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Second Circuit Clarifies Duty to Update Certain Disclosures

On March 12, 2010, the United States Court of Appeals for the Second Circuit provided guidance regarding a public company's duty to update and qualify certain public disclosures. *Illinois State Board of Investment v. Authentidate Holding Corp., Surendra Pai, John J. Waters, Denis H. Bunt, Peter R. Smith, John T. Botti,* 2010 U.S. App. LEXIS 5226 (2nd Cir. March 12, 2010).?

This case relates to Authentidate Holding Corporation's entry into an agreement with the United States Postal Service to be the preferred provider of the USPS's electronic postmark. The plaintiffs, which comprise a putative class of investors, allege that Authentidate had an obligation to disclose the status of certain amendments to the performance metrics contained in such agreement as well as a duty to update disclosures regarding its ability to achieve such performance metrics.?

The Second Circuit provided useful guidance with respect to when a duty to update public disclosures arises, circumstances under which cautionary language may obviate the need for future updates, and the materiality of public disclosures containing misstatements.

Duty to Update Forward-Looking Statements

In connection with the USPS agreement, the Second Circuit noted that Authentidate made the following relevant public disclosures on September 8, 2004:

- Authentidate's press release stated that "the Company believes it has reached an agreement in principle and anticipates that an agreement amending the original metrics will be completed shortly."
- In a conference call, Authentidate stated, "[W]e hope to have an amendment to our original agreement within the next few weeks...?We believe we have an agreement in principle...?[W]e're very confident we should have this amendment signed in the not too distant future."

Relying on precedent, the Second Circuit noted that there is no duty to update when there is no forward-looking statement that would "remain 'alive' in the minds of reasonable investors." To that end, the court distinguished between "vague statements of optimism," which would not require updating, and "definite positive projections," which would require updating once intervening events cause them to become misleading. The Second Circuit concluded that once Authentidate determined that the amendment of the metrics would not be agreed upon, it would be obligated to update its prior statements. That being said, although Authentidate's press release certainly contained a forward-looking statement, it did not require subsequent updating because it had been accompanied by appropriate cautionary language indicating that the amendment was not guaranteed.?

However, the Second Circuit distinguished the statements made in the conference call, which were not similarly accompanied by appropriate cautionary language. The court noted that, as a result of subsequent events, the statements had become misleading, and a boilerplate warning made at the beginning of the conference call did not adequately describe the specific risk to investors.?

Distinguishing Statements of Then-Present Fact

The Second Circuit also provided clarity in distinguishing between forward-looking statements and statements of then-present fact.?

In February and May 2005, Authentidate stated, "[W]e did a few things recently which we think put us back in compliance [with the revenue metrics]" and "management believes it cured the metric deficiency."?In its defense to plaintiffs' claim that such statements were misleading, Authentidate relied on the "bespeaks caution" doctrine and The Private Securities Litigation Reform Act's "safe harbor" provision, noting that the statements were accompanied by cautionary language. However, the Second Circuit disagreed, noting that such defenses only apply to forward-looking statements and that the statements made were statements of then-present fact, which could not be cured with cautionary language.??

Materiality of Misstatements

The Second Circuit noted that under Rule 10b-5, the plaintiffs' claims must, among other things, establish the materiality of the misstatements and/or omissions regarding the referenced amendment. Based on sales shortfalls and the fact that the stock price significantly dropped after two separate announcements that metrics would not be achieved, the court concluded that the misstatements could be considered material, as viewed by a reasonable investor, and that the claims could not be dismissed.?

However, the court did clarify that the duty to disclose "arises whenever [nonpublic] information renders prior public statements materially misleading," drawing the distinction from information that "a reasonable investor would very much like to know."?Furthermore, the court distinguished the plaintiffs' assertion that, in connection with a February 2004 stock offering, Authentidate had a duty to disclose low sales levels that would have placed the company in jeopardy of failing to satisfy the July 2004 revenue metric contained in the USPS agreement. The Second Circuit concluded that such statements would have been speculative and premature in light of the fact that the first metric was scheduled five months after the stock offering.?

Critical Points to Note

- Public disclosures containing definitive projections or forward-looking statements should be accompanied by carefully crafted cautionary language describing specific risks.?Boilerplate language may not provide a sufficient safe harbor for the forward-looking statement.
- When a prior "forward-looking statement" was accurate when made but, as a result of subsequent events, is no longer accurate, a duty to promptly and publicly update such prior statement may arise if it remains "alive in the marketplace" and is material. However, a well-crafted cautionary statement accompanying the original statement may obviate the need to update.
- Appropriate cautionary language will only provide protection for "forward-looking" public disclosures.?Statements of then-present or historical fact do not fall under the protection of such safe harbors.