

Service

Securities &
Corporate
Governance

Verbal Warnings Reinforce Access to Safe Harbor Protections

As companies prepare for second quarter earnings calls, the following practice pointer highlights the value of verbal warnings in advance of statements concerning results. A recent federal court case took up the issue when a retirement fund sued Coinstar Inc. and five of its executives for securities fraud related to various comments made by the executives. The judge dismissed one claim asserting false and misleading statements regarding revenue projections during a quarterly earnings call, finding that the statements were protected by the forward-looking statement safe harbor. The court based its ruling on the executives' verbal warning to investors that actual results might differ materially from projections contained in the remarks, with reference to Securities and Exchange Commission (SEC) filings for a discussion of the risk factors. In contrast, the court refused to dismiss a claim based on virtually identical projections made by executives a few weeks later because the statements were not accompanied by a verbal warning.

Although it might seem tedious to recite safe harbor warnings at the beginning of every meeting or conference call, this case illustrates the importance of the practice. At a minimum, executives should preface their remarks with a brief oral statement that actual results may differ materially from any forward-looking statements and refer listeners to the appropriate SEC filings.

The Coinstar Case

Employees' Retirement System of Rhode Island sued Coinstar Inc. and five executives in federal court in Washington, D.C., under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 for statements related to the performance of Redbox, a wholly owned subsidiary that generated approximately 80 percent of Coinstar's revenues through its self-service movie rental kiosks. The plaintiff alleged that beginning on October 28, 2010, Coinstar repeatedly provided misleading guidance about its fourth quarter and

fiscal year 2010 revenues and earnings while it was aware of factors adversely affecting the Redbox business. On January 13, 2011, Coinstar notified the public of an 11 percent earnings shortfall in fourth quarter earnings and the company's stock dropped more than 20 percent the following day.

The defendants asked the court to dismiss the claims on the basis that the statements at issue were protected by the "safe harbor" provision of the Private Securities Litigation Reform Act of 1995 (PSLRA). The PSLRA protects a forward-looking statement if it is identified as such and "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement."

After reviewing transcripts of the calls and meetings, the court found that statements regarding fourth quarter earnings projections on the third quarter earnings call were protected by the PSLRA safe harbor. According to the transcripts, the defendants advised investors that actual results could differ materially from expectations and referred investors to Coinstar's latest 10-K and 10-Q filings for a full list of risk factors. The court rejected the plaintiff's argument that mere reference to public filings was not sufficient and distinguished the facts presented from plaintiff's cited precedents based on the latter's reference to written press releases as opposed to oral statements. The court noted that the PSLRA protects forward-looking statements if they are accompanied by a verbal caveat that includes a reference to the availability of risk factors in "a readily available written document" identified by the speaker. The court went so far as to observe that the protection extends to knowingly false statements that include a caveat.

As to the plaintiff's allegations regarding statements reiterating Coinstar's earnings projections during conferences in November, the court declared that the safe harbor provision did not apply. In those instances, the court found that the executives failed to include any cautionary language in their comments concerning earnings projections. Although Coinstar requested judicial notice of PowerPoint slides that referred analysts to SEC filings, the court refused to consider them because they were not part of the pleadings.

If the case proceeds to trial, it is feasible that the PowerPoint slides will be sufficient to meet the PSLRA requirements, but Coinstar will incur significant legal costs to make the argument. Had the defendants verbally recited the necessary cautionary language during the analyst conferences, the case would be over.

What This Means to You

While awaiting final disposition of the Coinstar case, investor relations professionals and executives who interact with analysts and investors should heed the advice in the Coinstar decision and preface all statements with a verbal warning. At a minimum, the practice could save substantial legal fees

should allegations of fraud associated with the remarks arise. Regardless, the case highlights an important standard that all companies would be wise to adopt.

Contact Info

If you have any questions concerning these issues or other questions concerning securities laws, including public offerings and corporate governance, please contact your Husch Blackwell attorney.

Husch Blackwell LLP regularly publishes updates on industry trends and new developments in the law for our clients and friends. Please contact us if you would like to receive updates and newsletters or request a printed copy.

Husch Blackwell encourages you to reprint this material. Please include the statement, "Reprinted with permission from Husch Blackwell LLP, copyright 2012, www.huschblackwell.com" at the end of any reprints. Please also email info@huschblackwell.com to tell us of your reprint.

This information is intended only to provide general information in summary form on legal and business topics of the day. The contents hereof do not constitute legal advice and should not be relied on as such. Specific legal advice should be sought in particular matters.