 50% chance of closing or not. And it's also tricky to know the timing of these things. So I think it's a lot easier to know if something belongs on the pipeline or not, but it's even more tricky to figure out exactly when some of those things are going to actually close.

Id. at 687 (Goldman Sachs Conference, June 9, 2011).

Warnings like these in broader context show a company grappling with an uncertain business and financial environment. In combination with the cautionary statements on which QSI relies, it is clear QSI's cautionary statements were "meaningful." Congress did not require perfection. QSI's warnings show that it attempted to disclose its real risks, and viewed objectively, it did. Under either QSI's or WLF's standard, the Ninth Circuit decision was plainly wrong.

Congress wanted to encourage companies to disclose their projections. The counterbalance is "meaningful" disclosure of their risks. With an objective standard that examines the broader frame, courts would make better decisions about whether they did. WLF's standard thus would be faithful to the statutory text, further Congress's intent that companies disclose their projections and risks, and harmonize the Safe Harbor with this Court's securities jurisprudence.

CONCLUSION

The Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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