The Safe-Harbor Rule for Projections: Caveat Projector

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INTRODUCTION

The Securities and Exchange Commission (SEC) recently adopted a “safe-harbor rule” to shield voluntary corporate disclosures of projections and other types of forward-looking information from liability under the federal securities laws. The SEC hopes that the adoption of safe-harbor will encourage companies to make public disclosures of this type of corporate information. At first glance, a company may conclude that the SEC’s newly adopted rule provides sufficient incentive to enter into the unchartered waters of corporate disclosure of forward-looking information. An analysis of the Rule, however, reveals that the uncertainties and risks which have survived the adoption of safe-harbor leave substantial cause for concern.

This article will summarize the historical development of the SEC’s policies and practices regarding projections, and outline the framework of guidance and requirements established by the SEC for the public disclosure of projections. Next, a detailed analysis of the uncertainties and risks associated with such disclosures will be provided. Finally, the article will discuss the effects the adoption of the safe-harbor rule might have on judicial attitudes which surround the issuance of projections and the resulting impact on future corporate disclosure policies.

HISTORICAL DEVELOPMENT

Prior to 1973, the SEC’s disclosure policies under the Securities

2. Release, supra note 1.
Act of 1933 and the Securities Exchange Act of 1934 were restrictive as to projections. During this period, the SEC prohibited inclusion of economic forecasts and projections in filed documents. This exclusionary policy was premised on the SEC’s belief that: projections are not facts; projections are inherently unreliable; projections could be given undue credence if included in filed documents; and projections could be susceptible to improper manipulation by unscrupulous corporate managers.

After conducting public hearings, the SEC announced in February, 1973, that changes in its platform on projections “would assist in the protection of investors and would be in the public interest.” The SEC concluded that issuers should be permitted to make projections if underlying assumptions are set forth and if information is updated on a regular basis. Any such disclosure should be made in both an SEC filing and an immediate company release. Furthermore, the SEC announced that it would consider adopting rules stating that a projection is not a promise that projected re-

6. REPORT, supra note 3, at A-268. This exclusionary policy was founded on the belief that, “the Securities Act, like the hero of ‘Dragnet,’ is interested exclusively in facts. Conjectures and speculations as to the future are left by the Act to the investor on the theory that he is as competent as anyone to predict the future from the given facts.” Heller, Disclosure Requirements Under Federal Securities Regulation 16 BUS. LAW. 300, 307 (1961). See also SECURITIES AND EXCHANGE COMMISSION, DISCLOSURE TO INVESTORS, A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE ’33 AND ’34 ACTS 95-6 (1969) [hereinafter cited as THE WHEAT REPORT].
7. The Division of Corporation Finance received testimony from 53 witnesses, including representatives of publicly held corporations, the securities industry, the academic community, the self-regulatory organization, and the accounting and legal professions. Letters from over 200 interested parties were received and made part of the public record. Sec. Act Release No. 5362, [1972-1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,211.
9. See notes 102 through 115 infra and accompanying text.
11. Id.
results will be achieved. Then, a projection would not be false or misleading information if, in fact, not achieved. This proposed change in policy reflected a desire to bring full disclosure, clarity and reasonable standards to earnings projections provided to outsiders by issuers.

Recognizing that the potential for liability associated with misstatements and omissions in SEC filings may deter issuers from disclosing any projections, the SEC, in 1975, proposed for comment a safe-harbor rule. This Rule defined the circumstances under which "a projection should not be deemed to be an untrue or misleading statement of a material fact or a manipulative, deceptive, or fraudulent device, contrivance, act, or practice as those terms are used in the various liability provisions of the Acts." Just one year later, the SEC withdrew the proposed safe-harbor rule, even though it realized that without such a rule companies might be deterred from disclosing forward-looking information in filings. However, the SEC stated that it was neither "encouraging nor discouraging the making and filing of projections. . . ."

Yet acknowledging that issuers who decided to make projections during this period might need some guidance on preparation and disclosure of projections, the SEC published for comment a set of

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12. Id.

13. Id. at 82,665. To meet this objective, the SEC directed its Division of Corporation Finance to prepare releases, rules, and form changes to implement the policy. Id.


16. Sec. Act Release No. 5699, [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,461. At the time, the SEC withdrew the rule, it admitted that reasonably based and adequately disclosed projections should not subject issuers to per se liability if not achieved. Consequently, withdrawing this rule would appear to be inconsistent with the SEC's stated position.

The SEC also withdrew all the proposals designed to implement the safe-harbor rule, since they had been severely criticized by the commentators for being overly restrictive and complicated and for making the disclosure of projections too risky from a legal standpoint. See summary of comments in Sec. Reg. & L. Rep. (BNA) 320, at D-1 to D-4 (Sept. 24, 1975).

proposed Guides and appointed an Advisory Committee to study the entire corporate disclosure system. In its 1977 report, the Committee recommended the publication of forward-looking information in statements to shareholders and SEC filings and the adoption of a safe-harbor rule. Essentially, this Rule would provide protection from liability for unachieved forward-looking information unless it could be proved that the disclosure was without a reasonable basis or disclosed other than in good faith.

In November, 1978, the SEC issued a policy statement encouraging the disclosure of projections and authorized publication of the proposed Guides. In addition, the SEC proposed for comment two versions of a safe-harbor rule.

18. Id. The Guides set forth policies and practices to be applied to voluntary disclosures of projections in SEC filings. See also Division of Corporate Finance, Securities and Exchange Commission, Hendricks & Tomlinson Staff Reply, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,664 (an illustration of the application of the Guides during this interim period).


20. Report, supra note 3, at A344-65. The safe-harbor rule proposed by the Committee was identical to the Commission's safe-harbor rule for replacement cost information included in filed documents. § 3-17 (g) of Regulation S-X, 17 C.F.R. § 210.3-17(g) (1977).


23. Sec. Act Release No. 5993, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,757. One version originated from the SEC, whereas the other resulted from the Advisory Committee's Report. Report, supra note 3. The SEC's version was limited in scope to revenues, income (loss), earnings (loss) per share and other financial information. The Advisory Committee's version expanded the SEC's proposed coverage to include managements' plans and objectives for future operations, planned capital expenditures and financing, and statements of policy concerning dividends and overall capital structure.

The SEC's version limited coverage to issuers who were subject to the reporting requirements of § 15(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(d) (1970). The Advisory Committee's version was not limited to reporting companies.

As to burdens of proof, the SEC's version required the issuer to establish that projections had a reasonable basis and were disclosed in good faith. In contrast, the Advisory Committee proposed that the plaintiff establish that the projections did not have a reasonable basis or were not disclosed in good faith. The SEC justified its burden of proof allocation, claim-
On June 25, 1979, the SEC adopted a safe-harbor rule incorporating aspects of both proposals. This Rule is designed to provide protection from the applicable liability provisions of the federal securities laws for forward-looking statements made by issuers in SEC filings or in annual reports to shareholders.

Now that the SEC has formally adopted a safe-harbor rule, it is up to issuers to make the next move with respect to projections. Any action, however, must be made in light of the responsibilities and policies set out in the Guides and the new safe-harbor rule, as outlined below. In addition issuers, in designing their projection programs, must be aware of the potential pitfalls and uncertainties engendered by the Rule.

THE GUIDES AND SAFE-HARBOR - A FRAMEWORK FOR ANALYSIS

The Guides encourage the disclosure of projections and forward-looking information made with a reasonable basis and disclosed in good faith, provided that the information is made available that its position was consistent with Congressional intent as expressed in the course of drafting §§ 11 and 12 of the Securities Act of 1933. Sec. Act Release No. 5993, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,757, at n. 10. The Advisory Committee's version was more reflective of a policy encouraging disclosure of projections, since it was less restrictive in scope and placed the burden of proof on the plaintiff.

24. Release, supra note 1. In both form and substance, the final Rule was more characteristic of the Committee's version than the SEC's version.

At the same time, the SEC amended Rule 14a-9, 17 C.F.R. ¶ 240.14a-9 (1978), under the Exchange Act of 1934 to delete the reference to a prediction of dividends as a possible misleading statement in order to be consistent with the SEC's new position that a projection of future dividends is permissible.


26. Publication of the Guides by the SEC is intended to implement the position of the Advisory Committee and the SEC that the making of projections be encouraged. Though the Guides are not SEC rules and are merely advisory in nature, they provide companies with insight into what factors the SEC views as important insofar as the public disclosure of projections is concerned.

able to the public generally.\textsuperscript{28} Issuers are required to make full and prompt disclosure of material facts regarding their financial condition.\textsuperscript{29} This responsibility includes a duty to correct previously issued projections if they become false or misleading.\textsuperscript{30} Management is responsible for determining whether it should discontinue making projections, and this decision must be supported by a reasonable basis.\textsuperscript{31} While the Guides specifically pertain to projections in SEC filings, consistency would seem to mandate that they be applicable to financial forecasts in non-filed documents as well.

The Guides set forth the views of the Division of Corporation Finance on three important points relating to the preparation and disclosure of projections: (1) that management have a reasonable basis for its projections; (2) that the projections be presented in an appropriate format; and (3) that the accompanying disclosures facilitate investor understanding of the basis for and limitations of projections. Even though the Guides are neither SEC rules nor SEC approved, they will be followed by the Division of Corporation Finance in administering the disclosure requirements of the Securities Act and the Exchange Act.\textsuperscript{32}

Reasonable Basis for Projections

The Guides provide minimum guidance for preparing reasonably-based projections. In addition, reference is made to a company's history of operations or experience in projections,\textsuperscript{33} outside

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\textsuperscript{29} Guides, supra note 22.

\textsuperscript{30} Id. This duty to correct may even extend to situations where a company has made a mandatory submission of projections to regulatory authorities if the submission would also be available to the public. Sec. Act Releases No. 5992, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) \$ 81,756, at 81,039.

\textsuperscript{31} Guides, supra note 22.

\textsuperscript{32} Id. Therefore, issuers should be aware of the Guides since they will probably be used by courts in the context of controversies arising from the public disclosure of projections.

\textsuperscript{33} The 1975 proposal indicated that a history of operations or experience in making projections was a requirement to be met by all companies interested in publicly disclosing projections. Sec. Act Release No. 5581, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) \$ 80,167, at 85,303. The Advisory Committee on Corporate Disclosure expressed its opposition to this requirement. Report, supra note 3, at A-356. Hence, the position taken in the Guides is consistent with the Advisory Committee's statement.
review of management's projections,\textsuperscript{34} and disclosure of assumptions\textsuperscript{35} as assisting the issuer in establishing a reasonable basis. However, these factors are not determinative and beyond this gloss, the issuer is on its own.\textsuperscript{36}

\section*{Format for Projections}

Whether the projections are presented in an "appropriate format" is relevant to the "disclosed in good faith standard."\textsuperscript{37} According to the Guides, "in determining the appropriate format for projections, consideration must be given to, among other things, the financial items to be projected, the period to be covered, and the manner of presentation to be used."

\begin{itemize}
\item \textsuperscript{34} Interestingly enough, in 1973 the SEC took the position that verification by third parties was prohibited. Sec. Act Release No. 5362, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,211, at 82,668.


\item \textsuperscript{35} Though not stated in the Guides, the release strongly suggests that under certain circumstances disclosure of assumptions may be necessary to successfully establish that the projection was reasonably based. Sec. Act Release No. 5992, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,756, at 81,038.

\item \textsuperscript{36} Guides, supra note 22.

\item \textsuperscript{37} The Division is of the view that issuing only favorable projections may be misleading. This would seem to be relevant to the good faith determination. Guides, supra note 22.

\item \textsuperscript{38} \textit{Id}.
\end{itemize}
The Guides recognize that traditionally "revenues, earnings per share, and net income" are the key financial items of interest to investors, but projections may also include more than these three items. However, the issuer must avoid choosing items which are susceptible to misleading inferences. Moreover, management should select the most appropriate reporting period under the circumstances and, in addition, should disclose the most probable specific amount or the most reasonable range for each financial item projected.

Investor Understanding

The issuer has a responsibility to assure that disclosures accompanying the projection facilitate investor understanding of the basis for and limitations of the projection. The Guides suggest that the issuer consider disclosing the most significant assumptions or key factors upon which the projection depends. These disclosures are necessary when material to an understanding of the projected results and, therefore, the projection may be misleading without them.

A lack of adequate disclosure would arguably suggest an absence of good faith. To help avoid this result, the issuer should consider disclosing a cautionary statement indicating that undue certainty should not be attributed to the projection. In addition, the

39. The Guides suggest that revenues, earnings per share, and net income are usually presented together to avoid any misleading inferences and that sales without some measure of income would generally be misleading. Id.
40. Two to three years may be reasonable for some industries, where others may not be able to prepare reasonably based projections beyond one year. Id.
41. Ranges should not be so wide as to be misleading and multiple projections based on alternative sets of assumptions are permitted. Id. See also Prospectuses, supra note 7, at 237-38.
42. Guides, supra note 22.
43. Id. See notes 103 through 117 infra and accompanying text (discussion of complex problems associated with the disclosure of assumptions). The Guides suggest that there may be instances where a disclosure without assumptions may benefit the investor, but provide no indication of when such circumstances may exist. Guides, supra note 22.
44. For example, if the projected results are based to a significant degree upon the assumption that the introduction of a new product or service will meet certain levels of sales and contribution of earnings, disclosure of the projection without this information may be misleading. Sec. Act Release No. 5992, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,756, at 81,038. See note 114 infra and accompanying text (problems associated with this type of disclosure from management's standpoint).
45. Guides, supra note 22. It has been suggested, however, that such a caveat would be out of place in the context of a press release or other informal mode of corporate communication. Letter from Securities Law Committee of the Chicago Bar Association to the SEC
Guides suggest that management should consider disclosing the accuracy or inaccuracy of any previous projections.46

The Safe-Harbor Rule

The safe-harbor rule,47 like the Guides, also reflects the position

(June 17, 1976) (unpublished comment letter in SEC Public Reference File No. S7-628). A statement of management's intention to furnish updated projections should also be considered. Guides, supra note 22. The term "updated projections" includes projections for the next quarter or year as well as projections which correct previously issued projections for the current period. However, a statement of management's intention to furnish corrections of prior projections is superfluous, since management has an affirmative duty to furnish such corrections. See notes 118 through 130 infra and accompanying text.

46. Guides, supra note 22. It is hard to imagine any circumstance under which such information, if available, would not provide insight into the limitations of projections. One court has determined that "disclosure of the fact that previous forecasts had failed was required." Beecher v. Able, 374 F. Supp. 341, 354 (S.D.N.Y. 1974).

47. Rule, supra note 1. The rule under the Securities Act of 1933 reads as follows:

Reg. § 230.175. (a) A statement within the coverage of paragraph (b) below which is made by or on behalf of an issuer or by an outside reviewer retained by the issuer shall be deemed not to be a fraudulent statement (as defined in paragraph (d) below), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

(b) This rule applies to (1) a forward looking statement (as defined in paragraph (c) below) made in a document filed with the Commission or in an annual report to shareholders meeting the requirements of Rules 14a-3(b) and (c) or 14c-3(a) and (b) under the Securities Exchange Act of 1934, (2) a statement reaffirming the forward looking statement referred to in (b)(1) subsequent to the date the document was filed or the annual report was made publicly available, or (3) a forward looking statement made prior to the date the document was filed or the date the annual report was made publicly available if such forward looking statement is reaffirmed in a filed document or annual report made publicly available within a reasonable time after the making of such forward looking statement.

(c) For the purpose of this rule, the term "forward looking statement" shall mean and shall be limited to:

(1) a statement containing a projection of revenues, income (loss), earnings (loss) per share, capital expenditures, dividends, capital structure or other financial items;

(2) a statement of management's plans and objectives for future operations;

(3) a statement of future economic performance contained in management's discussion and analysis of the summary of earnings (as called for by Guides 22 and 1 under the Securities Act of 1933 and the Securities Exchange Act of 1934 and by instruction 5 to the Quarterly Report on Form 10-Q); or

(4) disclosed statements of the assumptions underlying or relating to any of the statements described in (1), (2), or (3) above.

(d) For the purpose of this rule the term "fraudulent statement" shall mean a statement which is an untrue statement of a material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or which constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud, as those terms are used in the Securities Act of 1933 or the rules or regulations promul-
that projections prepared with a reasonable basis and disclosed in
good faith should be permitted, but not required, to be included in
SEC filings. The Rule, however, takes this position one step fur-
ther by providing protection from liability for qualified state-
ments made by qualified projectors.

The Rule provides that a qualified statement made by a quali-
Fied projector is not a “fraudulent statement” unless the plaintiff
can establish that the statement was “made or reaffirmed without
a reasonable basis or was disclosed other than in good faith.” The
burden of proof, therefore, lies with the plaintiff.

In order for a statement to fall within the ambit of the Rule’s
protection, it must be a “forward-looking statement” containing or
relating to the following:

1. projections of certain financial items;
2. management plans and objectives;
3. future economic performance included in management’s dis-
cussion and analysis of the summary of earnings called for by
Guide 22 under the Securities Act of 1933 and Guide 1 of the
Securities Exchange Act of 1934 and Instruction 5 to the Quar-

gated thereunder.

(e) Notwithstanding any of the provisions of paragraphs (a) through (d), this
rule shall apply only to forward looking statements made by or on behalf of an
issuer if, at the time such statements are made or reaffirmed, the issuer is subject
to the reporting requirements of the Securities Exchange Act of 1934 and has filed
its most recent annual report on Form 10-K, or, if the issuer is not subject to the
reporting requirements of the Securities Exchange Act of 1934, the statements are
made in a registration statement filed under the Securities Act of 1933.

(f) Notwithstanding any of the provisions of paragraphs (a) through (e), this
rule does not apply to statements made by or on behalf of an issuer that is an
investment company registered under the Investment Company Act of 1940.

The text of the Rule is essentially the same under the Securities Exchange Act of 1934, 15

48. See notes 53 through 59 infra and accompanying text.
49. See notes 60 through 62 infra and accompanying text.
50. Rule, supra note 1, at Part (d). See note 47 supra for text of Part (d). There may be
difficulties applying the Rule’s definition of “fraudulent statement.” See Rowe, SEC Clari-
fies ‘Safe Harbor’ Projection Rules, Legal Times of Washington, July 16, 1979, at 9, cols. 2, 3 [hereinafter cited as Rowe].
52. See Release, supra note 1, at 81,940.
53. Financial items include “revenues, income (loss), earnings (loss) per share, capital
expenditures, dividends, capital structure, or other financial items.” Rule, supra note 1, at
Part (c). See note 47 supra for text of Part (c).
Further, the "forward-looking statement" must be either a statement originally made in a document filed with the SEC or an annual report to shareholders; a subsequent reaffirmation of a statement which was originally made in a document filed with the SEC or an annual report; or a statement made outside an SEC filing or annual report which is subsequently reaffirmed in a filed document or annual report within a reasonable time after the making of such statement. The Rule only protects those projections included in either a formal filing with the SEC or an annual report to shareholders.

The qualified statement must be "made by or on behalf of an issuer or by an outside reviewer retained by the issuer." The Rule is available to Securities Exchange Act of 1934 reporting companies as well as to non-reporting companies who include the projection in registration statements. Additionally, if the company is subject to the reporting requirements of the Securities Exchange Act of 1934, it must have filed its most recent Form 10-K in order

57. Disclosure of key assumptions "may be necessary . . . in order to meet the reasonable basis and good faith standards embodied in the rule. Because of the potential importance of assumptions to investor understanding and in order to encourage their disclosure, the rule, as adopted indicates specifically that disclosed assumptions also are within its scope." Release, supra note 1, at 81,942. See notes 103 through 117 infra and accompanying text (analysis of problems associated with disclosure of assumptions).
58. Rule, supra note 1, at Part (b). See note 47 supra for text of Part (b). There are no stated parameters for meeting the "reasonable time" requirement. A company, however, may be advised to file on Form 8-K any projection it wants protected by the Rule. See Rowe, supra note 50, at 9, col. 4.
59. Tying protection under the Rule to inclusion of the projection in a formal filing or annual report "reflects the Commission's continuing concern regarding selective disclosure" of forward-looking statements and the belief that staff review of those documents and the liability provisions of the securities laws will increase the care with which such statements are made. Release, supra note 1, at 81,943. See note 28 supra and accompanying text.
60. Rule, supra note 1, at Part (a). See note 47 supra for text of Part (a). The SEC reiterates the Guides' suggestion that the relationship between a reviewer and the issuer should be disclosed. Release, supra note 1, at 81,942 n. 14. Unlike the Guides, the Release is silent on whether a reviewer's qualifications, extent of review, or other material facts need be disclosed or whether a person who actively participates in the preparation of the projection may act as a reviewer. See note 34 supra. An issuer that is an investment company registered under The Investment Company Act of 1940 is not qualified for purposes of the Rule. Rule, supra note 1, at Part (f). See note 47 supra for text of Part (f).
61. Release, supra note 1, at 81,942-43.
to be eligible for safe-harbor protection.\textsuperscript{62}

\textit{Relationship Between the Guides and the Rule}

The relationship between the Guides and the Rule is unclear, especially since the SEC has failed to take a position on the issue. Companies will undoubtedly be confused by the lack of stated connection.\textsuperscript{63} Consequently, until subsequent guidelines, releases or judicial opinions clarify the issue, companies can only speculate as to the relationship between the two.

\textbf{Uncertainties and Risks Associated with Disclosures under the New Rule}

According to the SEC, "the adoption of the Rule is in the nature of an experiment."\textsuperscript{64} Thus, companies that publicly disclose projections in SEC filings will be operating within an untested sector of corporate disclosure. The following section of this article analyzes numerous uncertainties and risks which are engendered by the Rule and whether these dangers outweigh the rewards of public disclosure.

\textit{Authority to Adopt the Safe-Harbor Rule}\textsuperscript{65}

The Securities Act of 1933 states that the SEC has authority "to make, amend, and rescind such rules and regulations as may be necessary" to carry out the provisions of the Act.\textsuperscript{66} There is, how-

\textsuperscript{62} \textit{Id.} at 81,944. The SEC believes that a serious delinquency in filing or deficiency in content of filings may significantly impair an issuer's ability to prepare and disclose with a reasonable basis, as required by the Rule. \textit{Id.}

\textsuperscript{63} See Rowe, \textit{supra} note 50, at 10, col. 3. Thus, will application of safe-harbor be conditioned upon conformance with the Guides? Are the guidelines to be treated as benchmarks for meeting the "reasonable basis/good faith standard?" Will a plaintiff meet its burden of proof by merely showing nonconformance with the Guides? These are examples of questions that need to be answered. See Letter from Machinery & Allied Products Institute to the SEC (Dec. 28, 1978) (unpublished comment letter in SEC Public Reference File No. S7-760); Letter from Southern California Gas Company to the SEC (Dec. 29, 1978) (unpublished comment letter in SEC Public Reference File No. S7-760); Letter from Sullivan & Cromwell to the SEC (Jan. 4, 1979) (unpublished comment letter in SEC Public Reference File No. S7-760).

\textsuperscript{64} Release, \textit{supra} note 1, at 81,944.

\textsuperscript{65} This discussion is limited to the SEC's authority to adopt the safe-harbor rule for actions brought under § 11 and § 12(2) of the Securities Act of 1933, since the Rule may be inconsistent with the expressed policy and procedures underlying the 1933 Act. The apparent inconsistencies do not seem to be present in the context of actions brought under the antifraud provisions of the Securities Exchange Act of 1934.

\textsuperscript{66} The SEC cites as authority for the Rule: § 19(a) of the Securities Act of 1933, 15 U.S.C. § 77s(a) (1970); §§ 3(b) and 23(a)(1) of the Securities Exchange Act of 1934, 15
ever, a question as to whether the SEC properly exercised its authority in adopting the Rule. The Rule appears to be inconsistent with the standards of liability and burden of proof allocations established by the Act for private actions brought under section 11 and section 12(2) of the Act. This doubt makes suspect the purported safe-harbor protections afforded issuers and individual defendants.

Section 11 creates a private action for damages by purchasers of registered securities against the issuers and specified participants in an offering registered under the Securities Act of 1933 if the registration statements include untrue statements of material facts or fail to disclose material facts necessary to make the statements therein not misleading. An issuer faced with a private action brought under section 11 has only two limited defenses and well-defined defenses available to it. In addition, section 11(b)(3) pro-

U.S.C. § 78c and § 78w(a)(1)(1970); § 20 of the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79t (1970); and § 319(a) of the Trust Indenture Act of 1939, 15 U.S.C. § 77ss(a) (1970). The terms “rules and regulations” as used in § 19(a) of the Securities Act of 1933 includes “the forms for registration of securities under the act and the related instructions thereto.” 17 C.F.R. § 230.130 (1978). This includes authority to promulgate rules which define “accounting, technical and trade terms” used in the Act, but neither the legislative history nor the SEC indicate the scope of these terms.

67. See Rowe, supra note 50, at 3, col. 1; see also note 65 supra; Letter from Continental Illinois to the SEC (Jan. 19, 1979) (unpublished comment letter in SEC Public Reference File No. S7-760). But see 1 Bloomenthal, SEC. FED. CORP. L. REP. 1, 4 (Jan. 1979) (the Rule is not inconsistent with § 11’s imposition of absolute liability on issuers on the basis that the foundation of the Rule is “the premise that predictions of future events (or matters involving subject judgment) are not representations as to the event predicted, but representations that the maker has a reasonable basis for the prediction or judgment”); Letter from Sullivan & Cromwell to the SEC (Jan. 4, 1979), unpublished comment letter in SEC Public Reference File No. S7-760 (“since the concept of falsity and inadequacy as used in the area of projections refer to the absence of a reasonable basis or good faith, it would seem that the plaintiff should have the burden of proving such absence under Sections 11 and 12.” They also suggest that a misleading statement of historical fact raises an inference of wrongdoing on the part of defendant, thereby requiring an explanation by the wrongdoer whereas an inaccurate projection does not raise such an inference).


vides a complicated "due diligence in investigation" defense to all non-issuer defendants. Moreover, section 11(b)(3) assigns the burden of proof to the individual defendants.

Section 12(2) provides for a private action for recission or damages by purchasers against any person who offers or sells a security, whether or not registered, by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state material facts necessary to make the statements not misleading. This section assigns to each defendant the burden to prove that "he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."

Thus, it would appear that the SEC's power to promulgate the Rule is uncertain since the Rule both expressly provides issuers with a new defense under section 11 and attempts to reassign the burden of proof in a manner which conflicts with the policy underlying section 11 and section 12(2) of the Securities Act of 1933.

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The due diligence defense is complicated because it differs slightly depending upon whether the person asserting the defense acted in the capacity of expert (i.e., lawyer, engineer, accountant, etc.) or non-expert. Given the current debate over whether accountants actually have the ability and expertise to review projections prepared by management, it is difficult to determine who will be considered an expert for purposes of projection preparation. See note 34 supra.


75. The policy underlying the burden of proof allocation in § 11 and § 12 of the Act is presented in the following legislative history: "Unless responsibility is to involve merely paper liability it is necessary to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance." H.R. Rep. No. 85, 73d Cong., 1st Sess. 9-10 (1933), reprinted in 2 J. Ellenberger & E. Mahar, LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 at Item 18 (1973). See also III L. Loss, SECURITIES REGULATION 1683-1692 (2d ed. 1961); Hearing Before the Comm. on Interstate and Foreign Commerce on H.R. 4314, 73d Cong., 1st Sess. 124, 171, 244-45
Even if the Rule is found void for lack of authority, a defendant might still be insulated from liability under section 19(a) of the Securities Act of 1933 for acting in good faith reliance on a SEC rule.76 The availability of this protection, however, is unclear and obviously untested in the context of this Rule.77 As a consequence, these uncertainties may tend to discourage the public disclosure of projections,78 thereby frustrating the SEC's stated objective of encouraging such disclosures.

(1933), reprinted in 2 J. Ellenberger & E. Mahar, LEGISLATIVE HISTORY OF THE SECURITIES ACT of 1933 at Item 20 (1973). According to the SEC, the determination to reassign the burden of proof was partially based upon an interpretation of the liability provisions of the federal securities laws. The Commission said:

With respect to forward looking statements, the rule interprets various terms of the liability provisions of the federal securities laws to require a showing that a forward-looking statement was prepared without a reasonable basis and disclosed other than in good faith. If a plaintiff seeking to establish liability on the basis of a forward looking statement can make such a showing, he and the defendant must still meet whatever standards are applicable in the circumstances of the particular claim and the relief sought. See, e.g., Sections 12, and 17 [15 U.S.C. § 77e and q] of the Securities Act and Sections 10, 18 and 20 [15 U.S.C. § 78j, r, and t] of Exchange Act.

Release, supra note 1, at 81,940 n.9. It is interesting to note that footnote 9 of the Release omits any reference to § 11. Id. It is unclear whether this omission was a conscious avoidance of a difficult question.

The commentators warned the SEC that if the burden of proof were placed on the defendant, companies would be deterred from making projections, and the likelihood of frivolous, nuisance legislation based solely on the failure to meet projected results would increase. Release, supra note 1, at 81,940. In view of the SEC's overall goal of encouraging projection disclosure and in light of the commentator's warnings, it is understandable why the SEC chose to place the burden of proof on the plaintiff. Nevertheless, there is a potential for conflict between the policy expressed in the legislative history of the Securities Act of 1933 as related to the burden of proof allocation and the SEC's allocation of the burden under the Rule.

76. § 19(a) of the Securities Act of 1933, 15 U.S.C. § 77a(a) (1970), provides in pertinent part:

No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.


78. Though it may be argued that benefit to investors may flow from the operation of the Rule (i.e., an increase in the number of projections publicly disclosed), this benefit does not make usurpation of authority any more permissible.
What is a Forward-Looking Statement?

Issuers who make projections after adoption of the Rule must determine whether their statements fall within the scope of the Rule from a definitional standpoint. The Rule applies to “forward-looking statements” as defined in the Rule. The problem with the definition is that the words and terms used to define “forward-looking statement” have not themselves been defined. Consequently, these words and terms have been, and most likely will continue to be, interpreted in various ways.

Clearly, further exercise of the SEC’s power to define terms used

79. Rule, supra note 1, at Part (c). See notes 53 through 57 supra and accompanying text (definition of “forward-looking statement”).

80. See Rowe, supra note 50, at 10, col. 1. Thus, for example, in 1978 the SEC commented on the AICPA definitions of “forecast” and “projection.” The AICPA definitions distinguish between a projection (“financial results based on assumptions which are not necessarily the most likely”) and a forecast (“the most probable financial position, results of operation and changes in financial position”). The SEC stated that although the semantic distinctions may become conformed over time, it envisioned a definition which encompassed both “forecast” and “projection” as those terms are used by the AICPA. Sec. Act Release No. 5992. [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 81,756, n.3. Contra, Letter from Deloitte, Haskins & Sells to the SEC (Dec. 19, 1978) (unpublished comment letter in SEC Public Reference File No. S7-760) (belief that “the distinction in meaning of terms ‘forecast’ and ‘projection’ is much more than semantic”).

In its 1975 Release, the SEC proposed for comment the following definition of “projection”:

Proposed amendments to Rule 405 under the Securities Act and Rule 12b-5 under the Exchange Act define a “projection” to be a statement made by an issuer regarding material future revenues, sales, net income or earnings per share of the issuer, expressed as a specific amount, range of amounts ($1.80 to $2.20) or percentage variation from a specific amount ($2.20 plus or minus 10 percent or “an increase of 10 percent over last year”), or a confirmation by an issuer of any such statement made by another person. A note has been provided to explain that the definition is not intended to include announcements made to the public regarding preliminary results of periods ended but not yet reported. A second note indicates that statements that another person’s projection is “in the ballpark,” “attainable” or “on target” are examples of a confirmation.


Moreover, companies should be aware of the notion that forward-looking statements made in narrative form will probably be considered a projection. See Ruder, supra note 27, at 13. For example, one court held that a statement that “it is very likely that net income, if any, for fiscal 1966 will be nominal,” was an income projection since it implied that the company would break even. Beecher v. Able, 374 F. Supp. 341, 345 (S.D.N.Y. 1974).

Finally, it is unclear whether an informal statement by a company officer to an outsider that the outsider’s projection of earnings is “in the ballpark” or is “reasonable” will be deemed a projection. Compare address by G. Bradford Cook, American Society of Corporate Secretaries, April 19, 1973, reported in [1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,341 (an “in the ballpark” statement would be a projection) with Ruder, supra note 27, at 13 (an “in the ballpark” statement may be characteristic of a projection).
in its rules and regulations would offer more encouragement to managements to make projections. In the alternative, courts could provide definitions. Yet a case-by-case approach provides little, if any, incentive for companies to make projections.

The Reasonable Basis and Good Faith Standards

In theory, utilizing the general concepts of "reasonable basis" and "good faith" as the standards of care for projections is sound. To require less from an issuer who publicly discloses such forward-looking information would be a backward step in the law. Despite this theoretical soundness, it is doubtful that these standards will encourage issuers to project because of the uncertainties and risks associated with their application. These standards are subject to varying interpretations, and each issuer risks being judged, in hindsight, on its determination of what the criteria are. Neither the SEC nor the courts have given significant form or substance to the standards of reasonable basis and good faith for projections. In addition, the Rule fails to state what legal effect conformity or nonconformity with the Guides will have on meeting the reasona-

82. This case-by-case approach is also less desirable from the standpoint of the cost to litigants.
83. Indeed, the courts have applied these standards with reference to projections. See, e.g., Marx v. Computer Sciences Corp., 507 F.2d 485, 490 (9th Cir. 1974) (a statement containing a projection implies a reasonable method of preparation); G&M, Inc. v. Newbern, 488 F.2d 742, 746 (9th Cir. 1973) (gross disparity between projection and fact, together with misrepresentations and failures to disclose assumptions); REA Express, Inc. v. Interway Corp., 410 F. Supp. 192, 196 (S.D.N.Y.), rev'd on other grounds, 538 F.2d 953 (2d Cir. 1976) (projections based on outdated computations); Schiller v. The Slick Corp., [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,065, at 97,739 (S.D.N.Y. 1975); Dolgow v. Anderson, 53 F.R.D. 664, 689 (E.D.N.Y. 1971), aff'd per curiam, 464 F.2d 437 (2d Cir. 1972); 1 BROMBERG, SECURITIES FRAUD & COMMODITIES FRAUD, § 5.3, at 97; 3 BROMBERG, SECURITIES FRAUD & COMMODITIES FRAUD, § 7.2(1), at 147-48 (collecting cases); see also W. PROSSER, HANDBOOK OF THE LAW OF TORTS 701 (4th ed. 1971); RESTATEMENT (SECOND) OF TORTS § 526(b)(c) (1976); Fiflis, supra note 20, at 120-24; Release, supra note 1, at 81,940-41.
ble basis and good faith standards.\textsuperscript{87}

Some guidance may be found by examining court decisions which have interpreted the reasonable basis and good faith standards in the context of a broker-dealer recommending a security.\textsuperscript{88} These decisions have cited three separate duties as comprising a reasonable basis: to make a reasonable investigation (\textit{i.e.}, gathering and evaluating facts); to disclose any lack of knowledge regarding what is being represented; and to reveal any data indicating that the recommendation may be incorrect.\textsuperscript{89} Possibly, these same principles can be applied to projections made by issuers.\textsuperscript{90}

The court in \textit{Marx v. Computer Sciences Corp.}\textsuperscript{91} stated that the good faith standard relates to the reasonableness of an issuer's belief in the truth of the projection and whether there has been full disclosure of all facts necessary to "allay any misleading impression. . . ."\textsuperscript{92} Additionally, the duty to correct prior statements\textsuperscript{93} and the manner and mode of communication\textsuperscript{94} will impact significantly on meeting the good faith requirement.

In \textit{Dolgow v. Anderson},\textsuperscript{95} the court noted that reasonably based


\textsuperscript{88.} 5A A. \textsc{Jacobs}, \textit{The Impact of Rule 10b-5}, § 61.01 [e] [vii], at 3-51 (rev. ed. 1977) [hereinafter cited as \textsc{Jacobs}] (collecting cases). For an analysis of the origins and limitations of the standard as applied in broker-dealer cases, \textit{see} Brudney, \textit{Origins and Limited Applicability of the "Reasonable Basis" or "Know Your Merchandise" Doctrine}, 4 P.L.I. Inst. SEC. REG. 239 (1973) (reasonable basis doctrine is open-ended with no visible limits to its applicability or to the extent of inquiry required).

\textsuperscript{89.} \textsc{Jacobs}, supra note 88.

\textsuperscript{90.} \textit{Id.} at 3-54.

\textsuperscript{91.} 507 F.2d 485 (9th Cir. 1974).

\textsuperscript{92.} \textit{Id.} at 492.

\textsuperscript{93.} \textit{See} notes 118 through 130 \textit{infra} and accompanying text.

\textsuperscript{94.} \textit{See} note 124 \textit{infra} and accompanying text.

projections which are disclosed in good faith will not result in liability. Consequently, Monsanto Corporation and its management were vindicated in a Rule 10b-5 action. The court concluded that "the information published was the whole truth and . . . published in good faith," and Monsanto's failure to meet its projection was due in substantial part to an unforeseeable adverse change in the economy, both domestically and abroad. In reaching this conclusion, the court extensively discussed the liability standards. It determined that Monsanto met the reasonable basis and good faith standards because: the forecasts were based upon carefully prepared and extensively reviewed internal documents; the forecasts were consistent with the figures contained in the internal documents; and the forecasts were either met or there was timely disclosure of supervening developments which materially affected prior forecasts or, in the alternative, the company disclosed that changes in prior statements could be expected. Future projectors...
should be aware of the court's high regard for Monsanto's budgeting, forecasting, and verifying procedures.¹⁰²

Assumptions

The concept of assumptions creates a two-pronged set of problems for issuers. First, the selection of proper underlying assumptions will impact on the issuer meeting the “prepared with a reasonable basis” standard.¹⁰³ The second set of problems relates to disclosing these assumptions, which affects the “disclosed in good faith standard.”¹⁰⁴

With respect to assumption selection, the issuer is left to its own devices since the SEC has chosen to remain silent on the issue. Consequently, if an issuer fails to meet the projected results and is challenged, the trier of the fact will determine whether the assumptions selected were reasonable or whether subsequent unforeseen events caused the actual results to vary from projected results.¹⁰⁵ Therefore, the court might find unreasonable the assumptions an issuer thought were reasonable.¹⁰⁶

¹⁰² Since it is unlikely that all companies will be able to duplicate Monsanto's sophisticated procedures, everything falling short of Monsanto's approach will probably not be regarded as an unreasonable basis. See Herwitz, supra note 27, at 333; Ruder, supra note 27, at 39-40. If the Monsanto approach is viewed as the required minimum, the case would tend to support the utility of forecasting by large, stable organizations whose investors need forecasting the least. Gormley, supra note 34, at 45. Cf. Libby and Rollinson, Securities Law of Materiality as it May Relate to “Optional” Publication of Projections, 31 Bus. Law. 701, 704 (1976) (high technology enterprises may be prevented from making public projections if projections must be based on facts only).


Presumably, the obligation to disclose assumptions exists for every repetition of the projection, including those made in the press and other informal modes of corporate communication. Merow, SEC Proposed Rules: Civil Liability and the Securities Firms, 7 P.L.I. INST. SEC. REG. 127, 134 (1976) [hereinafter cited as Merow]; see also Marx v. Computer Sciences Corp., 507 F.2d 485, 491 (9th Cir. 1974) (company must take adequate precautions to see that press release contains all qualifying information). If assumptions are omitted by the press, it is unclear what impact such omission will have on the issuer's requirement to disclose in good faith.

¹⁰⁵ Weltman, supra note 34, at 148.

¹⁰⁶ For example, various interest rate forecasts circulate at a given time. If a company uses an interest rate forecast which is a minority view and it turns out to be incorrect, has a reasonable selection been made? See Letter from United Michigan Corp. to the SEC (Dec. 4, 1978) (unpublished comment letter in SEC Public Reference File No. S7-760). If a company is called upon to support the reasonableness of selected assumptions, it should be...
The accounting profession has offered some guidance to issuers on assumption selection. One way to determine the reasonableness of assumptions is to test the system or model used to develop the projection by evaluating “the system’s historical results, the degree of reliance management has placed on those results, and independent inputs into the system.” From this, one can measure reliability of both the system and the information it generates. Additionally, as stated in an AICPA position statement, a forecast is an estimate of the “most probable financial position, results of operations and changes in financial position. . . . [The

subject to a higher burden when it has a unique ability to evaluate the particular assumption and subject to a relatively lower burden when the assumption relates to general knowledge (e.g., higher burden for assumption relating to extent to which a company's products will comply with technical specifications; lower burden for assumption relating to increase in prime interest rates). Nits, Grits, supra note 7, at 277-8.


One commentator has suggested that an assumption is unreasonable if it is “chosen in reckless disregard of available contradictory information.” Carmichael, Financial Forecasts The Potential Role of Independent CPA's, J. ACCOUNTANCY 84 (Sept. 1974), quoted in Elgers & May, Problems with SEC’s Forecast Guidelines, 48 CPA J. 21, 24 (MAR. 1978).

109. Weltman, supra note 34, at 146. Yet because the system is dependent upon numerous assumptions pertaining to economic, marketing and financial considerations, satisfaction as to reasonableness may still be unavailable. Id. To illustrate this concept, Weltman provides the following example:

In the transportation industry, the starting point for a projection should be an econometric model which predicts the state of the economy in terms of industrial output. From that estimate, various decisions will be made regarding the purchase and maintenance of equipment, routing, price structure, etc.

How is the reasonableness of that first building block, the econometric model, tested? The models did not forecast the recent recession. As a matter of fact, several of them missed by a large margin. Furthermore, many of these models produce varying results. Who is to say that one is more correct than the others? Who is to say that the assumptions on which the model is based are reasonable? Even though general reliance is placed on the various models to predict the economy, it cannot be stated which one would be more appropriate in the circumstances.

The point of this example is not that any of the models are unreasonable but rather that it is difficult to determine that a particular model is not unreasonable. Since the model is the basis for all other assumptions, the reviewer would probably not be capable of making the required statement with regard to the forecast.

Id.
most probable means that the assumptions have been evaluated by management and the forecast is based on management's judgment of the most likely set of conditions and its most likely course of action.” Therefore, although procedures can be developed to review forecasts for consistency, judgment is the key criteria for selecting reasonable assumptions. In fact, a significant group within the profession believes that no third party should be permitted to, or is even qualified to, attest to the reasonableness of management's assumptions.

After the company has prepared a projection and has made the decision to publicly disclose this information, it must decide whether it should concurrently disclose the underlying assumptions. While disclosure of all assumptions is not mandatory, the SEC emphasizes that under certain circumstances the disclosure of underlying assumptions “may be material to an understanding of the projected results.” Consequently, in order to meet the rea-

111. Weltman, supra note 34, at 154.

In reference to assumptions, Arthur Andersen & Co. stated:

... the underlying assumptions established the quality of a forecast, and no outsider can evaluate the judgment that has gone into management's assumptions. Outside attestation with respect to the reasonableness in management's assumptions is meaningless — a trap for the unwary — since zones of reasonableness for many assumptions are so broad and the ways in which various reasonable assumptions can be combined are so numerous that different judgments regarding them could, in some cases, result in either a projection of successful operations or a forecast of disaster. Any report on or reference to an outside review, therefore, will imply more credibility than is warranted and is likely to be misleading.


Additionally, the position reflected in the AICPA code of conduct limits the type of opinion a CPA can render in this context: "A member shall not permit his name to be used in conjunction with any forecast of future transactions in a manner which may lead to the belief that the member vouches for the achievability of the forecast." Restatement of the Code of Professional Ethics, Rule 204.

113. Release, supra note 1, at 81,942. Commentators have repeatedly stated their beliefs that projections are virtually meaningless to the investor without some disclosure of assumptions. Mann, supra note 14, at 122. Accord, Jacobs, supra note 88, at 3-53; Nits, Grits, supra note 7, at 277; Ruder, supra note 27, at 20 (in order for projections by various issuers to be meaningfully compared, assumptions must either be relatively uniform or at least be
sonable basis and good faith standards, an issuer should disclose all "material" assumptions underlying the projections.114

In this respect, the court in Marx v. Computer Sciences Corp.118 stated that facts should accompany a publicly disclosed forecast if such facts "are necessary to allay any misleading impression thereby created."118 The court determined that the failure to disclose the existence and nature of operational problems and accounting procedures which had an effect on the economic health and growth potential of the defendant company made the forecast misleading. Under this court's reasoning, the plaintiff can "reason-

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114. Release, supra note 1, at 81,942; accord, Marx v. Computer Sciences Corp., 507 F.2d 485, 491 (9th Cir. 1974); see also Advisory Committee, supra note 20, at 369 (companies who are careful will include major assumptions with their projection disclosure); Schneider, supra note 95, at 60 ("inevitably it will have to be recognized that a full explanation of a projection is impossible and that only a portion of the assumptions can be disclosed in a meaningful manner.").

In the context of assumption disclosure, the elusive concept of materiality has yet to be clarified. It has been suggested that if the assumptions relate to a significant departure from the status quo or involve subjective judgment of management rather than objective data, they should be disclosed since their disclosure will enable the investors to assign an appropriate credibility factor to the projection. See Nits, Grits, supra note 7, at 277. According to several Advisory Committee members, an assumption is material if it is so unusual and important enough that failure to disclose it might make the projection misleading (e.g., assumption that a new product would be introduced during the year or that a large contract would be awarded). Advisory Committee, supra note 20, at 367.

Companies could have practical problems with this interpretation since the disclosure of plans to introduce a new product or service might be damaging to the company's competitive position, i.e., would provide advance notice to competitors. Letter from Bank America Corp. to the SEC (Feb. 2, 1979) (unpublished comment letter in SEC Public Reference File No. S7-760). Failure to disclose because of this potential effect is risky, since the SEC has not approved of non-disclosure on this basis.

Under SEC Rule 405 "material" is defined as follows: "(1) Material. The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered." 17 C.F.R. § 230.405 (1978).

In Beecher v. Able, 374 F. Supp. 341 (S.D.N.Y. 1974), the court relied upon the § 11, 15 U.S.C. § 77k(a) (1970), prohibition against material omissions as the basis for requiring disclosure of assumptions and thereby determined that an assumption is material if it is "sufficiently doubtful that reasonable investors, had they been informed of the assumption, might have been deterred from crediting the forecast." However, according to Beecher, those assumptions which are so reasonable and so likely to be borne out by the facts may be left unstated. Id. at 348. No matter which assumptions are disclosed, a hostile party can offer, after the fact, a convincing argument that the disclosure of some other assumption would have been more meaningful. Mann, supra note 14, at 125.

115. 507 F.2d 485 (9th Cir. 1974).
116. Id. at 491-92.
ably rely on the supposition either that the company has not omitted material facts conditioning the forecast or has chosen a means of dissemination which will contain necessary qualifications — failure to do either may be actionable."

**Duty to Correct Projections**

To fulfill the SEC's requirement that companies make full and prompt disclosure of material facts, an issuer must correct previously-issued projections when it becomes apparent that they are no longer accurate or if it is discovered later that the projection was inaccurate from the outset. There was debate, however, on whether the duty to correct should be specifically mentioned in the Rule and accompanying release. Some believed that specific mention would create future problems by raising an inference that the duty to correct existed only when explicitly mentioned in a rule. The debate resulted in a compromise whereby the duty was mentioned in the release and left out of the Rule.

117. *Id.*


119. See *Jacobs*, supra note 88, at § 88.04(b), at 4-14 and cases cited therein; 2 *Bromberg, Securities Fraud & Commodities Fraud*, § 6.11(543)(1977) (duty to correct remains as long as investor can reasonably rely on the statement); *Ross v. A. H. Robins Company, Inc.*, [Current Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,737 (S.D.N.Y. 1979), rev'd on other grounds, 607 F.2d 545 (2d Cir. 1979) (duty to correct prior statement so long as they are still alive); *SEC v. Pelorex Corp.*, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 94,122 (S.D.N.Y. 1973)(consent decree for failure to correct an obsolete and inaccurate projection), cited with approval in *Sporkin, SEC Development in Litigation and Molding of Remedies*, 29 Bus. LAW. 121, 122 (1974). This need for frequent revision may eventually destroy the usefulness of projections.

120. *Hager, SEC Hotly Disputes "Safe Harbor,"

Legal Times of Washington, July 11, 1979*, at 5, col. 3.

122. Release, *supra* note 1, at 81,943-44. Additionally, the Guides remind issuers of their responsibility to correct. Guides, *supra* note 22.

The practical problems associated with meeting the duty to correct are numerous. For example, "until a financial period is completed, too many forces outside the company's control are at work to hold management responsible for projections in the same manner in which it is held responsible for the validity of historical operating results." Letter from Pillsbury, Modern & Sutro to the SEC (Dec. 28, 1978) (unpublished comment letter in SEC Public Reference File No. S7-760). See also Letter from Bank America Corp. to the SEC (Feb. 2, 1979) (unpublished comment letter in SEC Public Reference File No. S7-760); Let-
To meet this duty to correct, the company should set up procedures for monitoring previously-issued projections. As noted by the court in Dolgow, periodic updating adds validity to a company’s overall projection system. If management decides that public updates are necessary, it must then determine in what manner and medium the correction will be made. Immediate disclosure in a press release followed by inclusion in an SEC filing would seem to be the most appropriate mode of communication.

The connection between the duty to correct and the application of the Rule is unclear. Failure to correct may be viewed as a material omission from the original projection. However, this conclusion does not take into account the possibility that a nondisclosure of corrective information may be premised on management’s judgment that developments currently impacting on the outstanding projection are short-lived. Moreover, it is uncertain whether a decision to withhold a correction is entitled to protection under the Rule even if the judgment is deemed to be reasonable and made in good faith.

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123. 53 F.R.D. 664 (E.D.N.Y. 1971). Accord, Gilroy, Disclosure and Related Problems of Bad News, 7 P.L.I. INST. SEC. REG. 71, 87 (1976). See note 99 supra (description of Monsanto’s forecasting system). It is unclear whether quarterly reviews will be adequate or if companies will be forced to monitor projections to the extent that monthly reviews resulting in Form 8-K filings will be necessary whenever a material assumption underlying the initial projection changes materially. See Sec. Act Release No. 5581. [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,167, at 85,306.

124. See Jacobs, What is a Misleading Statement or Omission Under Rule 10b-5?, 42 FORDHAM L. REV. 243, 288 (1973); Rowe, supra note 50, at 11, col. 1 (apparently it would be sufficient under the SEC’s proposals to amend Form S-16, SEC. Act Release No. 5998, [1978 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 81,761, to permit corrections on Form 8-K without specific reference to earlier statements). Companies have expressed concern that under certain circumstances they might not be able to quantify the impact subsequent events have upon previously issued projections. Under those circumstances, would it be adequate to merely disclose that the projection should no longer be relied upon? Since the SEC has not endorsed this type of disclosure, a company’s unilateral decision to take such an approach may be risky. See Letter from Bank America Corp. to the SEC (Feb. 2, 1979) (unpublished comment letter in SEC Public Reference File No. S7-760); Letter from Touche, Ross & Co. to the SEC (Dec. 28, 1978) (unpublished comment letter in SEC Public Reference File No. S7-760).

When a company publicly corrects a prior projection because it subsequently discovers that the projection was misleading from the outset, the company is in a dilemma. A correction of this nature implies that the original projection was false, particularly if no development, other than uncovering the previously existing error, intervened between the two announcements. In the context of the safe-harbor rule, the conclusion might be that the original statement was not reasonably prepared or not disclosed in good faith. While it would appear that the issue is whether a reasonable investigation would have uncovered the concealed data, nonetheless this situation places the issuer in an unfortunate predicament.

Presumably, the issuer who corrects as a result of subsequent unforeseen events will not be faced with the dilemma, assuming it is determined that the projection was not misleading when made and the change was a direct result of unforeseen events. Yet the company's projection still may be second-guessed if it is found that the subsequent events were foreseeable.

The Rule also fails to address the question of whether the duty to correct extends to projections prepared and publicly disclosed by third parties, such as financial analysts. It has been held that a company has no duty to correct misleading third party projections unless the third party is so closely allied to the company that investors would naturally attribute the statement to the company. The stock exchanges take the position that the company should, at the very least, comment on the third party projections if it deems them materially incorrect. Notwithstanding the posi-

127. Prior to the Rule, the SEC indicated that it favored the idea of companies correcting third party projections. See Address by G. Bradford Cook before the American Society of Corporate Secretaries, [1973 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,341, at 83,027 (however, there is no affirmative duty to correct every rumor). See also Dayan, Correcting Errors in the Press, 5 REV. SEC. REG. 941, 942 (1972); Sec. Act Release No. 5581, [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 80,167, at 85,306 (permitted to dissociate).
128. See Electronic Specialty Co. v. International Control Corp., 409 F.2d 937, 949 (2d Cir. 1969); Elkind v. Liggett & Myers, Inc., [1978 Transfer Binder] FED. SEC. L. REP. ¶ 96,602, at 94,566 (S.D.N.Y. 1978). It is probable, however, that courts will impose a duty to correct on the company by tracing the misstatement to information received by the third party from the company. Schneider, supra note 96, at 51. One court held that a company has a duty to correct third party projections if it acquiesces through silence and benefits thereby. Green v. Jonhop, Inc., 358 F. Supp. 413 (D. Ore. 1973) (corporation should have sought withdrawal of the faulty projections).
129. AMERICAN STOCK EXCHANGE COMPANY GUIDE § 403, at 108-109 (1973); NEW YORK STOCK EXCHANGE MANUAL § A2, at A-23 (1968). See also Prospectuses, supra note 7, at 234;
tions of the SEC, the courts and the exchanges on this issue, management may feel obliged to comment on an inaccurate third party projection in order to maintain credibility in the financial marketplace.\textsuperscript{180}

**The Future Impact of Safe-Harbor on Corporate Disclosure**

Because of the numerous uncertainties created by the SEC’s adoption of the safe-harbor rule for projections, it remains to be seen if many companies will be encouraged to disclose forward-looking information. Nevertheless, the SEC has affirmatively reversed its long-standing exclusionary policy on projections. This development, in and of itself, may have a significant effect upon judicial attitudes relating to the issuance of projections and the shaping of future corporate disclosure policies and requirements. In particular, the selective disclosure of projections and the possible imposition of an affirmative duty to disclose forward-looking information are of special interest.

**Selective Disclosure**

In its release accompanying the newly adopted safe-harbor rule, the SEC states that “linking the availability of the rule for statements made outside of filed documents to subsequent inclusion in such documents reflects the Commission’s continuing concern regarding the selective disclosure of forward-looking information.”\textsuperscript{181} The SEC believes that this requirement “will promote greater accessibility to this information to all investors.”\textsuperscript{182} The SEC’s intention, therefore, was not simply to encourage companies to include projections in filed documents but also to discourage companies from providing projections to small groups of individuals.\textsuperscript{183} Thus, the safe-harbor rule begins to take on the characteristics of a regulatory device to be used to indirectly regulate corporate conduct.

Historically, selective disclosure of forward-looking information...
has not been illegal, or even improper, unless the information was deemed material.\textsuperscript{134} If the SEC is now taking the position that all projections are material inside information,\textsuperscript{135} then neither the insider nor the company could ever trade in the company's own securities unless it voluntarily opted to publicly disclose any projections the company had in its possession.\textsuperscript{136} Additionally, if the Rule's filing requirement is interpreted as a condition of meeting the "disclosed in good faith" standard, the concept of selective disclosure may take on a new meaning when applied to corporate disclosure generally. In defending against a claim of selective disclosure, the time may come when a company may have to show that it publicly disclosed the information in an SEC filing in order to meet the general requirement of good faith.\textsuperscript{137}

\textit{Affirmative Duty to Disclose}\textsuperscript{138}

Historically, courts have been reluctant to require disclosure of projections,\textsuperscript{139} but this reluctance might have been a response to

\begin{footnotes}
\item 135. In its 1973 release, the SEC took the position that all projections were material. Sec. Act Release No. 5362, [1972-1973 Transfer Binder] Fed. Sec. L. Rep. (CCH) \$ 79,211, at 82,667. It backed down from this position in its 1975 release. Sec. Act Release No. 5581, [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) \$ 80,167, at 85,301 (projections are "significant information"). Is the SEC suggesting that it might become improper or possibly illegal to selectively disclose any non-public inside information, whether or not it is material by current standards? See Kripke, \textit{Projections and Appraisals: Analysis of the Case Law}, 7 P.L.I. Instr. Sec. Reg. 93, 104 (1976) (materiality questionable if the projection merely confirms what the public expects); Schneider, \textit{supra} note 96, at 50 (to be material, a projection must differ significantly from what the marketplace would expect). \textit{But see} Ruder, \textit{supra} note 27, at 17 (knowledge that a company has arrived at a projection is itself a material fact).
\item 136. See Mann, \textit{supra} note 14, at 116; Ruder, \textit{supra} note 27, at 14-15; Schneider, \textit{supra} note 96, at 55. One might argue, however, that by merely permitting (versus requiring) the inclusion of projections in SEC filings, the SEC is taking the position that some projections are not material.
\item 137. The wisdom of such a charge in policy and procedure is questionable. Nevertheless, the message in the Rule is open to this interpretation. It remains to be seen whether the courts and the SEC will take it this far.
\item 138. For a recent analysis of the affirmative duty to disclose see Bauman, \textit{Rule 10b-5 and the Corporation's Affirmative Duty to Disclose}, 67 Geo. L.J. 935 (1979) (the general duty to disclose should not apply to projections).
\end{footnotes}
the SEC's exclusionary policy on projections. Under the new SEC policy, however, courts might be more willing to require such disclosures.140 Forward-looking information may begin to take on more "prestige and stature" and, therefore, may come to be viewed as information deserving of a public forum.141 Consequently, it is likely that the SEC's new permissive policy concerning the disclosure of projections will eventually turn into a policy mandating disclosure,142 particularly when insiders or the company benefit by trading in the company's own stock.143

**Conclusion**

The uncertainties concerning the disclosure of projections which have survived adoption of the safe-harbor rule increase a company's exposure to litigation and liability. The purported protections provided by the Rule do not significantly minimize this increased vulnerability. The question of the Rule's validity when applied to private actions brought under the Securities Act of 1933 will do little to calm management's fears concerning this increased

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140. Schneider, supra note 96, at 54. It has been suggested that a court may not apply Rule 10b-5 to a mere failure to disclose projections after Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), in light of the Court's holding that proof of scienter is a necessary element in a private damage action under § 10(b). Gilroy, Disclosures and The Related Problems of Bad News, 7 P.L.I. Inst. Sec. Reg. 71, 80 (1976). The Court, however, explicitly left open the question of whether scienter would be required in actions brought by the SEC versus private actions. 425 U.S. 185, 194 n. 12. That question was recently addressed by the Second Circuit in SEC v. Aaron, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,800 (2d Cir. 1979), petition for cert. docketed, No. 79-66, whereby it held that "the scienter requirement enunciated in Hochfelder is not applicable to government enforcement actions brought under §§ 10(b) and 21(d) of the 1934 Act . . . proof of negligence alone will suffice." at 95,128.

141. Schneider, supra note 96, at 54.


143. Schneider, supra note 96, at 54.
exposure.\textsuperscript{144} The Rule does not provide the company with any added protection for actions brought under the Securities Exchange Act of 1934 since it merely codifies existing case law on liability for projections not achieved.\textsuperscript{145}

Therefore, if the SEC is sincerely interested in encouraging companies to publicly disclose projections and other types of forward-looking information, it will have to provide companies with more protection than that provided by the newly adopted safe-harbor rule. In that regard, the SEC could clarify issuer responsibility through interpretive releases setting forth concrete, realistic examples of what constitutes proper or improper preparation, disclosure, and revision of projections. If the SEC believes this approach would be too restrictive and impede experimentation with new methods of preparation and disclosure, it could temporarily provide companies with immunity from liability for unachieved results during this initial experimental period until increased experience with projections clarifies the existing uncertainties.\textsuperscript{146} Both alternatives would decrease the risk of litigation and liability and increase the flow of this type of information during the experimental stage, thereby stimulating further progress toward the SEC's stated objective of encouraging issuers to disclose forward-looking corporate information.

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\textsuperscript{144} See notes 66 through 78 supra and accompanying text.

\textsuperscript{145} See text accompanying note 96 supra. The law isn't changed by "excusing only appropriately qualified good faith statements made on a reasonable basis." Fiflis, supra note 20, at 109.

\textsuperscript{146} See Nits, Grits, supra note 7, at 259 n. 13; Prospectuses, supra note 7, at 238-39; The Wheat Report, supra note 6, at 95.