

The Second Circuit Issues An Important Decision Regarding The Scope Of The Bespeaks-Caution Doctrine That Is Relevant For Any Company Making Public Statements

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In a recent decision, the United States Court of Appeals for the Second Circuit made clear that the bespeaks-caution doctrine applies to forward-looking statements only and not to characterizations that communicate present or historical facts.¹ Any company that makes public statements should take heed. Disclosures about risks will cover forward-looking statements; but where a plaintiff can show that an allegedly false or misleading statement pertains to present or historical facts, the company may find itself embroiled in securities litigation.

In *MF Global*, plaintiffs in the putative class action suit brought claims under Sections 11, 12(a)(2), and 15 of the 1933 Securities Act, alleging in the complaint that MF Global misrepresented and failed to disclose relevant material information in a prospectus and registration issued when the brokerage firm went public in July 2007. MF Global's assurances of internal risk controls became a hot issue six months later when one of its brokers lost \$141.5 million in a single morning speculating in wheat futures. In doing so, the broker took positions "vastly in excess of" MF Global's trading limits and collateral requirements.² In wake of the enormous loss, which the firm absorbed, MF Global's stock plummeted, prompting the lawsuit.

In its prospectus and registration, MF Global had characterized its risk management system as "robust."³ After the trading loss and resulting stock price nose-dive, the plaintiffs argued that this characterization was a misrepresentation and that the firm failed to disclose relevant information about its risk

management. The defendants argued that plaintiffs' claims should be dismissed because the statements regarding risk management were forward-looking and covered by the bespeaks-caution doctrine.

The United States District Court for the Southern District of New York dismissed the complaint in its entirety for failure to state a claim.⁴ The district court held that "cautionary language elsewhere in the prospectus rendered the cited statements or omissions non-actionable pursuant to the bespeaks-caution doctrine."⁵ The bespeaks-caution doctrine provides that "a forward-looking statement accompanied by sufficient cautionary language is not actionable because no reasonable investor could have found the statement materially misleading."⁶ The district court held that the plaintiffs' claim of alleged failure to disclose information about the firm's risk management system merely related to MF Global's ability to prevent future negative outcomes.

Reversing in part and remanding, the Second Circuit held that the district court's decision "misstates the threshold test, and applies the bespeaks-caution doctrine too broadly."⁷ The Second Circuit noted that "there is a discernable difference between a forecast and a fact, and courts are competent to distinguish between the two."⁸ Although it declined to "draw a line" between forecast and fact, the Second Circuit offered the following guidelines:⁹

- A "non-forward-looking statement" is one that "provides an ascertainable or verifiable basis for the investor to make his own prediction"¹⁰ ;

1. *Iowa Public Employees' Retirement System v. MF Global, Ltd.*, No. 09-3919-cv, 2010 U.S. App. LEXIS 19138 (2d Cir. Sept. 14, 2010).

2. *Id.* at *3.

3. *Id.* at *18.

4. *Rubin v. MF Global, Ltd.*, 634 F. Supp. 2d 459 (S.D.N.Y. 2009). Plaintiffs also attacked other statements as false and misleading, but this alert focuses on the risk management system disclosure, which was the main issue before the Second Circuit.

5. *Iowa Public Employees Retirement System*, 2010 U.S. App. LEXIS 19138 at *6.

6. *Id.* at *8.

7. *Id.* at *14.

8. *Id.* at *16-17.

9. *Id.* at *17.

- Statements or omissions as to the operations in place and present intentions as to future operations may be non-forward-looking;
- Statements containing *both* forward-looking and non-forward-looking elements are severable; and
- The bespeaks-caution doctrine will not apply to characterizations that communicate present or historical fact as to measures taken to reduce risk.

The Second Circuit's decision provides fair warning to all companies that there is a limit to the bespeaks-caution doctrine. Companies need to be particularly careful and precise when making statements that could be construed as non-forward-looking.

The Second Circuit remanded the issue to the district court to analyze the plaintiffs' claims under the proper standard, as articulated in its opinion.

10. *Id.* at *16.

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