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Third Circuit Affirms “Safe Harbor” Protection for Forward Looking Statements Accompanied By Adequate Warnings and Cautionary Statements

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The United States Court of Appeals for the Third Circuit recently clarified the protection afforded under the “Safe Harbors” provision of the Private Security Litigation Reform Act (“PSLRA”) on certain types of forward-looking statements.

In Institutional Investors Group v. Avaya, Inc., No. 06-4595 (3d Cir. Apr. 30, 2009), the Third Circuit considered a putative class action against Avaya, Inc. (“Avaya”), its CFO and CEO, alleging that the defendants made false or misleading statements about earning growth and potential, and in responding to pricing pressure in violation of Rule 10b-5 of the Securities and Exchange Act of 1934.

The plaintiffs made the following factual allegations. In January of the fiscal year 2005, Avaya issued projections for increased revenue and operating margins for that year. In announcing its first quarter results for the fiscal year 2005, Avaya stated that the company was positioned to meet its fiscal year 2005 goals and the company was on track to meet those goals. On March 2, 2005, Avaya adjusted its projected annual revenue growth from 25-27% to 28%. On the same day, Avaya also advised that it was not offering unusual discounts or facing significant pricing pressure from market rivals.

On March 4, 2005, an independent market research group reported that a “sale channel check” showed weak spending for Avaya products and, further, Avaya had fired sales staff to cut costs. On March 7 and 10, 2005, Avaya again advised that there had been no significant price changes in the market. On March 21, 2005, a Lehman Brothers’ analyst reported that Avaya was offering 20-40% discounts for its mid-range products. Various former employees of Avaya, who were “confidential witnesses,” stated that Avaya had been giving substantial discounts to many of its customer beginning in mid-2004. On April 19, 2005, Avaya announced that revenues for the second quarter had increased only 21% over second quarter fiscal year 2004 revenues, and that the company would not meet its fiscal year 2005 projections for revenue growth.

The trial court granted defendants’ motion to dismiss plaintiffs’ complaint concerning Avaya’s

forecasts. In affirming the trial courts' ruling, the Third Circuit Court first addressed whether Avaya's statements regarding its fiscal year 2005 projections were protected from liability under PSLRA's Safe Harbor provisions for forward looking statements. Pursuant to 15 U.S.C. 78u-5(c), a forward looking statement is protected if it is: 1) identified as a forward looking statement and accompanied by meaningful cautionary language; 2) immaterial; or 3) is made without actual knowledge that it is false.

The Avaya Court ruled that the January 2005 statement that Avaya was positioned and on track to meet the fiscal year 2005 projections was protected under the Safe Harbors provision of PSLRA. The Court stated that these statements are implicit in every future projection and were "accompanied by meaningful cautionary statements identifying important factors" that might affect those projections. Specifically, the Court noted that in all of its SEC filings, Avaya listed specific factors and uncertainties that could affect future economic results. In addition, in its press releases Avaya further explained that the statements involved risks and uncertainties that could negatively affect financial results. Thus, the Court dismissed that part of the plaintiffs' complaint dealing with Avaya's forward looking statements.

The Avaya Court's ruling has set certain standards for publicly-held corporations. For instance, the court relied heavily on the warnings and cautionary statements provided in each of Avaya's press releases and SEC filings in determining that Avaya's forward looking statements fell within the "Safe Harbors" of the PSLRA. However, the Avaya Court noted that while the warnings and cautionary statements may contain some generic warning statements, there must also be company specific warnings and cautionary statements in order to be afforded Safe Harbor protection. The statements must all be identified as "forward-looking."

Should you have any questions about this decision, please contact us.