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Opinions Actionable as Securities Fraud

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ABSTRACT

This Article proposes a new analytical framework to apply to statements of opinion in securities fraud cases. Although statements of opinion form the basis of some of the most cutting-edge securities fraud claims—such as those asserted against securities analysts and credit rating agencies—statements of opinion do not fit squarely within the elements of securities fraud. In particular, three issues arise: (1) When is a statement of opinion false so as to qualify as a misrepresentation? (2) When is a statement of opinion material? (3) And, for that matter, what is the distinction between a statement of fact and a statement of opinion? Courts confronting these issues apply various analytically unsound and inconsistent tests. In response, this Article proposes a novel approach, drawing on the policy rationales underlying securities fraud claims, case law and scholarly commentary addressing how to apply the elements of securities fraud to statements of opinion, and comparable analyses in the contexts of common law fraud and defamation. First, this Article argues that statements of opinion are only false if both objectively unreasonable and subjectively disbelieved. Second, this Article proposes the following new *evaluation–inference* test to differentiate statements of opinion from statements of fact: Does the statement express the speaker's evaluation or inference of facts? Finally, this Article proposes the following new *reasonable implication* test to distinguish opinions that are immaterial as a matter of law from those that are potentially material: Does the opinion reasonably imply an allegedly false, material fact?

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I. INTRODUCTION

One of the most compelling questions in modern securities litigation is how to treat allegedly fraudulent statements of opinion—such as securities-analyst recommendations, credit ratings, and statements of corporate optimism. Much of the

securities litigation in the wake of the stock market crash of 2000 and the financial crisis of 2008 has centered on allegedly fraudulent opinions. After the 2000 crash, sell-side securities analysts were widely blamed for allegedly issuing "buy" recommendations consistent with the interests of their firms' investment banking clients but inconsistent with their own opinions about the covered stocks,[1] leading to widespread securities litigation.[2] Similarly, in the wake of the 2008 crisis, credit rating agencies were pilloried for allegedly issuing credit ratings consistent with the interests of their firms' clients but inconsistent with their own opinions about the rated securities,[3] also leading to securities litigation.[4] Finally, in the wake of both crashes, many companies—including quintessential examples like Worldcom and Citigroup—were sued by their investors for allegedly expressing unduly optimistic opinions about their businesses.[5]

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1. *E.g.*, Joint Press Release, Sec. & Exch. Comm'n, N.Y. Attorney Gen.'s Office, N. Am. Sec. Adm'rs. Ass'n, Nat'l Ass'n of Sec. Dealers, & N.Y. Stock Exch., Ten of Nation's Top Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), *available at* http://www.sec.gov/news/press/2003-54.htm (announcing the finalization of a global settlement with ten firms "follow[ing] joint investigations by the regulators of allegations of undue influence of investment banking interests on securities research at brokerage firms").

2. *E.g.*, *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 46 (1st Cir. 2005) (Purchasers of Agilent Technologies, Inc. stock alleged that the "buy" ratings in Credit Suisse's analyst reports were fraudulent because the analysts "actually believed that wise investors should not purchase Agilent securities.").

3. CONCLUSIONS OF THE FINANCIAL CRISIS INQUIRY COMMISSION xxv (2011), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_conclusions.pdf ("We conclude the failures of credit rating agencies were essential cogs in the wheel of financial destruction. The three credit rating agencies were key enablers of the financial meltdown.").

4. *E.g.*, King Cnty., Wash. v. IKB Deutsche Industriebank AG, 708 F. Supp. 2d 334, 336 (S.D.N.Y. 2010) (Investors who purchased notes issued by a structured investment vehicle alleged that credit rating agencies assigned fraudulently high credit ratings to the notes.).

5. *E.g.*, *In re* Citigroup Inc. Sec. Litig., 753 F. Supp. 2d 206, 229 (S.D.N.Y. 2010) (Citigroup investors premised securities fraud claims on various alleged misrepresentations, including the CEO's statement that "I feel good about the composition of our portfolios, not only in the corporate and sovereign area but especially in the U.S. mortgage area where we have avoided the riskier products at some cost to revenues in prior years."); *In re* MCI Worldcom, Inc. Sec. Litig., 191 F. Supp. 2d 778, 786 (S.D. Miss. 2002) (Worldcom investors premised securities fraud claims on various alleged misrepresentations, including the company's statement that "[t]he local and global reach of our network continues to set Worldcom apart from the rest of the industry.").

Applying the elements of a securities fraud claim to statements of *opinion* as opposed to statements of *fact* is like fitting a square peg in a round hole. As courts have interpreted § 10(b) of the Securities and Exchange Act and SEC Rule 10b-5,[6] a private claim for securities fraud contains the following elements: a misrepresentation or an omission of a material fact; scienter; a connection between the misrepresentation or omission and the purchase or sale of a security; reliance upon the misrepresentation or omission; economic loss; and loss causation.[7] When these elements are applied to statements of opinion, three issues arise: (1) When is a statement of opinion *false* so as to qualify as a misrepresentation? (2) When is a statement of opinion *material*? (3) And, for that matter, what is the distinction between a statement of fact and a statement of opinion?

Courts confronting these issues have adopted various tests that are analytically unsound, that yield inconsistent results, and that fail to further the fundamental policy goal of the securities acts "to insure the maintenance of fair and honest markets."[8] For example, without articulating why statements of opinion should be afforded special treatment, courts routinely require that the statements be both subjectively disbelieved and objectively unreasonable in order to be *false*, effectively raising the applicable scienter level for statements of opinion.[9] Despite the fact that the fact–opinion distinction is thereby potentially outcome–determinative, courts apply a series of illogical and inconsistent tests to make this distinction.[10] Finally, courts routinely dismiss opinions as immaterial as a matter of law, characterizing them as mere "puffery," even if reasonable investors could rely on the opinions to their detriment when making investment decisions.[11]

Several eminent scholars have criticized courts' treatment of statements other than "plain vanilla" statements of fact. For example, Professor Jennifer O'Hare, noting courts' inconsistent application of the puffery defense to vague statements, has proposed a framework to analyze the materiality of these statements.[12] Professor Donald C. Langevoort has identified

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6. 15 U.S.C. § 78j (2006 & Supp. V 2011); 17 C.F.R. § 240.10b-5 (2012).

7. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 157 (2008).

8. 15 U.S.C. § 78b (2006 & Supp. V 2011).

9. *See infra* Part III.A.

10. *See infra* Part III.C.

11. *See infra* Parts IV.A, IV.B.

12. Jennifer O'Hare, *The Resurrection of the Dodo: The Unfortunate Re-Emergence of the Puffery Defense in Private Securities Fraud Actions*, 59 OHIO ST. L.J. 1697, 1709, 1737 (1998).

courts' inconsistent treatment of half-truths and proposed a framework for assessing whether half-truths should be actionable as securities fraud.[13] Professor David A. Hoffman has proposed a new *presumed liability* regime to apply to so-called puffery, which he identifies in the securities context as "vague statement[s] of corporate optimism" about the future or about current conditions.[14] This Article contends that this deep body of scholarship, although apparently focused on different subsets of statements, has a common core: statements of opinion.

In response, this Article proposes a new analytical framework to apply to statements of opinion in securities fraud cases. This framework draws on policy rationales underlying securities fraud claims, case law and scholarly commentary addressing how to apply the elements of securities fraud to statements of opinion, and comparable analyses in the contexts of common law fraud and defamation. First, this Article agrees with most courts having addressed the issue that statements of opinion are only false if both objectively unreasonable and subjectively disbelieved. The subjective falsity requirement recognizes that there is "something special" about opinions, which reflect the speaker's mental processes. Additionally, in light of the consequent necessity of differentiating between statements of fact and statements of opinion, this Article proposes the following new *evaluation–inference* test to make this distinction: Does the statement express the speaker's evaluation or inference of facts? This test, which draws on comparable precedent in the contexts of defamation and common law fraud, pinpoints those statements that contain the aforementioned "something special." Further, this Article responds to courts' unsound materiality analyses of opinions by proposing the following new *reasonable implication* test to distinguish statements that are immaterial as a matter of law from those that are potentially material: Does the opinion reasonably imply an allegedly false, material fact? Comparable precedent developed in the defamation *pure–mixed opinion* context and in the common-law-fraud *puffery–opinion* context should guide courts as they apply the *reasonable implication* test in the securities fraud context.

In order to present this proposed analytical framework, this Article proceeds in four additional parts. Part II reviews the precedent establishing the rule that statements of opinion are

13. Donald C. Langevoort, *Half-Truths: Protecting Mistaken Inferences by Investors and Others*, 52 STAN. L. REV. 87, 88, 113 (1999).

14. David A. Hoffman, *The Best Puffery Article Ever*, 91 IOWA L. REV. 1395, 1405–11, 1445 (2006).

potentially actionable as securities fraud and explains why statements of opinion do not fit squarely within the elements of securities fraud. Next, Part III argues that a statement of opinion, unlike a statement of fact, is only false if it is subjectively false (*i.e.*, disbelieved by the speaker). Therefore, because the distinction between statements of fact and opinion is potentially outcome determinative, Part III proposes the novel *evaluation–inference* test to identify statements of opinion for purposes of securities fraud. In Part IV, turning to the materiality of those statements that thereby qualify as opinions, this Article proposes the new *reasonable implication* test to differentiate potentially material opinions from mere puffery. Finally, Part V summarizes this novel analytical rubric and briefly concludes.

II. OPINIONS CAN FORM THE BASIS OF SECURITIES FRAUD CLAIMS

Although courts occasionally state otherwise,[15] most courts recognize that statements of opinion are potentially actionable as securities fraud because they make implicit factual representations.[16] In particular, a statement of opinion contains the implicit factual representations (1) that the speaker actually holds the opinion expressed, and (2) that the opinion has a reasonable basis in fact.[17]

Indeed, in the seminal case of *Virginia Bankshares v. Sandburg*, the Supreme Court soundly rejected the argument that statements of opinion are per se not actionable under § 14(a) of the Securities Exchange Act, which—as implemented by S.E.C. Rule 14a-9—prohibits false or misleading statements in proxy statements.[18] The Court's ruling has been widely applied to claims pursuant to § 10(b) and S.E.C. Rule 10b-5, which uses virtually

15. *E.g.*, *In re* Bristol-Myers Squibb Sec. Litig., 312 F. Supp. 2d 549, 557 (S.D.N.Y. 2004) ("Likewise, statements of opinion are insufficient to form the basis of a misrepresentation or omission complaint under § 10(b).").

16. *In re* Nat'l Century Fin'l Enters., Inc., Inv. Litig., 580 F. Supp. 2d 630, 639 (S.D. Ohio 2008) ("[T]he Supreme Court has 'rejected the argument that statements containing opinions or beliefs . . . could not be a basis for' an action for securities fraud." (quoting Mayer v. Mylod, 988 F.2d 635, 638 (6th Cir. 1993))); *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 47 (1st Cir. 2005) ("Classifying ratings as opinions does not automatically shield them from liability under the securities laws." (citing Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1095 (1991))).

17. *In re Credit Suisse*, 431 F.3d at 47 ("[A] statement of opinion may be considered factual in at least two respects: as a statement that the speaker actually holds the opinion expressed and as a statement about the subject matter underlying the opinion.").

18. Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1095 (1991).

identical language to prohibit false or misleading statements in connection with the purchase or sale of any security.[19]

In *Virginia Bankshares*, a minority shareholder alleged that the board of directors solicited proxies for voting on a merger proposal by means of materially false or misleading statements of fact.[20] In particular, the shareholder alleged that the board's assertions that the merger plan allowed the minority shareholders to achieve "high" value and that the merger price was "fair" were materially misleading because the merger plan undervalued the shares.[21] Rejecting the company's argument that "statements of opinion or belief incorporating indefinite and unverifiable expressions cannot be actionable as misstatements of material fact,"[22] the Supreme Court explained that the directors' opinions were factual in two senses: "as statements that the directors do act for the reasons given or hold the belief stated and as statements about the subject matter of the reason or belief expressed."[23]

Some courts have suggested that a statement of opinion makes a third implicit factual representation: "that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement."[24] This is merely a restatement of the second implicit representation: that the opinion has a reasonable basis in fact. If undisclosed facts tended to seriously undermine the accuracy of an opinion, it—by definition—would lack a reasonable basis in fact. Take, for example, the statement that "the new drug is proving highly effective in clinical trials." If, in truth, the drug were not any more effective than a placebo, the second implicit representation—that the opinion has a reasonable basis in fact—would be false. There would be no need to resort to the purported third implicit representation—that the speaker was not aware of any undisclosed facts tending to seriously undermine the statement's accuracy. Therefore, this purported third implicit

19. Mayer v. Mylod, 988 F.2d 635, 639 n.2 (6th Cir. 1993) ("The court in *Virginia Bankshares* was concerned with Section 14(a), not Section 10(b) of the Securities Exchange Act. Section 14 concerns proxy statements, whereas Section 10 concerns other statements by a corporation. *Virginia Bankshares* is instructive for this case, however, because the Securities and Exchange Commission has promulgated the same rule for each section: violations occur under each section whenever a statement is false or a material omission makes the statements which are made misleading.").

20. *Va. Bankshares*, 501 U.S. at 1088–89.

21. *Id.* at 1088.

22. *Id.* at 1090.

23. *Id.* at 1092.

24. *E.g.*, *In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir. 1989).

factual representation is duplicative, circular,[25] and risks transforming an *affirmative misrepresentation* case (premised on the allegedly false opinion) into a *nondisclosure* case (premised on the failure to disclose the allegedly undermining facts).[26]

Even though securities fraud claims can be premised on statements of opinion, opinions do not fit squarely within the traditional elements of a securities fraud claim.[27] First, when is a statement of opinion *false* so as to qualify as a "misrepresentation of fact"? As explained above, an opinion makes two implicit factual representations: (1) that the speaker actually holds the opinion expressed, and (2) that the opinion has a reasonable basis in fact. Is an opinion *false* if one of these implicit representations is false, or does falsity require that both be false?

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25. *E.g.*, *In re* Trex Co., Inc. Sec. Litig., 454 F. Supp. 2d 560, 577 (W.D. Va. 2006) ("The analysis is somewhat circular when the plaintiffs claim that an omission renders an affirmative statement misleading."); *In re* No. Nine Visual Tech. Corp. Sec. Litig., 51 F. Supp. 2d 1, 15 (D. Mass. 1999) ("[T]he Class has cited a number of affirmative allegations that it believes are actionably misleading based on the failure to disclose the inventory valuation problem. The Court must ask: Are these allegations claims of nondisclosure . . . or are they claims of affirmative misstatement . . . ?"). *See also* John S. Poole, *Improving the Reliability of Management Forecasts*, 14 J. CORP. L. 547, 556 (1989) (declining to treat the half-truth principle "as an inherent implied representation unique to opinions and predictions").

26. *In re* Citigroup Inc. Sec. Litig., 753 F. Supp. 2d 206, 232 (S.D.N.Y. 2010) ("Nevertheless, a duty to disclose arises when disclosure is necessary to make prior statements not misleading." (internal quotation marks omitted)); Lormand v. US Unwired, Inc., 565 F.3d 228, 248–49 (5th Cir. 2009) ("Once the defendants engaged in public discussions concerning the benefits of Type II affiliation and the no-deposit programs, they had a duty to disclose a 'mix of information' that is not misleading."); *In re* Apollo Grp. Inc. Sec. Litig., 509 F. Supp. 2d 837, 841 (D. Ariz. 2007) ("In other words, while Defendants may not have an affirmative duty to disclose interim regulatory findings, they do have 'a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading.'" (quoting Hanon v. Dataproducts Corp., 976 F.2d 497, 504 (9th Cir. 1992))). Although this distinction might seem like parsing between two sides of the same coin, a *nondisclosure* fraud case is potentially easier for a plaintiff to win than an *affirmative misrepresentation* fraud case, providing for a "run-around" of the elements of an affirmative misrepresentation case without a reasonable basis. For one, reliance is presumed in nondisclosure cases but not in affirmative misrepresentation cases. Moreover, the subjective falsity requirement discussed below in Parts III.A, III.B, and III.C would arguably not apply if the claim were premised on the failure to disclose rather than on the affirmatively false opinion.

27. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 157 (2008) (listing the elements of securities fraud as: (1) a misrepresentation or an omission of a material fact; (2) scienter; (3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation).

Second, when does a statement of opinion misrepresent *material* facts? For purposes of securities fraud, materiality requires "a substantial likelihood that a reasonable shareholder would consider it important" in deciding how to invest.[28] When would a reasonable investor rely on a statement of opinion as opposed to dismissing it as mere puffery?

Finally, intrinsically intertwined in the above two issues is the most pressing question of all: What is a statement of *opinion* for purposes of securities fraud? If a statement's characterization as an opinion affected neither the falsity analysis nor the materiality analysis, this would be a moot question. If, however, as most courts and this Article contend, the characterization influences both analyses, identifying precisely those statements that should be treated as opinions is essential. Moreover, risking circularity, the unique attributes of those statements that are classified as opinions should help guide how the elements of falsity and materiality apply to opinions.

To answer these three questions, this Article draws on precedent developed in the contexts of common law fraud and defamation. Common-law fraud, defamation, and securities fraud share the same core allegation—the defendant made a false statement.[29] The implications of being a statement of opinion differ somewhat in each context, but the precedent developed in the contexts of common law fraud and defamation is nonetheless instructive as courts struggle to address statements of opinion in the context of securities fraud.

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28. Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

29. *Stoneridge Inv. Partners*, 552 U.S. at 157 (listing the elements of securities fraud as including a misrepresentation or omission of material fact); RESTATEMENT (SECOND) OF TORTS § 525 (1977) ("One who fraudulently makes a *misrepresentation of fact*, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation." (emphasis added)); *Id.* § 538A (defining a *misrepresentation of opinion* for purposes of common law fraud); *Id.* § 558 ("To create liability for defamation there must be: (a) *a false and defamatory statement* concerning another; (b) an unprivileged publication to a third party; (c) fault amounting at least to negligence on the part of the publisher; and (d) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication." (emphasis added)). *See also* Brief of Forbes LLC et al. as Amici Curiae at 28, Secs. & Exch. Comm'n v. Pirate Investor LLC, 580 F.3d 233 (4th Cir. 2009) (No. 08-1037), 2008 WL 2307442 at *28 ("Indeed, in relevant substance, the SEC's claim is very much like a defamation claim—it is brought to assess damages for inaccurate information just like a defamation claim is brought to impose liability for false speech.").

Usually the allegedly false statements at the heart of securities fraud and defamation are made under different circumstances. In the paradigmatic securities fraud case, the speaker makes an unduly rosy statement about his or her business. By contrast, in the quintessential defamation case, the speaker makes an unduly derogatory statement about a third party or the third party's products. Occasionally, however, securities fraud and defamation overlap. For example, public companies sometimes assert defamation claims against securities analysts and news organizations, contending that they have made unduly negative statements about the companies, thus harming the companies' stock price.[30] Occasionally, the companies allege that the speakers were motivated to increase the value of short positions in the companies' stock or to increase the value of long positions in competitors' stock, thus bringing the alleged defamation within the scope of the securities laws.[31]

Similarly, although common-law fraud and securities fraud are both usually premised on unduly rosy statements, common law fraud class actions with respect to securities are usually preempted pursuant to the Securities Litigation Uniform Standards Act.[32] Therefore, as a practical matter, common law fraud is often focused on allegedly false statements about one's products, while securities fraud is often focused on allegedly false statements about one's business. Occasionally, however, large investors who need not resort to a class action assert common law fraud claims

30. *E.g.*, Biospherics, Inc. v. Forbes, Inc., 151 F.3d 180, 182–83 (4th Cir. 1998) (A corporation asserted a defamation action against *Forbes Magazine*, alleging that a stock tip story contained false and defamatory statements about the corporation, causing the value of the company's stock to plummet.); SPX Corp. v. Doe, 253 F. Supp. 2d 974, 974–77 (N.D. Ohio 2003) (A corporation asserted a defamation claim against an anonymous individual who posted negative comments about the corporation, such as "Strong Sell," on a Yahoo! message board.).

31. *E.g.*, Medifast, Inc. v. Minkow, No. 10-CV-382 JLS, 2011 WL 1157625, at *1 (S.D. Cal. Mar. 29, 2011) ("Plaintiffs . . . allege that Defendants engaged in a series of coordinated attacks on Medifast and the TSFL program designed to increase the value of a short position Defendants held in Medifast stock.").

32. 15 U.S.C. § 77p (2006) ("No covered class action based upon the statutory or common law of any State or subdivision thereof may be maintained in any State or Federal court by any private party alleging . . . that the defendant used or employed any manipulative or deceptive device or contrivance in connection with the purchase or sale of a covered security."); Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 87 (2006) ("SLUSA does not actually pre-empt any state cause of action. It simply denies plaintiffs the right to use the class-action device to vindicate certain claims.").

premised on allegedly fraudulent conduct in connection with securities.[33]

Recognizing that common law fraud and defamation share a core element—a false statement—with securities fraud, courts sometimes cite the precedent developed in these areas as persuasive authority in securities fraud cases. For example, in *Virginia Bankshares, Inc. v. Sandberg*, a securities case,[34] the Supreme Court cited *Milkovich v. Lorain Journal Co.*,[35] a defamation case, as persuasive authority about whether combining misleading statements with true statements neutralizes their deceptiveness.[35] In *Dura Pharmaceuticals, Inc. v. Broudo*, another securities case, the Supreme Court cited "the common-law roots of the securities fraud action (and the common-law requirement that a plaintiff show actual damages)" in support of its holding that a plaintiff must prove loss causation.[36] Just as common law fraud, defamation, and securities fraud share the same core allegation—that the defendant made a false statement—they share the quandary of how to analyze statements of opinion.[37]

III. WHAT IS AN OPINION FOR PURPOSES OF SECURITIES FRAUD AND DOES IT MATTER?

This section answers two interrelated questions: (1) Should opinions be treated specially for purposes of *falsity*; and (2) if so, what is an *opinion*? First, Part A shows that most courts require an opinion to be both objectively and subjectively false in order to qualify as *false* for purposes of securities fraud and explains that this effectively raises the applicable scienter level for statements of opinion. Despite the concomitant necessity of distinguishing statements of opinion from statements of fact, as explained in Part B, courts do not apply a uniform test to make this distinction. Part C argues that, consistent with most courts having addressed this issue, an opinion is only false if it is both objectively and subjectively so. Finally, drawing from the dual falsity implication

33. *See Dabit*, 547 U.S. at 87 ("The Act does not deny any individual plaintiff, or indeed any group of fewer than 50 plaintiffs, the right to enforce any state-law cause of action that may exist.").

34. Milkovich v. Lorain Journal Co., 497 U.S. 1, 18–19 (1990).

35. Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1097 (1991).

36. Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 344 (2005). *But see* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 552 U.S. 148, 162 (2008) ("Section 10(b) does not incorporate common-law fraud into federal law.").

37. *E.g.*, RESTATEMENT (SECOND) OF TORTS § 538A (1977) (defining a misrepresentation of opinion for purposes of common law fraud); *Id.* § 566 (1977) (explaining when a statement of opinion is actionable as defamatory).

and the comparable precedent in the contexts of defamation and common law fraud, Part D proposes the following *evaluation–inference* test to differentiate statements of opinion from statements of fact: Does the statement express the speaker's evaluation or inference of facts?

A. Courts Treat Opinions Specially by Requiring Subjective Falsity

Recognizing that a statement of opinion is potentially actionable as a misrepresentation of fact gives rise to a complex problem—how to prove the falsity of a statement of opinion. In contrast, proving the falsity of a statement of fact is relatively straightforward. For example, the statement that "the third quarter's profits rose by 5%" would be false if the profits actually fell during that quarter. A statement of opinion, however, contains two embedded factual statements: (1) The speaker actually holds the opinion expressed, and (2) the opinion has a reasonable basis in fact. Which of these implicit factual statements must be false in order for the opinion to qualify as a *misrepresentation*? Courts addressing this issue commonly refer to the falsity of the implicit assertion that the speaker actually holds the opinion expressed as *subjective falsity* and the falsity of the implicit assertion that the opinion has a reasonable basis in fact as *objective falsity*.[38]

In *Virginia Bankshares*, the Supreme Court held that subjective falsity alone—without objective falsity—is insufficient to establish that an opinion is false.[39] The Court explained that allowing subjective falsity to suffice would open the floodgates by permitting litigation based merely on the "impurities" of an "unclean heart."[40] Moreover, the Court reasoned that this objective falsity requirement does not pose an undue burden on plaintiffs because, in most cases, subjective and objective falsity go hand in hand.[41] A few lower courts, however, in apparent disregard of

38. *E.g.*, *In re* REMEC Inc. Sec. Litig., 702 F. Supp. 2d 1202, 1229 (S.D. Cal. 2010); Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156, 1162 (9th Cir. 2009); *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 48, 52 (1st Cir. 2005).

39. *Va. Bankshares*, 501 U.S. at 1096. *But see In re Credit Suisse*, 431 F.3d at 47 ("Because the plaintiffs cannot clear the subjective falsity hurdle, we need not answer the thornier question of whether a plaintiff who challenges a statement of opinion also must plead facts sufficient to show, from an objective standpoint, that the statement either expressly or by fair implication contained a false or misleading assertion about its subject matter.").

40. *Id. Accord* Fait v. Regions Fin. Corp., 655 F.3d 105, 112 (2d Cir. 2011) ("This approach makes logical sense. Requiring plaintiffs to allege a speaker's disbelief in, and the falsity of, the opinions or beliefs expressed ensures that their allegations concern the factual components of those statements.").

41. *Va. Bankshares*, 501 U.S. at 1096.

Virginia Bankshares, have stated rules that would permit mere subjective falsity to establish an opinion's falsity for purposes of securities fraud liability.[42]

The Supreme Court's *Virginia Bankshares* opinion did not explicitly address the converse issue—namely, whether objective falsity alone, without subjective falsity, is sufficient to establish that an opinion is false. However, Justice Scalia, concurring in part and concurring in the judgment, interpreted the Court's opinion as requiring both subjective and objective falsity:

> As I understand the Court's opinion, the statement "In the opinion of the Directors, this is a high value for the shares" would produce liability if in fact it was not a high value and the directors knew that. It would not produce liability if in fact it was not a high value but the directors honestly believed otherwise.[43]

Justice Scalia explained that, because the federal cause of action at issue "was never enacted by Congress, . . . the more narrow we make it (within the bounds of rationality) the more faithful we are to our task."[44] Indeed, consistent with Justice Scalia's interpretation, most lower courts having explicitly addressed this issue interpret *Virginia Bankshares* as requiring a

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42. *In re* Apple Computer Sec. Litig., 886 F.2d 1109, 1113 (9th Cir. 1989) ("A projection or statement of belief contains at least three implicit factual assertions: (1) that the statement is genuinely believed, (2) that there is a reasonable basis for that belief, and (3) that the speaker is not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement. A projection or statement of belief may be actionable to the extent that *one* of these implied factual assertions is inaccurate." (emphasis added)); *In re* XM Satellite Radio Holdings Sec. Litig., 479 F. Supp. 2d 165, 177 (D.D.C. 2007) ("Under the doctrine established by *Virginia Bankshares v. Sandberg*, . . . statements of opinion, if they are material, may be actionable if they are not actually believed when made, if there is no reasonable basis for them, *or* if the speaker is aware of undisclosed facts that tend seriously to undermine the statements' accuracy." (emphasis added)); *In re* Apollo Grp. Inc. Sec. Litig., 509 F. Supp. 2d 837, 844 (D. Ariz. 2007) (characterizing the test as "disjunctive"); *In re* Nokia OYJ (Nokia Corp.) Sec. Litig., 423 F. Supp. 2d 364, 397 (S.D.N.Y. 2006) (stating that an opinion may be actionable if it "was without a basis in fact *or* the speakers were aware of facts undermining the positive statements" (emphasis added)); D.E. & J Ltd. P'ship v. Conaway, 284 F. Supp. 2d 719, 741 (E.D. Mich. 2003) (stating that the opinions at issue would be false if issued "without a genuine belief or reasonable basis").

43. *Va. Bankshares*, 501 U.S. at 1108–09 (Scalia, J., concurring).

44. *Id.* at 1110 (citing Thompson v. Thompson, 484 U.S. 174, 190–92 (1988) (Scalia, J., concurring)). Justice Scalia is referring to his disapproval of implied private rights of action, such as the one that the Supreme Court recognized for breach of § 14(a) of the Securities Exchange Act in *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

plaintiff to prove both objective and subjective falsity in order to establish that an opinion is false for purposes of securities fraud liability, albeit with little analysis.[45]

B. The Subjective Falsity Requirement Raises the Applicable Scienter Level

The subjective falsity requirement, when applied, effectively raises the applicable scienter level. Both subjective falsity and

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45. *E.g.*, *Fait v. Regions Fin. Corp.*, 655 F.3d at 110 ("[W]hen a plaintiff asserts a claim under section 11 or 12 based upon a belief or opinion alleged to have been communicated by a defendant, liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."); Rubke v. Capitol Bancorp, Ltd., 551 F.3d 1156, 1162 (9th Cir. 2009) ("Because these fairness determinations are alleged to be misleading opinions, not statements of fact, they can give rise to a claim under section 11 only if the complaint alleges with particularity that the statements were both objectively and subjectively false or misleading."); Nolte v. Capital One Fin. Corp., 390 F.3d 311, 315 (4th Cir. 2004) ("In *Virginia Bankshares, Inc. v. Sandberg*, the Supreme Court held that in a securities fraud case, a statement of opinion may be a false factual statement if the statement is false, disbelieved by its maker, and related to matters of fact which can be verified by objective evidence." (citations omitted)); Greenberg v. Crossroads Sys., Inc., 364 F.3d 657, 670 (5th Cir. 2004) ("A statement of belief is only open to objection where the evidence shows that the speaker did not in fact hold that belief *and* the statement made asserted something false or misleading about the subject matter." (emphasis added)); Mayer v. Mylod, 988 F.2d 635, 639 (6th Cir. 1993) ("[S]tatements which contain the speaker's opinion are actionable under Section 10(b) of the Securities Exchange Act if the speaker does not believe the opinion and the opinion is not factually well-grounded."); United States v. Causey, No. CRIM. H-05-025-SS, 2005 WL 2647976, at *9 (S.D. Tex. Oct. 17, 2005) ("*Virginia Bankshares* and its progeny establish that vague, conclusory statements are actionable when juxtaposed to allegations that they are false expressions of a corporate manager's opinion or belief, they are misleading about their subject matter, and capable of proof by objective evidence of historical fact."); *In re* Salomon Analyst AT&T Litig., 350 F. Supp. 2d 455, 465 (S.D.N.Y. 2004) ("It is well established that liability under section 10(b) can be predicated on statements of opinion, where it can be shown not merely that a proffered opinion was incorrect or doubtful, but that the speaker deliberately misrepresented his actual opinion."); *D.E. & J Ltd. P'ship*, 284 F. Supp. 2d at 736 ("Material statements which contain the speaker's opinion are actionable under Section 10(b) only if the speaker does not believe the opinion and the opinion is not factually well-grounded."); Bond Opportunity Fund v. Unilab Corp., No. 99-Civ-11074, 2003 WL 21058251, at *5 (S.D.N.Y. May 9, 2003) ("Plaintiffs who charge that a statement of opinion, including a fairness opinion, is materially misleading, must allege 'with particularity' 'provable facts' to demonstrate that the statement of opinion is both objectively and subjectively false. Thus, the plaintiff must show both that the directors did not actually hold the belief or opinion stated, *and* that the opinion stated was in fact incorrect." (citation omitted)).

scienter address the defendant's state of mind when making the allegedly false statement.[46] Judge Gerard E. Lynch in the Southern District of New York aptly explained the merger of subjective falsity and scienter into a single analysis as follows:

> Although in the typical case falsity and scienter are different elements, in a false statement of opinion case the two requirements are essentially identical. For example, in a case where a material misstatement of fact is alleged, the statement may be both objectively false *and* believed in good faith by the speaker to be true. However, in contrast, a material misstatement of opinion is by its nature a false statement, not about the objective world, but about the defendant's own belief. Adequately alleging the falsity of a statement like "I believe AWE will grow" is the same as adequately alleging scienter on the part of the speaker, since the statement (unlike a statement of fact) cannot be false at all unless the speaker is knowingly misstating his truly held opinion.[47]

This merger has four important impacts on the analysis of alleged misrepresentations of opinion: (1) The applicable scienter level for securities fraud is raised from recklessness to actual knowledge; (2) the subjective falsity pleading standard is influenced by the Private Securities Litigation Reform Act's (PSLRA) strong inference pleading requirement; (3) the PSLRA's special scienter standard for forward-looking statements is subsumed into the subjective falsity requirement; and (4) the subjective falsity requirement adds a "state of mind" element to securities claims without one.

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46. *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 48 (1st Cir. 2005) ("[T]he subjective aspect of the falsity requirement and the scienter requirement essentially merge; the scienter analysis is subsumed by the analysis of subjective falsity."); *In re* Nat'l Century Fin. Enters., Inc., Inv. Litig., 580 F. Supp. 2d 630, 639 (S.D. Ohio 2008) (addressing subjective falsity) ("The issue of whether Moody's believed the opinion will be addressed below in relation to the element of scienter."); *In re* DRDGold Ltd. Sec. Litig., 472 F. Supp. 2d 562, 569 (S.D.N.Y. 2007) ("In analyzing whether DRD's statements regarding the 'sustainability' of the NWO and DRD's 'strong balance sheet' were not sincerely held opinions and thus actionable misrepresentations, the 'material misrepresentation' requirement for pleading fraud essentially collapses into the scienter requirement.").

47. *In re Salomon Analyst*, 350 F. Supp. 2d at 466.

1. The Applicable Scienter Level for Statements of Opinion Is Actual Knowledge

Although the Supreme Court has not yet reached this issue,[48] the courts of appeals agree that the element of scienter with respect to alleged misrepresentations of fact is established if the defendant acted intentionally or recklessly.[49]

In contrast, when analyzing whether an opinion is subjectively false, most courts require more than recklessness to establish subjective falsity.[50] As Judge Lynch explained:

> It is not sufficient for these purposes to allege that an opinion was unreasonable, irrational, excessively optimistic, not borne out by subsequent events, or any other characterization that relies on hindsight or falls short of an identifiable gap between the opinion publicly expressed and the opinion truly held.[51]

Other courts have described this subjective falsity requirement in similar terms: disbelief of the opinion expressed;[52] deliberate

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48. Matrixx Initiatives, Inc. v. Siracusano, 131 S. Ct. 1309, 1323 (2011) ("We have not decided whether recklessness suffices to fulfill the scienter requirement.").

49. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 n.3 (2007) ("Every Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly.").

50. *See In re* Bank of Am. Corp. Sec., Derivative, & ERISA Litig., 757 F. Supp. 2d 260, 310 (S.D.N.Y. 2010) ("Although there is some disagreement among the district courts in this Circuit as to whether recklessness can satisfy the subjective falsity requirement, the prevailing conclusion is that a plaintiff must allege that the defendant did not actually believe the stated opinion."). *But see In re Nat'l Century Fin. Enters.*, 580 F. Supp. 2d at 639 (after merging the subjective falsity and scienter analyses, applying the recklessness standard); *In re DRDGold Ltd.*, 472 F. Supp. 2d at 571–73 (after collapsing the subjective falsity analysis into the scienter analysis, analyzing whether the plaintiffs' allegations gave rise to a "strong inference of recklessness"); *D.E. & J Ltd. P'ship*, 284 F. Supp. 2d at 740 (applying the "knowledge" or "reckless disregard" test to determine if an auditor's opinion was made "without a genuine belief").

51. *In re Salomon Analyst*, 350 F. Supp. 2d at 466.

52. Broderick v. PriceWaterhouseCoopers LLP, 169 F. App'x 496, 499 (9th Cir. 2006) ("There was no materially false or misleading statement: PHP qualified its remarks with words such as 'believes,' 'Company's . . . interpretation' and 'in management's opinion.' Plaintiffs do not allege that the company did not in fact hold such beliefs at the time that the statement was made."); *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 47 (1st Cir. 2005) ("A plaintiff can challenge a statement of opinion by pleading facts sufficient to indicate that the speaker did not actually hold the opinion expressed (throughout

misrepresentation of a truly held opinion;[53] knowing misstatement of a truly held opinion;[54] knowing falsity;[55] and actual knowledge.[56] Regardless of the terminology used, however, this subjective falsity requirement requires more than mere recklessness.

Because the subjective falsity requirement is more stringent than the ordinary scienter requirement, the merger of these two analyses when the alleged misrepresentation is a statement of opinion has the effect of raising the applicable scienter level.[57] In other words, when the alleged misrepresentation is a statement of opinion, the applicable scienter level is raised from *recklessness* to *actual disbelief* or *actual knowledge* of falsity.[58]

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this opinion, we refer to such allegations as claims of 'subjective falsity')."); Belmont Holdings Corp. v. Sun Trust Banks, Inc., No. 1:09-cv-1185-WSD, 2010 WL 3545389, at *6 (N.D. Ga. Sept. 10, 2010) ("Absent an allegation that Defendants did not believe the statements incorporated into the RS/P, Plaintiff has not stated a claim for misstatements relating to SunTrust's opinion regarding the adequacy of its loan reserves."); Podany v. Robertson Stephens, Inc., 350 F. Supp. 2d 375, 381 (S.D.N.Y. 2004) (dismissing a securities fraud claim premised on an analyst's "buy" rating where the plaintiff failed to allege sufficient evidence that "he did not subjectively believe the opinion he was propounding in his analyst reports").

53. Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166, 182 (S.D.N.Y. Oct. 4, 2010) ("[A statement of opinion] is only actionable if 'defendants deliberately misrepresented a truly held opinion.'" (quoting *Podany*, 318 F. Supp. 2d at 153–54)); *Podany*, 318 F. Supp. 2d at 153–54 ("The sine qua non of a securities fraud claim based on false opinion is that defendants deliberately misrepresented a truly held opinion.").

54. *In re Salomon Analyst*, 350 F. Supp. 2d at 466 (explaining that an opinion "cannot be false at all unless the speaker is knowingly misstating his truly held opinion").

55. *In re Credit Suisse*, 431 F.3d at 49 ("The plaintiff must . . . point to provable facts that strongly suggest knowing falsity."); *In re Bank of Am. Corp.*, 757 F. Supp. 2d at 311 (analyzing the subjective falsity of opinions by applying a *knowingly false* standard).

56. *In re Bank of Am. Corp.*, 757 F. Supp. 2d at 311 ("[The actual knowledge standard for subjective falsity] comports with the Supreme Court's view in *Virginia Bankshares* that statements of belief are statements of fact in the sense that they convey that the speaker 'do[es] act for the reasons given or hold the belief stated,' and that such statements may be attacked by 'circumstantial evidence bearing on the facts that would reasonably underlie the reasons claimed and the honesty of any statement' regarding those reasons." (quoting Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1092–93 (1991))).

57. Wendy Gerwick Couture, *Price Fraud*, 63 BAYLOR L. REV. 1, 64 (2011) ("[T]he falsity and scienter elements converge when an opinion is the basis of a securities fraud claim, effectively raising the scienter level to knowledge.").

58. *See* Ian Ayres & Gregory Klass, *Promissory Fraud*, 78 N.Y. ST. B.J. 26, 28–29 (2006) (noting a similar convergence between the falsity and scienter

2. *The* Strong Inference of Scienter *Pleading Standard Informs Whether Subjective Falsity Is Pleaded Adequately*

The Private Securities Litigation Reform Act (PSLRA) and Federal Rule of Civil Procedure 9(b) impose heightened pleading standards on claims for securities fraud.[59] With respect to the falsity element, the PSLRA and Rule 9(b) require that falsity be pleaded with particularity.[60] With respect to the element of scienter, the PSLRA requires a plaintiff to plead facts giving rise to a "strong inference" of scienter.[61] As the Supreme Court explained, a "complaint will survive . . . only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged."[62]

When these heightened pleading standards are applied to allegedly fraudulent opinions, the pleading standards for falsity and scienter merge.[63] In other words, the precedent developed in the context of pleading the strong inference of scienter informs whether a plaintiff has adequately pleaded the element of subjective falsity.[64] Therefore, a complaint will survive dismissal

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elements in the context of promissory fraud) ("Courts reason that a promisor cannot be mistaken about his or her own intent. Thus if the defendant didn't intend to perform [thus rendering his implied representation of the intent to perform false], the misrepresentation must have been a knowing one, and hence there is no need for separate proof of scienter.").

59. The PSLRA applies "in each private action arising under this chapter that is brought as a plaintiff class action pursuant to the Federal Rules of Civil Procedure." 15 U.S.C. § 78u-4(a)(1) (2006). Rule 9(b) applies to all civil actions asserting fraud and filed in federal court. FED. R. CIV. P. 1, 9(b).

60. 15 U.S.C. § 78u-4(b)(1)(B) (2006) ("[T]he complaint shall specify . . . the reason or reasons why the statement is misleading."); FED. R. CIV. P. 9(b) ("[A] party must state with particularity the circumstances constituting fraud . . . .").

61. 15 U.S.C. § 78u-4(b)(2)(A) (Supp. V 2011). By contrast, Rule 9(b) does not require that the element of scienter be pleaded with particularity: "Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." FED. R. CIV. P. 9(b).

62. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 324 (2007).

63. *E.g.*, *In re* Bank of Am. Corp. Sec., Derivative, and ERISA Litig., 757 F. Supp. 2d 260, 319 (S.D.N.Y. 2010) ("Thus, the PSLRA's requirement that a plaintiff must plead 'with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,' applies to the Derivative Plaintiffs' claim that the BofA Directors' opinion was false or misleading." (quoting 15 U.S.C. § 78u-4(b)(2))); *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 49 (1st Cir. 2005) ("[T]he plaintiff must, for each allegedly false opinion, plead provable facts strongly suggesting that the speaker did not believe that particular opinion to be true when uttered.").

64. *In re Credit Suisse*, 431 F.3d at 48 ("Because subjective falsity is so intricately tied to scienter in false opinion cases, the authorities relative to

only if a reasonable person would deem the inference of the speakers' disbelief in the expressed opinion "cogent and at least as compelling as any opposing inference . . . ."[65]

3. The PSLRA's Actual Knowledge Requirement for Forward-Looking Statements Subsumes the Subjective Falsity Requirement

The PSLRA affords safe harbor protection to a forward-looking statement if "the plaintiff fails to prove that [it] . . . was made with actual knowledge . . . that the statement was false or misleading."[66] Like the subjective falsity requirement, the safe harbor has the effect of raising the applicable scienter level from recklessness to knowledge.[67] The safe harbor protection was enacted in order to counteract "[t]he muzzling effect of abusive securities litigation."[68] As the Joint Explanatory Statement of the Conference Committee explained, "Fear that inaccurate projections will trigger the filing of securities class action lawsuit[s] has muzzled corporate management."[69] The safe harbor protection, by raising the bar for a plaintiff to survive dismissal and to prevail on the merits, seeks to encourage companies to share predictions with the public, thereby enhancing market efficiency.[70]

Forward-looking statements are quintessential opinions. As defined in the statute, a forward-looking statement is essentially a prediction.[71] And indeed, absent a crystal ball, any prediction is necessarily subjective, requiring the speaker to infer an unknown fact (i.e., the future) from a known set of facts (i.e., the present).[72]

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pleading scienter are instructive (although not necessarily controlling) when determining whether a plaintiff has satisfied his or her pleading burden with respect to the subjective aspect of the falsity claim.").

65. *Tellabs, Inc.*, 551 U.S. at 324.

66. 15 U.S.C. § 78u-5(c)(1)(B) (2006).

67. *See supra* Part III.B.1.

68. H.R. CONF. REP. NO. 104-369, at 42 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 741.

69. *Id.* at 742.

70. *Id.* ("The Conference Committee has adopted a statutory 'safe harbor' to enhance market efficiency by encouraging companies to disclose forward-looking information.").

71. 15 U.S.C. § 78u-5(i)(1) (2006). *See also* Wendy Gerwick Couture, *Mixed Statements: The Safe Harbor's Rocky Shore*, 39 SEC. REG. L.J. 257, 260 (2011) ("The common element in this definitional list is the requirement that the statement refer to a *future*, as opposed to a *present or past*, state of affairs.").

72. *See infra* Part III.E.3.

Therefore, both the PSLRA safe harbor and the subjective falsity requirement apply to forward-looking statements. These two standards are virtually identical.[73] As such, the PSLRA's actual knowledge requirement effectively subsumes the subjective falsity requirement for a subset of opinions—namely, predictions.

4. The Subjective Falsity Requirement Adds a Scienter Element to Securities Claims Without One

The subjective falsity requirement, if applied to securities claims under §§ 11 and 12(a)(2) of the Securities Act, injects a scienter requirement into otherwise strict liability claims. Section 11 imposes strict liability on certain parties, including issuers and underwriters, for false or misleading statements in registration statements,[74] and § 12(a)(2) imposes strict liability on sellers for false or misleading statements in prospectuses and other offering communications.[75] Section 11 affords nonissuer defendants a *due diligence* defense,[76] and § 12(a)(2) affords defendants a *reasonable care* defense[77]—which have the effect of imposing a negligence-like state of mind requirement on defendants.[78] Even so, however, plaintiffs are not required to prove scienter.[79]

The subjective falsity requirement, when applied to §§ 11 and 12(a)(2) claims premised on opinions, effectively imports a scienter element into these claims.[80] One commentator has argued

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73. *See supra* Part III.B.1.
74. 15 U.S.C. § 77k (2006).
75. *Id.* § 77l(a)(2).
76. *Id.* § 77k(b).
77. *Id.* § 77l(a)(2).
78. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 208 (1976) (characterizing the § 11 due diligence defense) ("In effect, this is a negligence standard."); *In re* Software Toolworks Inc. Sec. Litig., 50 F.3d 615, 621 (9th Cir. 1995) ("[S]ection 11's 'reasonable investigation' standard is similar, if not identical, to section 12(2)'s 'reasonable care' standard.").
79. BLACK'S LAW DICTIONARY 1463 (9th ed. 2009) (defining *scienter* as "[a] degree of knowledge that makes a person legally responsible for the consequences of his or her act or omission; the fact of an act's having been done knowingly" or "[a] mental state consisting in an intent to deceive, manipulate, or defraud").
80. *E.g.*, Fait v. Regions Fin. Corp., 655 F.3d 105, 110 (2d Cir. 2011) ("[W]hen a plaintiff asserts a claim under section 11 or 12 based upon a belief or opinion alleged to have been communicated by a defendant, liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."); Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156, 1162 (9th Cir. 2009) ("Because these fairness determinations are alleged to be misleading opinions, not statements of fact, they can give rise to a claim under section 11 only if the complaint alleges with particularity that the

that the subjective falsity requirement therefore "contravenes congressional intent to lessen the burdens of proof under the securities laws, because it essentially incorporates the equivalent of a scienter burden."[81]

C. Courts Do Not Apply a Uniform Test to Distinguish Statements of Fact and Statements of Opinion in Securities Fraud Cases

Despite the necessity of distinguishing between statements of fact and statements of opinion in order to assess whether the plaintiff must plead and prove subjective falsity, courts do not apply a uniform test to make this distinction in securities fraud cases.

1. The I Know It When I See It *Test*

First, a number of courts seem to apply an *I know it when I see it* test, merely characterizing certain statements as opinions without articulating a rationale. For example, in *Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co.*,[82] the court characterized the statement that "Swiss Re's sub-prime-related activities outside its invested assets had 'significantly less risk than the risk that [Swiss Re was] exposed to through the investment that [it had] made recently in sub-prime bonds'" as a statement of opinion because "a statement of relative risk is a statement of opinion."[83] Similarly, in *In re DRDGold Ltd. Securities Litigation*,[84] the court concluded that statements about the "sustainability" of restructuring and a "'strong balance sheet' appear to be more properly characterized as optimistic statements of opinion as opposed to fact."[85]

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statements were both objectively and subjectively false or misleading."). *But see Fait*, 655 F.3d at 112 n.5 ("Contrary to plaintiff's concern, the standard applied here does not amount to a requirement of scienter. We do not view a requirement that a plaintiff plausibly allege that defendant misstated his truly held belief and an allegation that defendant did so with fraudulent intent as one and the same.").

81. John S. Poole, *Improving the Reliability of Management Forecasts*, 14 J. CORP. L. 547, 570 (1989).

82. 753 F. Supp. 2d 166 (S.D.N.Y. 2010).

83. *Id.* at 182 (alterations in original).

84. 472 F. Supp. 2d 562 (S.D.N.Y. 2007).

85. *Id.* at 569.

2. The Literal Test

Other courts applying a literal test give great weight to the inclusion of phrases like "I think," "I believe," and "in my opinion" when analyzing whether an alleged misrepresentation is a statement of opinion or fact, apparently without regard to the substance of the representation following that phrase.[86] For instance, in *Broderick v. PriceWaterhouseCoopers LLP*,[87] the court noted that the defendant "qualified its remarks with words such as 'believes,' 'Company's . . . interpretation' and 'in management's opinion.'"[88] Similarly, in *Malin v. XL Capital Ltd.*,[89] the court used italics to highlight certain phrases that indicated the statements' status as opinion:

> The language used by Defendants—e.g., XL "*believes*" the reserves are sufficient, "we *think* we've turned a corner now," "I *believe* we are in an unencumbered position to move forward," "we *believe, given all the facts we know today*, it is at the right reserve levels," and the Company "*believes* the methods presently adopted [for estimating loss reserves] provide a *reasonably* objective result"—qualifies the statements and indicates their status as opinions, rather than guarantees.[90]

86. *E.g.*, *In re* Bristol-Myers Squibb Sec. Litig., 312 F. Supp. 2d 549, 557 (S.D.N.Y. 2004) ("Typical of the statements challenged by Plaintiffs is Lane's statement on a conference call with Wall Street analysts following the announcement of the Company's investment in ImClone Systems that 'we *think* that this is a tremendous strategic opportunity. We *think* [Erbitux] is real blockbuster *potential*, has the *potential* to be one of the most exciting, if not the most exciting, oncology compound introduced *over the next several* years . . . [a]nd it's a compound with an 18-year patent life, ready to go to market *hopefully* next year.'" (alterations in original)); D.E. & J Ltd. P'ship v. Conaway, 284 F. Supp. 2d 719, 736 (E.D. Mich. 2003) ("The full text makes clear that the statements which Plaintiffs contend are false are statements of opinion. ('We believe that these financial statements reasonably present our financial position and results of operations'; 'we maintain comprehensive systems of internal controls [which] we believe provide . . . reasonable assurance [that asset [sic] are safeguarded and transactions are executed in accordance with established procedures].')" (alterations in original)).

87. 169 F. App'x 496 (9th Cir. 2006).

88. *Id.* at 499.

89. 499 F. Supp. 2d 117 (D. Conn. 2007).

90. *Id.* at 144 (alteration in original).

3. The Judgment or Subjectivity Test

Finally, a number of courts engage in a more nuanced analysis, characterizing opinions as statements that involve judgment or subjectivity. For example, as the First Circuit explained, most stock analysts' ratings are statements of opinion because "[a]rmed with the same background facts, two knowledgeable analysts, each acting in the utmost good faith, could well assign different ratings to the same stock."[91] Similarly, a number of courts have juxtaposed statements of objective or verifiable fact with those of subjective opinion.[92] According to these courts, statements about the source of information,[93] the amount of sales in the past quarter,[94] the firm's market capitalization,[95] an executive's promotion,[96] the firm's provision of certain types of telephone and Internet service,[97] and the liquidity of an investment[98] are statements of objective fact. In contrast, statements about the adequacy of

91. *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 47 (1st Cir. 2005) ("Most ratings are, therefore, best understood as statements of opinion, not as unadulterated statements of objective fact.").

92. *E.g.*, Fait v. Regions Fin. Corp., 655 F.3d 105, 111 (2d Cir. 2011) ("[T]he statements regarding goodwill at issue here are subjective ones rather than 'objective factual matters.'").

93. Secs. & Exch. Comm'n v. Pirate Investor LLC, 580 F.3d 233, 240 n.11 (4th Cir. 2009) ("Claims regarding the source of information are not expressions of subjective opinion, but are representations of an objectively verifiable fact.").

94. *In re* Salomon Analyst Level 3 Litig., 373 F. Supp. 2d 248, 251–52 (S.D.N.Y. 2005) ("'Facts' about a company include data like amount of sales in a past quarter or the firm's market capitalization on a given date (closing price of the stock multiplied by number of shares outstanding), or events like an executive's promotion to CEO or the acquisition of a competitor.").

95. *Id.*

96. *Id.*

97. Scritchfield v. Paolo, 274 F. Supp. 2d 163, 183 (D.R.I. 2003) ("The next subset of alleged fraud essentially concerns one statement that was repeated at the bottom of various 1999 press releases: '[LOA] is a . . . "CLEC" and . . . "IISP" providing local dial-tone, instate toll, long distance, high-speed Internet access and cable programming solutions . . . .'") ("The statement is a representation of present and verifiable fact—LOA marketed itself and may have attracted investors because it represented itself as a company that could provide and was providing these services. If it could not or was not providing these services at the time it issued these statements, it may have committed actionable fraud.").

98. Owens v. Gaffken & Barriger Fund, LLC, No. 08-Civ-8414, 2009 WL 3073338, at *7 (S.D.N.Y. Sept. 21, 2009) ("The alleged misrepresentations concerning the liquid nature of the investment and the plaintiff's easy access to cash withdrawal cannot be couched as a matter of opinion or optimism, but rather, were concrete representations concerning the Fund's purpose and function.").

reserves for predicted loan losses[99] and valuation models[100] are statements of subjective opinion. Finally, a number of courts have cited the exercise of professional judgment—such as that of an auditor or a ratings agency—as a hallmark of an opinion.[101]

D. The Falsity of an Opinion Is Established Only if It Is Both Objectively and Subjectively False

This Article agrees with the majority of courts having addressed this issue that, for an opinion to be false, it must be both subjectively and objectively false, not merely objectively false.[102]

First, this dual-falsity requirement recognizes that an opinion, in addition to conveying something objective, conveys something subjective—the speaker's mental processes. This "something special" that opinions convey is recognized in a variety of other contexts in the law. For example, the Federal Rules of Evidence recognize that opinions are unique. Rule 701 limits the admissibility of opinion testimony of lay witnesses to those that are "helpful to clearly understanding the witness's testimony or to

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99. Belmont Holdings Corp. v. Sun Trust Banks, Inc., No. 1:09-CV-1185, 2010 WL 3545389, at *6 (N.D. Ga. Sept. 10, 2010) ("Whether SunTrust had adequate reserves for its predicted loan losses generally is not a matter of objective fact, but rather a statement of SunTrust's opinion regarding what portion of its loan portfolio would be uncollectable.").

100. *In re* Salomon Analyst Level 3 Litig., 373 F. Supp. 2d 248, 251–52 (S.D.N.Y. 2005) ("First, the Court rejects plaintiffs' characterization of valuation models as 'fact' rather than 'opinion.' . . . In contrast to these objective statements, financial valuation models depend so heavily on the discretionary choices of the modeler-including choice of method (e.g., discounted cash flow vs. market-based methods), choice of assumptions (such as the proper discount rate or cost of capital for a particular firm or industry), and choice of 'comparables' that the resulting models and their predictions can only fairly be characterized a subjective opinions.").

101. *In re* Nat'l Century Fin. Enters., Inc. Inv. Litig., 580 F. Supp. 2d 630, 639 (S.D. Ohio 2008) ("There is no dispute that, even as described in the complaint, the ratings that Moody's assigned to the notes ultimately represented Moody's own judgment or opinion about the quality of the bond."); Payne v. DeLuca, 433 F. Supp. 2d 547, 580 (W.D. Pa. 2006) ("In allegations based on the defendant's violation of GAAP, the plaintiff must show 'that the accounting judgments which were made were such that no reasonable accountant would have made the same decision if confronted with the same facts.'" (quoting *In re* Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1426 (9th Cir. 1994))); D.E. & J Ltd. P'ship v. Conaway, 284 F. Supp. 2d 719, 740 (E.D. Mich. 2003) ("The opinion rule discussed above is particularly applicable with respect to opinions by auditors, which generally involve issues such as the auditor's dependence on information supplied by the client, application of complex accounting and auditing standards, and varying degrees of professional judgment.").

102. *See supra* Part III.A.

determining a fact in issue."[103] This limitation recognizes that opinion lay testimony has something special to it—which can be invaluable to a jury, such as when it interprets evidence that the jury would not otherwise fully understand, and which also can infringe on the jury's fact-finding function, such as when it is offered "in lieu of the individual components of perception."[104] As another example, the Model Rules of Professional Conduct prohibit attorneys from "knowingly . . . mak[ing] a false statement of material fact . . . to a third person,"[105] and the comments distinguish between these prohibited factual misstatements and opinions—like "[e]stimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim"—that are not within the scope of the prohibition.[106]

Second, this dual falsity requirement recognizes that this "something special" about opinions enhances market efficiency, thus meriting the heightened protection that the subjective falsity requirement affords. The dissemination of opinions about securities is a valuable way to enhance market efficiency. For example, the Supreme Court has characterized securities analysis as "necessary to the preservation of a healthy market."[107] Congress, also recognizing the importance of securities analysis to capital-raising, recently enacted the JOBS Act, which lifts restrictions on securities analyst coverage of "emerging growth compan[ies]."[108] When enacting the Dodd–Frank Act, Congress similarly recognized that credit rating agencies, which play a gatekeeper role similar to that of securities analysts, are "central to

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103. FED. R. EVID. 701.

104. 29 CHARLES ALAN WRIGHT & VICTOR JAMES GOLD, FEDERAL PRACTICE & PROCEDURE § 6255 (1997).

105. MODEL RULES OF PROF'L CONDUCT R. 4.1(a) (2010).

106. MODEL RULES OF PROF'L CONDUCT R. 4.1 cmt. 2 (2010).

107. Dirks v. Secs. & Exch. Comm'n, 463 U.S. 646, 657 (1983); *id.* at 657 n.17 (quoting the SEC's briefing) ("The SEC expressly recognized that '[t]he value to the entire market of [analysts'] efforts cannot be gainsaid; market efficiency in pricing is significantly enhanced by [their] initiatives to ferret out and analyze information, and thus the analyst's work redounds to the benefit of all investors.'" (alterations in original)).

108. Jumpstart Our Business Startups Act (The JOBS Act) § 105(b), 15 U.S.C. § 78o-6(c) (Westlaw 2012) (prohibiting certain restrictions on communications between securities analysts and potential investors and on communications among analysts, company management, and investment banking personnel); H.R. REP. NO. 112-406, at 6 (2012), *reprinted in* 2012 U.S.C.C.A.N. 278, 279 ("H.R. 3606 also improves the flow of information about EGCs [Emerging Growth Companies] to investors by removing burdensome and outdated restrictions on communications between companies, research analysts, and investors.").

capital formation, investor confidence, and the efficient performance of the United States economy."[109] Finally, the unique insights of companies and their officers and directors are essential to market efficiency. Indeed, when enacting the Private Securities Litigation Reform Act, Congress explicitly recognized the importance of a company's expression of its opinions about the future of its business in achieving market efficiency.[110] Yet, if an honestly expressed opinion were potentially actionable merely because, after the fact, it were deemed unreasonable, voluntary expression of opinions would be stifled. Thus, just as the PSLRA affords safe harbor protection to forward-looking statements in order to encourage companies to share their opinions about the future,[111] the subjective falsity requirement lessens the self-censorship of these valuable communications.

Indeed, the contention that opinions should be treated specially in the context of securities fraud draws on the work of numerous eminent scholars who, recognizing that courts struggle mightily when applying the elements of securities fraud to statements other than "plain vanilla" statements of fact, have identified various subsets of statements and proposed analytical frameworks that should apply to those subsets. None of these scholars has focused specifically on statements of opinion. Yet, a close analysis of their proposed subsets shows that they intersect around statements of opinion. For example, Professor Jennifer O'Hare, noting courts' inconsistent application of the puffery defense to (1) vague forward-looking statements and (2) vague statements characterizing present facts, has proposed a framework to analyze the materiality of these statements.[112] Professor Donald C. Langevoort has identified courts' inconsistent treatment of half-truths and proposed a framework for assessing whether half-truths should be actionable as securities fraud.[113] Professor David A. Hoffman has proposed a new *presumed liability* regime to apply to so-called puffery, which he identifies in

109. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 931(1), 124 Stat. 1376 (2010).

110. H.R. CONF. REP. 104-369, at 43 (1995), *reprinted in* 1995 U.S.C.C.A.N. 730, 742 ("The Conference Committee has adopted a statutory 'safe harbor' to enhance market efficiency by encouraging companies to disclose forward-looking information.").

111. *Id.* at 731 ("And it establishes a safe harbor for forward looking statements, to encourage issuers to disseminate relevant information to the market without fear of open-ended liability.").

112. O'Hare, *supra* note 12, at 1709, 1737.

113. Langevoort, *supra* note 13, at 88, 113.

the securities context as "vague statement[s] of corporate optimism" about the future or about current conditions.[114]

Therefore, this Article contends that the "specialness" of opinions should be reflected in the dual-falsity requirement, which mandates that an opinion is not *false* unless both objectively and subjectively so. In other words, the special part of an opinion—the speaker's mental processes—must be misrepresented in order for an opinion to be *false*. Of course, this Article's recommendation presupposes that one can identify that subset of statements—namely, opinions—that merit this "special" treatment. Indeed, as discussed below, the dual falsity implication of being classified as an opinion should help guide the creation of the standard to identify statements of opinion.

E. Courts Should Apply the Novel Evaluation–Inference *Test to Identify Statements of Opinion*

The issue of whether an opinion must be objectively and subjectively false is interrelated with the issue of how to identify an opinion. Underlying the dual-falsity requirement is the recognition that opinions have "something special" about them—the mental processes of the speaker. The key to identifying statements of opinion is identifying what exactly is special about them. To place a finger on this specialness, this Part first draws guidance from the same quandary in the contexts of defamation and common law fraud. Then, this Part proposes that an opinion for purposes of securities fraud is a statement requiring evaluation or inference. In particular, this Part proposes the following *evaluation–inference* test to differentiate statements of fact from statements of opinion for securities fraud purposes: Does the statement express the speaker's evaluation or inference of facts? Finally, this Part explains how this test dovetails with the dual-falsity requirement and compares this test to the current tests that courts apply in the contexts of defamation, common law fraud, and securities fraud.

1. The Fact–Opinion Distinction in the Defamation Context

The fact–opinion distinction was once paramount in the law of defamation, with courts and commentators interpreting Supreme Court precedent as holding that statements of opinion may not be

114. Hoffman, *supra* note 14, at 1405–11, 1445.

actionable because they are protected by the First Amendment.[115] In *Milkovich v. Lorain Journal Co.*,[116] however, the Supreme Court rejected the contention that the fact–opinion distinction is determinative of First Amendment protection: "[W]e think the 'breathing space' which '[f]reedoms of expression require in order to survive' is adequately secured by existing constitutional doctrine without the creation of an artificial dichotomy between 'opinion' and fact."[117] Although the fact–opinion distinction is no longer outcome determinative in defamation cases, the scholarship that developed around this issue is nonetheless instructive when analyzing this issue in the securities fraud context.

One of the most influential scholars in this area, Dean W. Page Keeton, divided opinions into two categories—evaluative and deductive.[118] Subsequent scholars have adopted these categories when discussing the scope of common law defamation and the scope of First Amendment protection of opinions.[119] In an evaluative opinion, "the speaker makes a normative judgment based on facts known" to the speaker.[120] In a deductive opinion, the speaker applies his or her "deductive skills" to a body of facts, thereby "lead[ing] to the inference of a new fact."[121] By

115. *See* Gertz v. Robert Welch, Inc., 418 U.S. 323, 339–40 (1974) ("We begin with the common ground. Under the First Amendment there is no such thing as a false idea. However pernicious an opinion may seem, we depend for its correction not on the conscience of judges and juries but on the competition of other ideas.").

116. 497 U.S. 1 (1990).

117. *Milkovich*, 497 U.S. at 19 (quoting Phila. Newspapers, Inc. v. Hepps, 475 U.S. 767, 772 (1986)).

118. W. Page Keeton, *Defamation and Freedom of the Press*, 54 TEX. L. REV. 1221, 1233 (1976) ("A deductive opinion could be characterized as an imputation of past misconduct or purportedly existing fact, drawn as an inference from the existence of other facts. By contrast, an evaluative opinion is simply a condemnation of the defendant for having committed certain conduct."); W. PAGE KEETON ET AL., PROSSER AND KEETON ON TORTS §113A (5th ed. 1984). Dean Keeton made the additional distinction between opinions that do not imply any facts and those that do. *Id.* This distinction is not instructive on the fact–opinion issue, but it is instructive on the materiality issue addressed below in Part IV.C.5 and is addressed further there.

119. Joseph H. King, *Defamation Claims Based on Parody and Other Fanciful Communications Not Intended to Be Understood As Fact*, 2008 UTAH L. REV. 875, 901–02 (2008); Kathryn Dix Sowle, *A Matter of Opinion:* Milkovich *Four Years Later*, 3 WM. & MARY BILL RTS. J. 467, 473–75 (1994); Ronald K. Chen, *Once More into the Breach: Fact Versus Opinion Revisited After* Milkovich v. Lorain Journal Co., 1 SETON HALL CONST. L. J. 331, 334–37 (1991).

120. Chen, *supra* note 119, at 334–35.

121. *Id.* at 335. Notably, Dean Keeton's usage of the term *deductive opinion*, which is premised on inferring an unknown fact from known facts, differs from

implication, Dean Keeton's categories limit the scope of statements that are as classified as opinions to those that involve either evaluation or inference.

2. The Fact–Opinion Distinction in the Common-Law Fraud Context

In the common law fraud context, as articulated in the *Second Restatement of Torts*, opinions are defined quite broadly: "A representation is one of opinion if it expresses only (a) the belief of the maker, without certainty, as to the existence of a fact; or (b) his judgment as to quality, value, authenticity, or other matters of judgment."[122] The *Restatement* definition has been widely cited by courts struggling to differentiate between statements of fact and of opinion in misrepresentation cases.[123]

Part (b) of the *Restatement* definition bears a close resemblance to Dean Keeton's *evaluative opinion* classification. The *Restatement* cites the statement that "an automobile is a good car" as an example because "it is a matter upon which individual judgments may be expected to differ."[124] Like Dean Keeton's *evaluative opinion* classification, the description of an automobile as "good" is an evaluation drawn from facts known to the speaker.

Part (a) of the *Restatement* test also bears a close resemblance to Dean Keeton's *deductive opinion* classification. Like Dean Keeton's classification, Part (a) includes a speaker's inferences about the existence of facts, drawn from the speaker's analysis of facts known to the speaker.

In one key area, however, Part (a) of the *Restatement* definition sweeps more broadly than Dean Keeton's *deductive opinion* classification. Part (a) includes qualified statements of fact, even if the speaker is not inferring the stated facts. Take as an example a forgetful speaker who, unable to remember the acreage of a parcel of land, states, "I believe that there are ten acres here." This

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the social science definition of *deductive reasoning*, which is premised on determining a valid conclusion from true premises. *See* P. N. Johnson-Laird, *Deductive Reasoning*, 50 ANN. REV. PSYCHOL. 109, 110 (1999) ("By definition, deduction yields *valid* conclusions, which must be true given that their premises are true . . . .").

122. RESTATEMENT (SECOND) OF TORTS § 538A (1977).

123. *E.g.*, Marino v. United Bank of Ill., N.A., 484 N.E.2d 935, 937 (Ill. App. 1985); McEneaney v. Chestnut Hill Realty Corp., 650 N.E.2d 93, 96 (Mass. App. Ct. 1995); Consol. Papers, Inc. v. Dorr-Oliver, Inc., 451 N.W.2d 456, 459 (Wisc. Ct. App. 1989).

124. RESTATEMENT (SECOND) OF TORTS § 538A cmt. b (1977).

statement, which expresses the speaker's belief, without certainty, about the existence of fact would fall squarely within Part (a) of the definition.[125] Yet, this qualified statement of fact, which represents neither the speaker's evaluation nor inference, would fall outside the scope of Dean Keeton's classifications.

3. In the Context of Securities Fraud, an Opinion Requires the Exercise of Evaluation or Inference

Drawing from these comparable distinctions in the contexts of defamation and common law fraud, this Article argues that, for purposes of securities fraud, opinions should be defined as statements requiring the speaker's evaluation or inference. A statement of evaluation expresses the speaker's judgment as to quality, value, or other matters of judgment. As an example, a CEO's statement that "our high-tech division is uniquely positioned to take over the market share abandoned by X company" would qualify as an opinion because the CEO exercised independent judgment in order to evaluate the division's position. A statement of inference expresses the speaker's inference about the existence of a fact, based on the speaker's analysis of other data. As an example, a CEO's statement, "I think that our competitors are expending fewer resources than we are on research and development," would qualify as an opinion, assuming that the competitors' R&D budgets were not public, because the CEO inferred the statement's substance.

a. The Importance of the Opinion Characterization

This test identifies the "something special" that makes applying the elements of securities fraud to statements of opinion so tricky. As discussed above, several prominent scholars have identified various subsets of statements and proposed analytical frameworks that should apply to those subsets.[126] None of those scholars has focused specifically on statements of opinion, yet statements of evaluation or inference are at the heart of these scholars' subsets.

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125. RESTATEMENT (SECOND) OF TORTS § 538A cmt. c (1977) ("The form of the statement is important and may be controlling. 'I believe that there are ten acres here,' is a different statement, in what it conveys, from 'The area of this land is ten acres.' The one conveys an expression of some doubt while the other leaves no room for it."); RESTATEMENT (SECOND) OF TORTS § 538A cmt. b (1977) ("The difference is one between 'This is true,' and 'I think this is true, but I am not sure.'").

126. *See supra* Part III.D.

Professor O'Hare's forward-looking statements,[127] Professor Langevoort's predictive "half-truths,"[128] and Professor Hoffman's vague statements of corporate optimism about the future—all of which necessarily require the speaker to infer an unknown fact (the future) from known facts—are quintessential opinions. Similarly, Professor O'Hare's "vague statements characterizing present facts" and Professor Hoffman's vague statements of corporate optimism about the present include evaluative statements of opinion.[129]

b. Comparison to Tests Currently Applied in Securities Fraud Cases

This *evaluation–inference* test is preferable to the *I know it when I see it* approach that some courts apply because it is capable of repetition. A uniform and predictable test is imperative so that corporate actors are not afraid to speak, lest they inadvertently subject themselves to liability.

Moreover, this *evaluation–inference* test is better than merely relying on phrases like "I think" and "in my opinion" because it elevates substance over form. For example, under the proposed test, both of the following two statements would be treated as opinions: (1) "I believe that the company is well-poised to capture the additional market share vacated by Borders"; and (2) "the company is well-poised to capture the additional market share vacated by Borders." The assessment about the company's ability to capture additional market share incorporates the speaker's judgment, regardless of whether it is preceded by the phrase "I believe." The phrase "I believe" is merely implied in the second

127. *See* O'Hare, *supra* note 12, at 1709 (citing *In re* Storage Tech. Corp. Sec. Litig., 804 F. Supp. 1368, 1372 (D. Colo. 1992)) (referencing a company's prediction that a product would be a "blowout winner" as an example of a vague, forward-looking statement). Because it was uncertain whether the product would indeed be a success, the company's prediction, drawn from known facts about the product, constituted a deductive opinion.

128. *See* Langevoort, *supra* note 13, at 116 (citing a company's release of a projection, without also disclosing that that the company is also considering more pessimistic projections internally, as an example of a half-truth).

129. *See* O'Hare, *supra* note 12, at 1713 n.95 (citing Searls v. Glasser, 64 F.3d 1061, 1066 (7th Cir. 1995)) (referencing a company's statement that it was "recession-resistant" as an example of a "vague statement [] of present facts"). This statement, which expresses a company's subjective evaluation drawn from known facts about the company, is an evaluative opinion. *See also* Hoffman, *supra* note 14, at 1410 n.84–85 (citing examples of puffing statements about current conditions).

statement.[130] The converse is also true. Neither of the following two statements, made by the chairman of the board of directors, would be treated as an opinion: (1) "The board met for three hours before voting on the merger"; and (2) "I believe that the board met for three hours before voting on the merger." The mere addition of the qualifying phrase "I believe" would not transform a statement of fact, which was neither inferred nor evaluative, into a statement of opinion.

Further, the *evaluation–inference* test is consistent with the more nuanced analyses applied by courts such as the First Circuit, which requires that opinions involve judgment or subjectivity.[131] Like those courts, the *evaluation–inference* test recognizes that the special treatment afforded opinions—including specialized falsity and materiality analyses—is only appropriate if the statement is special. The speaker's independent evaluation or inference is the added value. In other words, the speaker's evaluation or inference might differ from another's, even if the other were presented with the same background facts from which to reach an evaluation or an inference, and it is that "something special" that makes the statement an opinion.[132]

Applying the *evaluation–inference* test to those statements that courts have classified as opinions in securities cases demonstrates that most statements that courts have classified as opinions are within the scope of the *evaluation–inference* test, despite the disparate tests that courts have applied. For instance, the following examples drawn from case law are within the evaluation test's scope: "Swiss Re's sub-prime-related activities outside its invested assets had 'significantly less risk than the risk that [Swiss Re was] exposed to through the investment that [it had] made recently in sub-prime bonds'";[133] statements about the "sustainability" of restructuring;[134] statements about a "strong balance sheet";[135] "we

130. *See* RESTATEMENT (SECOND) OF TORTS § 525 cmt. d (1977) ("Indeed, every assertion of the existence of a thing is a representation of the speaker's state of mind, namely, his belief in its existence.").

131. *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 47 (1st Cir. 2005) ("Most ratings are, therefore, best understood as statements of opinion, not as unadulterated statements of objective fact.").

132. *Id.* ("Armed with the same background facts, two knowledgeable analysts, each acting in the utmost good faith, could well assign different ratings to the same stock."); RESTATEMENT (SECOND) OF TORTS § 538A cmt. b (1977) ("One common form of opinion is a statement of the maker's judgment . . . as to which opinions may be expected to differ.").

133. Plumbers' Union Local No. 12 Pension Fund v. Swiss Reinsurance Co., 753 F. Supp. 2d 166, 174 (S.D.N.Y. 2010) (alterations in original).

134. *In re* DRDGold Ltd. Sec. Litig., 472 F. Supp. 2d 562, 569 (S.D.N.Y. 2007).

believe, given all the facts we know today, it is at the right reserve levels,"[136] statements about the adequacy of reserves for predicted loan losses;[137] and a credit rating.[138] Each of these examples represents the speaker's evaluation of known facts to reach an evaluative opinion. Moreover, forward-looking statements, which are quintessential opinions, are statements of inference drawn from known facts.

c. Comparison to Tests Applied in the Contexts of Defamation and Common Law Fraud

The evaluation prong of the proposed test is consistent with Dean Keeton's classification of evaluative opinions and with prong (b) of the *Restatement*'s common law fraud test. The inference prong of the proposed test is consistent with Dean Keeton's classification of deductive opinions and, like Dean Keeton's classification, is narrower than prong (a) of the common law fraud test.

In particular, the *evaluation–inference* test proposed in this Article is narrower than the common law fraud test because it excludes mere qualified statements of fact from the definition of *opinion*. For example, if a company's CEO were to state, "I believe that we started that product line in 2002," this would not qualify as an opinion for purposes of securities fraud because the statement's substance is knowable to the speaker. This statement expresses neither the CEO's judgment nor the speaker's inference. Rather, this statement more closely resembles a qualified statement of fact.

This category of statement is excluded from the proposed definition of opinion for two reasons. First, the inclusion of a qualification does not have independent value to merit the heightened requirements associated with statements of opinion. Rather than exercising judgment or making an inference, the CEO is merely qualifying the statement to express uncertainty. This qualification does not have independent value that transforms a statement of fact about the year that the product line was launched into a statement of opinion.

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135. *Id.*

136. Malin v. XL Capital Ltd., 499 F. Supp. 2d 117, 144 (D. Conn. 2007).

137. Belmont Holdings Corp. v. Sun Trust Banks, Inc., No. 1:09-CV-1185, 2010 WL 3545389, at *6 (N.D. Ga. Sept. 10, 2010).

138. *In re* Nat'l Century Fin. Enters. Inc. Inv. Litig., 580 F. Supp. 2d 630, 639 (S.D. Ohio 2008).

Second, the inclusion of a statement of belief about a fact that is known to the speaker is the mere expression of a statement implicit in every factual representation. Every statement of fact is accompanied by the implicit representation that the speaker believes that the statement is accurate.[139] Thus, the explicit inclusion of the phrase "I think" should not magically transform a statement of fact into an opinion with the concomitant subjective falsity requirement. For example, a CEO stating, "We started the product line in 2002," would contain the implicit representation that the CEO believed this fact to be true. The mere verbalization of an implicit statement should not operate to transform a statement of fact into a statement of opinion.

The qualification is not thereby meaningless, however. If the qualification were sufficient to render it unreasonable for an investor to rely on the accompanying statement of fact, the element of materiality would not be met.[140] As an example, if the CEO were to make the following qualified assertion of fact, it would likely be immaterial as a matter of law: "I don't have the data in front of me and my memory is shaky, but I believe we started the product line in 2002." The inclusion of a qualification does not, however, transform this statement into an opinion.

IV. WHEN IS AN OPINION MATERIAL?

As this Article has argued so far, an *opinion* is defined as a statement expressing the speaker's evaluation or inference of facts,[141] and an opinion is only false if the speaker both objectively unreasonably and subjectively disbelieved it.[142] A final complexity remains when applying the elements of securities fraud to statements of opinion: When is a statement of opinion "material"? Courts routinely divide statements of opinion in two groups: (1) those that are immaterial as a matter of law; and (2) those that are potentially material. Despite the fact that this division is often outcome determinative, courts fail to apply a uniform, analytically sound test to differentiate between these two types of opinions.

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139. *See* RESTATEMENT (SECOND) OF TORTS § 525 cmt. d (1977) ("Indeed, every assertion of the existence of a thing is a representation of the speaker's state of mind, namely, his belief in its existence.").

140. Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (defining *materiality* as "a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" (citation omitted)).

141. *See supra* Part III.E.

142. *See supra* Part III.D.

Part A of this section demonstrates that courts routinely dismiss statements of opinion as immaterial as a matter of law, yet Part B shows that courts fail to apply analytically sound tests when deciding which statements to categorize as immaterial. To solve the analytical problems underlying the tests that courts currently apply, Part C proposes the following *reasonable implication* test in order to identify those opinions that are potentially material: Does the opinion reasonably imply an allegedly false, material fact? Further, Part C demonstrates that the *reasonable implication* test is informed by and consistent with comparable tests applied in the contexts of defamation and common law fraud.

A. Courts Distinguish Between Opinions That Are Immaterial As a Matter of Law and Those That Are Potentially Actionable

An alleged misrepresentation is material for purposes of securities fraud if there is "a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[143] Stated differently, a statement is material if "there is a substantial likelihood that a reasonable shareholder would consider it important" in deciding how to invest.[144]

The objective materiality standard for securities fraud balances the fundamental importance of fair and honest markets against the dangers of setting the materiality standard too low.[145] On one hand, as the Supreme Court has recognized, "[t]here cannot be honest markets without honest publicity."[146] This consideration weighs in

143. Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (citation omitted).

144. *Id.* at 231 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

145. *See* Wendy Gerwick Couture, *White Collar Crime's Gray Area: The Anomaly of Criminalizing Conduct Not Civilly Actionable*, 72 ALB. L. REV. 1, 28–29 (2009) (explaining this delicate balance); *see also* Hoffman, *supra* note 14, at 1398 (characterizing the puffery doctrine as "walking the line between overdeterrence of speech and underdeterrence of fraud"). As noted by Professor Margaret V. Sachs, the objective materiality standard also achieves a related delicate balance between encouraging and discouraging investor class actions by simultaneously enabling and limiting them. Margaret V. Sachs, *Materiality and Social Change: The Case for Replacing "The Reasonable Investor" with "The Least Sophisticated Investor" in Inefficient Markets*, 81 TUL. L. REV. 473, 486–89 (2006). On one hand, the objective standard permits a class-wide determination of materiality. *Id.* On the other hand, the materiality standard limits strike suits by barring claims premised on alleged misrepresentations upon which only an unreasonable investor would have relied. *Id.*

146. *Basic*, 485 U.S. at 230 (quoting H.R. REP. NO. 73-1383, at 11 (1934)). *See also* 15 U.S.C. § 78b (2006 & Supp. V 2011) (stating that one purpose of securities regulation is "to insure the maintenance of fair and honest markets");

favor of a lower materiality standard—both to lower the bar for required disclosures and to deter affirmative false statements. On the other hand, an unduly low standard carries its own dangers. When applied to a company's omissions, "a minimal standard might bring an overabundance of information within its reach, and lead management 'simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.'"[147] Moreover, when applied to affirmative misrepresentations, the materiality standard prevents "every miniscule inaccuracy in public statements of SEC filings" from being actionable, thus encouraging companies to speak voluntarily without fear of inadvertently incurring liability.[148]

Although the materiality element is a question of fact, courts routinely dismiss statements of opinion because they are immaterial as a matter of law,[149] often characterizing these statements as "mere puffery."[150] Although the term *puffery* is

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Basic, 485 U.S. at 230 (recognizing that a central purpose of the securities laws is "to protect investors against manipulation of stock prices"); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976) (stating that the purpose of the securities law is "to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing").

147. *Basic*, 485 U.S. at 231 (quoting *TSC Indus.*, 426 U.S. at 448–49).

148. *See* THOMAS LEE HAZEN, LAW OF SECURITIES REGULATION § 12.9[3][B] (6th ed. 2011).

149. *See* David A. Hoffman, *The "Duty" to Be a Rational Shareholder*, 90 MINN. L. REV. 537, 585–86 (2006) (reporting the results of an empirical study) ("Over time . . . courts have become more willing to apply 'puffery' and 'bespeaks caution' doctrines which are (1) bright-line rules that focus on the language of disclosures, (2) associated with each other, and (3) more likely to appear at early staged in litigation."); Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83, 86, 119 (2002) ("In a large number of cases applying the puffery doctrine, this materiality determination is made at the motion to dismiss stage.").

150. Woodward v. Raymond James Fin., Inc., 732 F. Supp. 2d 425, 433 (S.D.N.Y. 2010) ("[S]tatements of puffery or mere generalizations are not material misstatements. A reasonable investor, by definition, does not rely upon general and vague statements of puffery."); *In re* REMEC Inc. Sec. Litig., 702 F. Supp. 2d 1202, 1229 (S.D. Cal. 2010) ("Courts often analyze the materiality of such statements because no reasonable investor would rely on a company's subjective expression of optimism for the future."); *In re* Guidant Corp. Sec. Litig., 536 F. Supp. 2d 913, 928 (S.D. Ind. 2008) ("We note also that several of the statements disputed by Plaintiffs can be understood as immaterial, non-actionable corporate puffery."); Payne v. DeLuca, 433 F. Supp. 2d 547, 561 (W.D. Pa. 2006) ("Puffery comes into play when a court is considering the materiality of statements alleged to have been misleading. While materiality

technically inapposite in most securities fraud cases,[151] this puffery characterization has essentially become synonymous with immateriality. A few courts have instead tied the puffery characterization with the falsity element, stating that puffery is incapable of falsity.[152] This minority characterization is best interpreted as identifying a subset of puffery: Surely, any statement that is incapable of falsity is also immaterial because no reasonable investor would rely on such a statement when making an investment decision.[153]

Many scholars have criticized courts' failure to consider a statement's context when dismissing it as mere puffery.[154] As Professor Stefan J. Padfield has noted, this practice conflicts with the Supreme Court's mandate to assess a statement's materiality in

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determinations are typically reserved for the trier of fact, 'complaints alleging securities fraud often contain claims of omissions or misstatements that are obviously so unimportant that courts can rule them immaterial as a matter of law at the pleading stage.'" (quoting *In re* Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1426 (3d Cir. 1997)); Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 200–01 (3d Cir. 1990) ("To say that a statement is mere 'puffing' is, in essence, to say that it is immaterial . . . ."); United States v. Causey, No. CRIM. H-05-025-SS, 2005 WL 2647976, at *3 (S.D. Tex. Oct. 17, 2005) ("Puffing is not actionable because it is immaterial.").

151. O'Hare, *supra* note 12, at 1703–22 (arguing that the "puffery" defense is inapposite in securities fraud cases premised on a company's statements to investors because, unlike the assumptions underlying the caveat emptor doctrine (which is the theoretical underpinning of the puffery defense), the company has greater access to information and the investors have a reason to trust the company).

152. *In re* Nokia OYJ (Nokia Corp.) Sec. Litig., 423 F. Supp. 2d 364, 400 (S.D.N.Y. 2006) ("These are exactly the kind of hopeful statements, tinged with caution, that cannot reasonably be found to be misleading and therefore relied upon to allege violations of the securities laws."); *In re* Cable & Wireless, PLC, Sec. Litig., 321 F. Supp. 2d 749, 767 (E.D. Va. 2004) ("The Fourth Circuit has also held that soft, puffing business communications and statements, like those profiled above, do not demonstrate falsity." (citing Howard v. Haddad, 962 F.2d 328, 331 (4th Cir. 1992))); *In re Cable & Wireless, PLC*, 321 F. Supp. 2d at 768 ("All of the statements Plaintiffs attribute to Defendants as violations of the securities laws are 'soft' and 'puffery' as defined in cases such as *Howard*, and thus do not demonstrate falsity.").

153. *Accord In re* Trex Co., Inc. Sec. Litig., 454 F. Supp. 2d 560, 572 (W.D. Va. 2006) ("For a statement to be material, it must be demonstrably false.").

154. *E.g.*, Stefan J. Padfield, *Immaterial Lies: Condoning Deceit in the Name of Securities Regulation*, 61 CASE W. RES. L. REV. 143, 171 (2010); O'Hare, *supra* note 12, at 1737 ("[C]ourt[s] should not simply review the language of the statement, label the statement as puffery, and dismiss the action as a matter of law.").

light of its effect on "the total mix of information."[155] Somewhat cynically, Professors Stephen M. Bainbridge and G. Mitu Gulati have explained this tension as result-oriented:

> [F]or the most part, context seems to matter only when the outcome is dismissal. If putting the statement into context lends credence to a decision to dismiss, the bespeaks caution doctrine is invoked. If taking a statement out of context makes dismissal more plausible, however, puffery is invoked. It is this disparity of treatment, coupled with the superficiality of analysis, which suggests the presence of a heuristic.[156]

Courts have also struggled with the juxtaposition of the *Virginia Bankshares* holding that statements of opinion can be actionable as false statements of fact because they make implicit representations[157] and the routine practice of dismissing statements of opinion as mere puffery. Many courts have characterized *Virginia Bankshares*' holding as a limitation or exception to the general rule that puffery is not actionable.[158] For example, in *In re*

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155. Basic Inc. v. Levinson, 485 U.S. at 231–32 (1988) (citation omitted) (stating the "total mix" standard); Padfield, *supra* note 154, at 171 ("Courts generally ignore context when applying the puffery doctrine, contrary to the 'total mix' aspect of the definition of materiality.").

156. Bainbridge & Gulati, *supra* note 149, at 123.

157. Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1092 (1991).

158. *In re* REMEC Inc. Sec. Litig., 702 F. Supp. 2d 1202, 1231 (S.D. Cal. 2010) ("Like his predictions in September 2003, Ragland's December statements are optimistic statements that usually are not actionable as securities fraud. Plaintiffs rely on the *exception* to that general rule. They argue that Ragland knew his positive, public statements were inaccurate at the time he made them." (emphasis added) (citation omitted)); *In re* DRDGold Ltd. Sec. Litig., 472 F. Supp. 2d 562, 569 (S.D.N.Y. 2007) (rejecting the defendants' argument that the alleged misstatements were inactionable "statements of opinion and puffery" because "opinion statements are actionable if Plaintiffs can plead 'with particularity that defendants did not sincerely believe the opinion they purported to hold'" (quoting Podany v. Robertson Stephens, Inc., 318 F. Supp. 2d 146, 154 (S.D.N.Y. 2004))); *In re* Dura Pharm., Inc. Sec. Litig., 452 F. Supp. 2d 1005, 1033 (S.D. Cal. 2006) ("This ['mere puffery'] rule has its limitations; a projection of optimism becomes actionable 'when (1) the statement is not actually believed, (2) there is no reasonable basis for the belief, or (3) the speaker is aware of undisclosed facts tending seriously to undermine the statement's accuracy.'" (citations omitted)); Lapin v. Goldman Sachs Grp., Inc., 506 F. Supp. 2d 221, 239 (S.D.N.Y. 2006) ("The important limitation on these principles is that optimistic statements may be actionable upon a showing that the defendants did not genuinely or reasonably believe the positive opinions they touted (i.e., the opinion was without a basis in fact or the speakers were aware of facts undermining the positive statements), or that the opinions imply certainty."); Fisher v. Kansas, 467 F. Supp. 2d 275, 282 (E.D.N.Y. 2006)

Citigroup Inc. Securities Litigation, the court stated that puffery could be actionable if it were objectively and subjectively false:

> These [statements] are expressions of "puffery and corporate optimism" that "do not give rise to securities violations." Such statements of optimism or predictions about future performance are actionable only "if they are worded as guarantees or are supported by specific statements of fact, or if the speaker does not genuinely or reasonably believe them."[159]

Other courts have skirted the issue, dismissing securities fraud claims based on opinions both because the objective–subjective falsity element is not satisfied *and* because they are immaterial as a matter of law.[160]

Contrary to the reasoning of these courts, the analytically sound way to rationalize the *Virginia Bankshares* holding that

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(immediately after determining that the alleged misrepresentations were "inactionable puffery," suggesting that they would potentially be actionable if they were objectively and subjectively false); City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 669–70 (6th Cir. 2005) ("Thus, federal courts 'everywhere "have demonstrated a willingness to find immaterial as a matter of law certain kinds of rosy affirmation heard from corporate managers and numbingly familiar to the marketplace-loosely optimistic statements that are so vague, [and] so lacking in specificity, . . . that no reasonable investor could find them important to the total mix of information available."' However, opinions may be deemed false or misleading under the securities laws if proof of their falsity can be established 'through the orthodox evidentiary process.'" (citations omitted)).

159. *In re* Citigroup Inc. Sec. Litig., 753 F. Supp. 2d 206, 248 (S.D.N.Y. 2010) (citations omitted).

160. Malin v. XL Capital Ltd., 499 F. Supp. 2d 117, 145 (D. Conn. 2007) ("There is no showing that O'Hara believed these statements to be false when made, as set out in more detail in the next section. Moreover, these statements are generally not actionable as a general statement of optimism."); *In re* Apple Computer, Inc., 127 F. App'x 296, 304 (9th Cir. 2005) ("[P]laintiffs do not allege any factual statement that was false. . . . [T]hat the new Power Mac was quite possibly the 'best Power Mac ever' is an opinion, plausibly held. Further, when valuing a corporation, investors do not rely on such vague statements of optimism." (citations omitted)); *In re* No. Nine Visual Tech. Corp. Sec. Litig., 51 F. Supp. 2d 1, 29–30 (D. Mass. 1999) ("Thus, the statements regarding expected sales growth in the fourth quarter are not actionable. . . . Soft, puffing statements such as these generally lack materiality because the market price of a share is not inflated by vague statements predicting growth. The Class contends that such statements can be actionable when accompanied by facts known by [the defendant], and contemporaneous with the [challenged statements], that would show that [the defendant's] anticipated success was unlikely. That may be true, but the Class has not alleged any such facts . . . ." (citations omitted) (internal quotation marks omitted)).

opinions can be actionable as false statements of fact with the puffery doctrine is to recognize that they address different elements of a securities fraud claim—with the former addressing the *misrepresentation of fact* element and the latter addressing the materiality element. The court in *In re XM Satellite Radio Holdings Securities Litigation* accurately explained this relationship:

> Plaintiffs argue that under *Virginia Bankshares*, statements such as these that "reflect the [d]efendants' opinions or 'subjective assessment'" are actionable if they lack "a factual basis that justifies them as accurate, the absence of which renders them misleading." However, such statements of opinion may only be actionable under § 12(b) if they are *materially* misleading.[161]

Stated otherwise, under *Virginia Bankshares*, a statement of opinion can qualify as a false statement of fact, thus satisfying the *misrepresentation of fact* element. Of course, this is only one element of a securities fraud claim. The misrepresentation of fact must also be *material*. The puffery doctrine relates to whether the materiality element is satisfied. Therefore, the courts that characterize *Virginia Bankshares* as a limitation or exception to the puffery doctrine are, in effect, characterizing apples as an exception to oranges. Instead, courts should recognize that, under *Virginia Bankshares*, a statement of opinion can qualify as a "misrepresentation of fact." Then, if this element is satisfied (as well as the other elements), courts should analyze whether that misrepresentation of fact is mere puffery or potentially material.[162]

B. Courts Fail to Apply Analytically Sound Tests to Identify Statements of Opinion That Are Immaterial As a Matter of Law

Courts apply various tests, many of which are analytically unsound, to identify statements of opinion that are immaterial

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161. *In re* XM Satellite Radio Holdings Sec. Litig., 479 F. Supp. 2d 165, 182 n.13 (D.D.C. 2007) (alterations in original) (citations omitted); *id.* at 177 ("Under the doctrine established by *Virginia Bankshares v. Sandberg* . . . statements of opinion, *if they are material*, may be actionable if they are not actually believed when made, if there is no reasonable basis for them, or if the speaker is aware of undisclosed facts that tend seriously to undermine the statements' accuracy." (emphasis added) (citations omitted)).

162. *E.g.*, *In re* Credit Suisse First Bos. Corp., 431 F.3d 36, 53 (1st Cir. 2005) ("Because the plaintiffs have failed to meet these PSLRA pleading requirements in regard to subjective falsity and scienter, we need not address other issues, such as . . . the materiality of the allegedly false statements . . . .").

puffery, resulting in conflicting and confusing precedent. As the court aptly stated in *Scritchfield v. Paolo*, "[T]he line of demarcation between puffery and actionable misstatement is often less than pellucid."[163] Indeed, Professors Bainbridge and Gulati have criticized the puffery doctrine as a prime example of a substantive law heuristic that judges apply because of their lack of experience in securities law, overreliance on law clerks, and desire to move cases off of their dockets.[164]

For example, applying various puffery tests, courts have held that the following opinions are immaterial as a matter of law: There is a "high likelihood" that a merger will close;[165] we have an "expectation of continued strong market growth";[166] production of a product "seems to be getting fairly close to fruition";[167] a product is "quality" or "best";[168] marketing expenditures are "cost effective," "sound," "smart," and "efficient";[169] the new Power Mac is quite possibly the "best Power Mac ever";[170] the company and its licensees have made "remarkable progress toward commercialization of our MRAM intellectual property";[171] the acquisition created "a premier financial services franchise with significantly enhanced wealth management, investment banking and international capabilities";[172] a newly combined firm is "uniquely positioned to win market share";[173] the inventory system is "dynamic";[174] the project is "moving forward quite smoothly";[175] there is "tremendous market interest" in the XT3

163. Scritchfield v. Paolo, 274 F. Supp. 2d 163, 172 (D.R.I. 2003).

164. Bainbridge & Gulati, *supra* note 149, at 86, 119–22.

165. *In re* Guidant Corp. Sec. Litig., 536 F. Supp. 2d 913, 928 n.15 (S.D. Ind. 2008) (dismissing as puffery a statement "in which Defendant Dollens expressed his opinion that there was a very high likelihood that the J & J merger would close").

166. *Id.* (dismissing as puffery a press release that "indicated an expectation of continued strong market growth").

167. *In re* NVE Corp. Sec. Litig., 551 F. Supp. 2d 871, 896 (D. Minn. 2007).

168. City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 671 (6th Cir. 2005).

169. *In re* XM Satellite Radio Holdings Sec. Litig., 479 F. Supp. 2d 165, 180 (D.D.C. 2007).

170. *In re* Apple Computer, Inc., 127 F. App'x 296, 304 (9th Cir. 2005).

171. *In re NVE Corp.*, 551 F. Supp. 2d at 898.

172. *In re* Bank of Am. Corp. Sec., Derivative, & ERISA Litig., 757 F. Supp. 2d 260, 314 (S.D.N.Y. 2010).

173. *Id.*

174. Commc'ns Workers of Am. Plan for Emps. Pensions & Death Benefits v. CSK Auto Corp., 525 F. Supp. 2d 1116, 1121 (D. Ariz. 2007).

175. Limantour v. Cray Inc., 432 F. Supp. 2d 1129, 1153 (W.D. Wash. 2006).

product;[176] the company's smart antennas are "ideal solutions";[177] and "we currently view our shares as undervalued."[178]

On the other hand, courts have held that the following—arguably equally vague and ambiguously optimistic—opinions are potentially material: Sales and demand for a product are "strong";[179] the company is "pleased" with its performance and financial results;[180] a pharmaceutical product was "well-received" by physicians;[181] interest in two technologies "has never been higher";[182] the second quarter indicated "increasing demand";[183] the company's customer service is "great," "truly exceptional," and "superior";[184] the company is the "premier provider of high-speed DSL services in the Northeast corridor";[185] due diligence was "very, very extensive."[186]

Indeed, consistent with these latter holdings, the Supreme Court in *Virginia Bankshares* rejected the defendants' argument that directors' opinions that a merger plan afforded "high" value and that a merger price was "fair" were immaterial as a matter of law.[187] The company argued that no reasonable investor would consider these "indefinite and unverifiable expressions" to be important when deciding how to vote.[188] Noting the information imbalance between shareholders and directors and the common understanding that directors owe fiduciary duties to shareholders,[189] the Court held: "That such statements may be

176. *Id.*

177. *In re* Metawave Commc'ns Corp. Sec. Litig., 298 F. Supp. 2d 1056, 1090–91 (W.D. Wash. 2003).

178. *In re* Staffmark, Inc. Sec. Litig., 123 F. Supp. 2d 1160, 1173 (E.D. Ark. 2000).

179. *In re* Dura Pharm., Inc. Sec. Litig., 452 F. Supp. 2d 1005, 1033 (S.D. Cal. 2006).

180. *Id.*

181. *Id.*

182. Billhofer v. Flamel Techs., SA, 663 F. Supp. 2d 288, 298 (S.D.N.Y. 2009).

183. *In re* Metawave Commc'ns Corp. Sec. Litig., 298 F. Supp. 2d 1056, 1085–86 (W.D. Wash. 2003).

184. Scritchfield v. Paolo, 274 F. Supp. 2d 163, 184 (D.R.I. 2003).

185. *Id.* at 175.

186. *In re* Bank of Am. Corp. Sec., Derivative, & ERISA Litig., 757 F. Supp. 2d 260, 310 (S.D.N.Y. 2010).

187. Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1090 (1991).

188. *Id.*

189. *Id.* at 1091 ("Shareholders know that directors usually have knowledge and expertness far exceeding the normal investor's resources, and the directors' perceived superiority is magnified even further by the common knowledge that state law customarily obliges them to exercise their judgment in the shareholders' interest.").

materially significant raises no serious question."[190] Yet, as the former holdings demonstrate, courts routinely dismiss comparable statements on the basis that they are immaterial as a matter of law.

In sum, courts do not consistently separate opinions that are immaterial as a matter of law from those that are potentially material. This chaos is not surprising because courts apply a variety of vague, and sometimes analytically unsound, tests to make this distinction.

1. The Primary Tests Currently Applied

a. The Unduly Vague *Test*

One of the tests most frequently applied to identify opinions that are immaterial as a matter of law is the *unduly vague* standard.[191] The *Wenger v. Lumisys, Inc.* court's explanation of this standard is typical: "Vague statements of opinion are not actionable under the federal securities laws because they are considered immaterial and discounted by the market as mere 'puffing.'"[192] Courts applying the *unduly vague* test look for words like *quality* or *best*, which are "too squishy" and "too untethered to anything measurable,"[193] or similar words like *sound* or *efficient*, which are mere "generalized positive statements."[194]

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190. *Id.* at 1090.

191. *In re* Nokia OYJ (Nokia Corp.) Sec. Litig., 423 F. Supp. 2d 364, 397 (S.D.N.Y. 2006) ("The corporate puffery rule applies to loose optimism about both a company's current state of affairs and its future prospects."); Limantour v. Cray Inc., 432 F. Supp. 2d 1129, 1146 (W.D. Wash. 2006) ("To determine whether a statement is mere puffery, the Court must examine whether a statement is so 'exaggerated' or 'vague' that no reasonable investor would rely on the statement when considering the total mix of available information."); *In re* Cable & Wireless, PLC, Sec. Litig., 321 F. Supp. 2d 749, 766–67 (E.D. Va. 2004) ("Courts have demonstrated a willingness to find immaterial, as a matter of law, a certain kind of rosy affirmation commonly heard from corporate managers and familiar to the marketplace-loosely optimistic statements that are so vague, so lacking in specificity, or so clearly constituting the opinions of the speaker, that no reasonable investor could find them important to the total mix of information available."); Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 200–01 (3d Cir. 1990) ("To say that a statement is mere 'puffing' is, in essence, to say that it is immaterial, either because it is so exaggerated ('You cannot lose.') or so vague ('This bond is marvelous.') . . . .").

192. Wenger v. Lumisys, Inc., 2 F. Supp. 2d 1231, 1245 (N.D. Cal 1998).

193. City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 671 (6th Cir. 2005).

194. *In re* XM Satellite Radio Holdings Sec. Litig., 479 F. Supp. 2d 165, 180 (D.D.C. 2007).

b. The Hyperbole Test

The hyperbole test is also frequently used to differentiate immaterial opinions from those that are potentially material.[195] As the Eighth Circuit explained, some opinions are "such obvious hyperbole that no reasonable investor would rely upon them."[196] The Third Circuit cited the statement "you cannot lose" as an opinion that is "so exaggerated" as to be immaterial as a matter of law.[197] For example, courts have dismissed characterizations of MRAM memory technology as "the Holy Grail of memory"[198] and of a new product called the G4 Cube as "the most beautiful product [Apple] ever designed"[199] as immaterial as a matter of law.

c. The Commonplace Test

Under the commonplace test, which often overlaps with the unduly vague and hyperbole tests, courts dismiss opinions as immaterial as a matter of law because they are "commonplace" statements by a corporate manager. Courts have characterized these opinions as "rosy affirmation[s] commonly heard from corporate managers and familiar to the marketplace"[200] and as "nothing more than a general platitude that accompanies nearly every press release or public statement issued by a financial institution."[201] Applying this test, one court in the Eastern District of Arkansas explained:

> In this case, the Defendants are credited with making such comments as "we currently view our shares as undervalued," and "StaffMark's share price ha[s] declined below its fair value," and "we are buyers at these prices." However, any investor tuning into a cable business

195. *Limantour*, 432 F. Supp. 2d at 1146 ("To determine whether a statement is mere puffery, the Court must examine whether a statement is so 'exaggerated' or 'vague' that no reasonable investor would rely on the statement when considering the total mix of available information.").

196. Parnes v. Gateway 2000, Inc., 122 F.3d 539, 547 (8th Cir. 1997).

197. Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 200–01 (3d Cir. 1990).

198. *In re* NVE Corp. Sec. Litig., 551 F. Supp. 2d 871, 895 (D. Minn. 2007) (internal quotations omitted).

199. *In re* Apple Computer, Inc., 127 F. App'x 296, 301(9th Cir. 2005) (alteration in original).

200. *In re* Cable & Wireless, PLC, Sec. Litig., 321 F. Supp. 2d 749, 766–67 (E.D. Va. 2004).

201. Woodward v. Raymond James Fin., Inc., 732 F. Supp. 2d 425, 434–35 (S.D.N.Y. 2010).

> program on any given day would hear the same or similar comments being made by some corporate executive touting the strength of his company and the bargain price for which its shares currently sell. No reasonable investor would be influenced by such statements.[202]

For the same reason, a court in the Southern District of New York dismissed the following opinion as immaterial as a matter of law: "Raymond James' leadership believes that the managed growth strategy, commitment to risk management and conservative lending practices that helped the firm avert the subprime crisis and post solid operating results in 2007 will continue to serve the company well in the coming year."[203]

2. A Fundamental Flaw in the Primary Tests

In addition to their tendency to lead to inconsistent results, a fundamental problem with these primary tests is that they fail to recognize that a reasonable investor could actually rely on opinions falling within these tests' scope. For example, "X product is a good product" is a quintessential "unduly vague" statement.[204] And indeed, courts applying the *unduly vague* standard are correct that a reasonable investor would not rely on this representation as an indication about the relative quality of X product.[205] These courts fail to recognize, however, that a reasonable investor could rely on this statement as a representation that, at the very least, X product has not been recalled. By dismissing the statement out of hand as an unduly vague opinion, without an inquiry into what component of the statement is allegedly false or misleading, courts sweep the puffery brush too broadly.

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202. *In re* Staffmark, Inc. Sec. Litig., 123 F. Supp. 2d 1160, 1173 (E.D. Ark. 2000) (alteration in original).

203. *Woodward*, 732 F. Supp. 2d at 434.

204. *See* Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 200–01 (3d Cir. 1990) ("To say that a statement is mere 'puffing' is, in essence, to say that it is immaterial, either because it is so exaggerated ('You cannot lose.') or so vague ('This bond is marvelous.') . . . .").

205. City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 671 (6th Cir. 2005). ("[S]uch statements describing a product in terms of 'quality' or 'best' or benefiting from 'aggressive marketing' are too squishy, too untethered to anything measurable, to communicate anything that a reasonable person would deem important to a securities investment decision. The statements are analogous to those deemed immaterial by a broad spectrum of federal courts.").

Similarly, the statement that MRAM is "the Holy Grail of memory" falls squarely within the hyperbole test.[206] Again, courts are correct that a reasonable investor would not rely on an opinion like this one as a representation about whether MRAM has 300 gigabytes or 400 gigabytes of capacity. Courts fail to recognize, however, that a reasonable investor could interpret this statement as a representation that MRAM has at least some memory capacity. Courts' dismissal of hyperbolic statements like this without inquiring into what component of the opinion is allegedly false is too simplistic.

Finally, opinions within the commonplace test suffer from the same problem. For example, courts are correct that no reasonable investor would interpret the opinion "we currently view our shares as undervalued" as a representation that the shares' fundamental value is higher than the market price,[207] but a reasonable investor could interpret it as a representation that the company is not insolvent, rendering its shares worthless. Dismissal of opinions like this one without an inquiry into what component of the opinion is allegedly false fails to recognize this nuance.

Indeed, the results of a recent materiality survey performed by Professor Padfield are consistent with this analytical flaw.[208] The survey presented five short factual scenarios, drawn from actual cases in which alleged misrepresentations were dismissed as immaterial, and asked participants if they would "consider the additional information important in deciding whether to buy [the company's] stock."[209] For example, the survey presented some background information about the demand for Telco's product, the T-6500. Then, the survey asked the following question:

> Assume you are now considering buying Telco stock and you receive the following additional information: Later, in response to a question, Telco's CEO states, "On the 6500, demand for that product is exceeding our expectations." Would you consider the additional information important in deciding whether to buy Telco stock? Yes [or] no.[210]

Sixty-two percent of the survey's respondents answered "yes."[211] Professor Padfield interpreted the survey results as

206. *In re* NVE Corp. Sec. Litig., 551 F. Supp. 2d 871, 895 (D. Minn. 2007) (internal quotation marks omitted).

207. *In re Staffmark, Inc.*, 123 F. Supp. 2d at 1173.

208. Stefan J. Padfield, *Is Puffery Material to Investors? Maybe We Should Ask Them*, 10 U. PA. J. BUS. & EMP. L. 339 (2008).

209. *Id.* at 377–81.

210. *Id.* at 380.

211. *Id.* at 373.

suggesting "that judges are too quick to grant dismissals in securities cases on the basis of puffery."[212]

This author agrees with Professor Padfield's conclusion but argues further that the survey highlights the importance of incorporating alleged falsity into the materiality analysis. Notably missing from the survey's factual scenarios were allegations about why the statements were false. For example, on one hand, a reasonable investor might very well consider the Telco CEO's statement to be material because it implies that the 6500 product is still in production. On the other hand, no reasonable investor would consider the CEO's statement to constitute an implied representation about a specific level of demand for the product. Asking survey participants to assess the materiality of the statement in a vacuum, effectively asking them to speculate for themselves about why a statement might be misleading, invariably leads to inconsistent results, as it did in this survey. The same lesson applies to courts.

3. Courts' Analytically Unsound Attempts to Solve the Problem with the Primary Tests

Implicitly recognizing that the primary tests sweep too broadly, some courts have developed "exceptions" whereby opinions are actionable despite falling within the scope of these tests. These exceptions are analytically unsound, however, because they are premised on the notion that establishing another element of securities fraud can magically revive the materiality element.

The first exception applied by some courts is that puffery becomes actionable if disbelieved.[213] For example, a district court in the Southern District of California explained this exception as follows: "Ragland's December statements are optimistic statements that usually are not actionable as securities fraud. Plaintiffs rely on the exception to that general rule. They argue that

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212. *Id.* at 375.

213. HAZEN, *supra* note 148, § 12.9[4] ("Reading the relevant securities cases yields the following general rule: while a good faith opinion (or even 'puffing') is not material, a statement of opinion made with no belief in its truth is actionable."). *E.g.*, *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 507 (S.D.N.Y. 2009) ("Optimistic statements, however, 'may be actionable upon a showing that the defendants did not genuinely or reasonably believe the positive opinions they touted . . . or that the opinions imply certainty.'" (quoting Lapin v. Goldman Sachs Grp., Inc., 506 F. Supp. 2d 221, 239–40 (S.D.N.Y. 2006))); Malin v. XL Capital Ltd., 499 F. Supp. 2d 117, 144–45 (D. Conn. 2007) (suggesting that "non-actionable statements of opinion" are nonetheless actionable if the defendants did not sincerely believe the opinions that they purported to hold).

Ragland knew his positive, public statements were inaccurate at the time he made them."[214] Similarly, a district court in the Southern District of New York rejected the defendants' argument that the alleged misstatements were nonactionable "statements of opinion and puffery" because "opinion statements are actionable if Plaintiffs can plead 'with particularity that defendants did not sincerely believe the opinion they purported to hold.'"[215]

This exception is analytically unsound because it is premised on the notion that the presence of one element of securities fraud—scienter—can transform an immaterial statement into a material one.[216] This exception conflates the scienter and materiality elements.

The second exception developed by courts is that puffery becomes actionable if extremely false.[217] For example, a district court in the Southern District of New York applied this exception as follows:

> [A]lthough statements that sales and demand for Ceclor CD were "strong," that the Company was "pleased" with Dura's performance and financial results, and that Ceclor CD was "well received" by physicians are generalized, the facts alleged in the TAC lead to a strong inference that there was no reasonable basis for believing such statements to be true because the sales were achieved by overloading

214. *In re* REMEC Inc. Sec. Litig., 702 F. Supp. 2d 1202, 1231 (S.D. Cal. 2010) (citations omitted).

215. *In re* DRDGold Ltd. Sec. Litig., 472 F. Supp. 2d 562, 569 (S.D.N.Y. 2007) (quoting Podany v. Robertson Stephens, Inc., 318 F. Supp. 2d 146, 154 (S.D.N.Y. 2004)).

216. *See In re* XM Satellite Radio Holdings Sec. Litig., 479 F. Supp. 2d 165, 177 (D.D.C. 2007) ("Under the doctrine established by *Virginia Bankshares v. Sandberg* . . . statements of opinion, *if they are material*, may be actionable if they are not actually believed when made, if there is no reasonable basis for them, or if the speaker is aware of undisclosed facts that tend seriously to undermine the statements' accuracy." (emphasis added)).

217. *E.g.*, *In re* Cable & Wireless, PLC, Sec. Litig., 321 F. Supp. 2d 749, 768 (E.D. Va. 2004) ("Plaintiffs, in rebuttal, cite *In re Cinar Corp. Sec. Litig.*, 186 F. Supp. 2d 279, 319 (E.D.N.Y. 2002) (quoting Shields v. Citytrust Bancorp, 25 F.3d 1124, 1129 (2d Cir. 1994)), which holds that puffery is acceptable only '[if] the company has some legitimate reason to be optimistic.' . . . Even under *CINAR*, Defendants had, as most corporate executives do, some legitimate reason for optimism." (alteration in original)); Eisenstadt v. Centel Corp., 113 F.3d 738, 746–47 (7th Cir. 1997) (characterizing the puffery inquiry as whether a company said things that were so discordant with reality that they would induce a reasonable investor to buy the stock at a higher price than it was worth *ex ante*).

> wholesalers with the product. Accordingly, the puffery rule does not insulate Defendants from liability.[218]

A district court in the Southern District of Texas stated the exception similarly:

> Standing alone, general statements of corporate optimism are often held by courts to be immaterial as a matter of law. However, when juxtaposed to allegations of falsity capable of proof by evidence of historical fact, generally optimistic statements are not immune from charges of fraud merely because they are vague, conclusory expressions of opinion and belief about a company's then-current and/or future prospects.[219]

Applying this exception, courts have held that the following statements—which fall within the scope of the primary puffery tests—are nonetheless actionable: that the company's customer service is "great," "truly exceptional," "superior," the "best," and "world class";[220] that orders during the quarter indicated "increasing demand";[221] and that interest and certain technology has "never been higher."[222]

Again, this exception is premised on the analytically unsound idea that the presence of one element of securities fraud—here, falsity—can transform an immaterial statement into a material one.[223] This exception conflates the falsity and materiality elements.

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218. *In re* Dura Pharm., Inc. Sec. Litig., 452 F. Supp. 2d 1005, 1033 (S.D. Cal. 2006).

219. United States v. Causey, No. CRIM. H-05-025-SS, 2005 WL 2647976, at *9 (S.D. Tex. Oct. 17, 2005).

220. Scritchfield v. Paolo, 274 F. Supp. 2d 163, 184 (D.R.I. 2003).

221. *In re* Metawave Commc'ns Corp. Sec. Litig., 298 F. Supp. 2d 1056, 1086 (W.D. Wash. 2003).

222. Billhofer v. Flamel Techs., SA, 663 F. Supp. 2d 288, 299 (S.D.N.Y 2009) (rejecting a puffery argument) ("Even if companies measure 'interest' in their products in a variety of ways, they cannot then make categorical claims that interest has *never been higher* without some basis for that statement.").

223. Commc'ns Workers of Am. Plan for Emps. Pensions & Death Benefits v. CSK Auto Corp., 525 F. Supp. 2d 1116, 1121 (D. Ariz. 2007) ("No matter how untrue a statement may be, it is not actionable if it is not the type of statement that would significantly alter the total mix of information available to investors." (quoting Wenger v. Lumisys, Inc., 2 F. Supp. 2d 1231, 1245 (N.D. Cal. 1998))).

C. Courts Should Apply the Novel Reasonable Implication *Test to Identify Opinions That Are Immaterial As a Matter of Law*

This Article proposes that courts apply the following *reasonable implication* test to distinguish potentially material opinions from those that are immaterial as a matter of law: Does the opinion reasonably imply an allegedly false, material fact?

Several scholars, without citation to authority for this test, have assumed that a test similar to the *reasonable implication* test applies when analyzing whether a statement of opinion is material. Professor Thomas Lee Hazen, in the treatise *The Law of Securities Regulation*, characterizes as a "general rule" that "merely because statements are couched as opinion does not preclude a finding that there is an express or implied misrepresentation of fact."[224] Similarly, Professor Peter Huang, in passing, stated: "To be legally actionable, puffery must induce false implied meanings that are thus deceptive, misleading, and can be disproved."[225] Courts have not adopted this test, however. This Article seeks to provide a theoretical basis for the *reasonable implication* test, with the goal of convincing courts to apply this test when analyzing the materiality of statements of opinion.

1. Solution to the Analytical Problem Underlying the Primary Tests

This proposed *reasonable implication* test solves the analytical problem underlying the primary tests currently used to differentiate immaterial opinions from those that are potentially material because it incorporates an inquiry into what component of the opinion is allegedly false or misleading. For example, the materiality of the vague opinion "X product is a good product" would depend on why the plaintiff contended that the opinion was false. If the plaintiff contended that this opinion was false because the product was of lesser quality than competitors' products, the court would dismiss the opinion as immaterial as a matter of law. The opinion, with its use of the vague word *great*, does not reasonably imply this allegedly false fact.[226] On the other hand, if

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224. HAZEN, *supra* note 148, § 12.9[4].

225. Peter H. Huang, *Moody Investing and the Supreme Court: Rethinking the Materiality of Information and the Reasonableness of Investor*, 13 SUP. CT. ECON. REV. 99, 115 (2005).

226. *See* Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 200–01 (3d Cir. 1990) ("To say that a statement is mere 'puffing' is, in essence, to say that it is immaterial, either because it is so exaggerated ('You cannot lose.') or so vague ('This bond is marvelous.') . . . .").

the plaintiff contended that this opinion was false because the product had been recalled for safety defects, the court would rule that the opinion is potentially material. The opinion reasonably implies that the product is still marketable, which—as alleged—is a false, material fact.

Similarly, the materiality of the hyperbolic statement that MRAM is "the Holy Grail of memory" would depend on why the plaintiff contended that the opinion was false. If the plaintiff contended that it were false because the memory only had 300 gigabytes of capacity, the court would dismiss the opinion as immaterial as a matter of law because the hyperbolic statement does not imply a specific memory capacity. If, however, the plaintiff contended that the statement was false because the MRAM did not have any memory capacity, the court would rule that the opinion is potentially material because the opinion reasonably implies that MRAM has at least some memory, which is an allegedly false, material fact.

Likewise, the materiality of the commonplace opinion "we currently view our shares as undervalued" would depend on why the plaintiff contended that the opinion was false. If the plaintiff contended that the opinion were false because fundamental value did not exceed market price, the court would dismiss the opinion as immaterial as a matter of law because no reasonable investor would imply from such a commonplace statement a specific fundamental value.[227] If, however, the plaintiff contended that this opinion were false because the company was insolvent and its shares worthless, the court would rule that the opinion was potentially material. A reasonable investor could imply from the opinion that the shares had at least some value—an allegedly false, material fact.

Judge Thomas S. Zilly in the Western District of Washington applied an analysis similar to the *reasonable implication* test when analyzing the materiality of the opinions that product orders during the second quarter indicated "increasing demand" and that "[b]ecause of this, [the company] anticipate[s] improved results in the second half of the year."[228] Under the *reasonable implication* test, the materiality of these opinions would depend on the allegedly false component. If the plaintiff contended that these opinions implied a greater degree of demand than actually existed, the court should dismiss the claim because no reasonable investor

227. *In re* Staffmark, Inc. Sec. Litig., 123 F. Supp. 2d 1160, 1173 (E.D. Ark. 2000).

228. *In re* Metawave Commc'ns Corp. Sec. Litig., 298 F. Supp. 2d 1056, 1062 (W.D. Wash. 2003).

would interpret these vague statements as implying a certain level of demand. If, on the other hand, the plaintiff contended that these opinions implied that the product was marketable, the court should not dismiss the claim because a reasonable investor could so interpret these statements. Judge Zilly's analysis echoes the analysis under the proposed test: "The statements about GSM demand did not merely exaggerate the amount of demand, but represented that there actually was demand when the GSM product was not functional. The statements could be relied upon by a reasonable investor."[229]

Thus, this proposed *reasonable implication* test is an analytically sound means of addressing the concerns underlying the analytically unsound *puffery is actionable if disbelieved* and *puffery is actionable if really false* "exceptions."[230] The essence of both exceptions is that a vague, optimistic, or commonplace opinion should be actionable if reality differs drastically from the tone of the opinion statement. The *reasonable implication* test for materiality is consistent with this essence, but it achieves this goal in an analytically sound manner. For example, under current tests, the opinion "this company is in great shape" would likely be characterized as puffery because it is unduly vague and commonplace. If the speaker knew at the time of the statement that the company would seek bankruptcy protection within 24 hours, some courts would attempt to apply one of the analytically unsound exceptions to puffery—either because the speaker disbelieved the opinion or because the opinion was really false—in order to restore the opinion's materiality. Under the *reasonable implication* test, however, this opinion would be deemed potentially material, without resort to these analytically unsound exceptions. The court would recognize that, although a reasonable investor would not rely on the opinion as a statement about the company's relative profitability, a reasonable investor could interpret the opinion as implying that the company was solvent.[231] Because the plaintiff alleged that, in fact, the company was insolvent at the time of the statement, the opinion was material because it reasonably implied an allegedly false, material fact.

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229. *Id.* at 1086.

230. *See supra* Part IV.B.3.

231. *Cf. Eisenstadt*, 113 F.3d at 745 ("Suppose that on February 18 Centel's lawyers had told Centel that it couldn't legally sell any of its assets because they were encumbered and the lienors would not give their consent to a sale. In these circumstances to have announced that the auction process was going smoothly would have been materially deceptive. 'Going smoothly' may mean nothing more than-going; but it means at least that . . .").

2. Consistent with Well-Reasoned Court Opinions in Securities Fraud Context

This proposed *reasonable implication* test is consistent with the similar recognition of some courts that the materiality of an opinion depends on whether the opinion reasonably implies the existence of objective facts[232] or if it implies certainty.[233] As the most extreme example, if the opinion not only implies, but also explicitly states, that it is supported by "objective data," it is potentially material because it gives rise to a reasonable belief in the existence of allegedly false facts.[234] Similarly, if an opinion reasonably implies the existence of false, material facts, it is potentially material.[235] For instance, the opinion that due diligence

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232. *In re* Bank of Am. Corp. Sec., Derivative, & ERISA Litig., 757 F. Supp. 2d 260, 310 (S.D.N.Y. 2010) ("[T]here is a difference between enthusiastic statements amounting to general puffery and opinion-based statements that are anchored in 'misrepresentations of existing facts.'" (quoting Novak v. Kasaks, 216 F.3d 300, 315 (2nd Cir. 2000))); *Id.* ("These statements fall into the category of fact-based expressions of opinion rather than enthusiastic, vague, forward-looking puffery.").

233. *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 509 (S.D.N.Y. 2009) (including the heading, "Even if Statements by Moody's Were Puffery, They Implied Certainty"); Lapin v. Goldman Sachs Grp., Inc., 506 F. Supp. 2d 221, 239 (S.D.N.Y. 2006) ("The important limitation on these principles is that optimistic statements may be actionable upon a showing that . . . the opinions imply certainty.").

234. City of Monroe Emps. Ret. Sys. v. Bridgestone Corp., 399 F.3d 651, 675 (6th Cir. 2005) ("[W]e conclude that a reasonable juror in this case could conclude that Firestone's statement that 'the objective data clearly reinforces our belief that these are high-quality, safe tires' carried with it the representation that there was a reasonable basis for that belief, and that Firestone was not aware of any undisclosed facts tending to seriously undermine the accuracy of the statement, and that both those representations were misleading."). *See also In re* NVE Corp. Sec. Litig., 551 F. Supp. 2d 871, 894 (D. Minn. 2007) ("However, the Bridgestone case hinged on the fact that the company had stated that 'objective data' supported its claim. Optimistic statements by Defendants in this case regarding the general importance and quality of the MRAM technology did not contain any assertion that the statements were supported by 'objective data' or were otherwise subject to verification by proof.").

235. *E.g.*, Scritchfield v. Paolo, 274 F. Supp. 2d 163, 174 (D.R.I. 2003) ("The contribution of *Peritus* is its emphasis on the objectively reasonable inferences, once again supported by context, that can be drawn from the challenged language; statements that only evince subjective beliefs or opinions are not actionable.") (discussing *In re* Peritus Software Servs., Inc. Sec. Litig., 52 F. Supp. 2d 211 (D. Mass. 1999)); Nanopierce Tech., Inc. v. Southridge Capital Mgmt. LLC, No. 02-Civ-0767, 2003 WL 21507294, at *8 (S.D.N.Y. June 30, 2003) ("[T]he misleading character o[f] a statement is not changed by its vagueness or ambiguity. Liability may follow where management intentionally fosters a mistaken belief concerning a material fact, such as its

was "very, very extensive" was a potentially material "fact-based expression[] of opinion";[236] and the opinion that a firm was the "premier provider of high-speed DSL services in the Northeast corridor" reasonably implied that the firm was "comparatively superior to all other high-speed DSL service providers in the Northeast."[237] If, on the other hand, the opinion does not reasonably imply any allegedly false facts, it is immaterial as a matter of law.[238] Similarly, if the opinion does not imply certainty or is a mere "naked" opinion, it is immaterial as a matter of law.[239]

3. Supportive of Policies Underlying Materiality Element

First, the *reasonable implication* test responds to the widespread scholarly criticism that the puffery doctrine fails to incorporate a contextual inquiry.[240] The *reasonable implication* test proposed in this Article resolves the tension between the puffery doctrine and the "total mix" mandate by incorporating context into the materiality analysis.[241] Especially relevant to the inquiry into whether an opinion implies any false material facts is the following contexts: (1) why the plaintiff contends that the opinion is false;

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evaluation of the company's progress and earning prospects in the current year." (quoting Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 164 (2d Cir. 1980))).

236. *In re Bank of Am.*, 757 F. Supp. 2d. at 310.

237. *Scritchfield*, 274 F. Supp. 2d at 175.

238. *E.g.*, *In re* No. Nine Visual Tech. Corp. Sec. Litig., 51 F. Supp. 2d 1, 21 (D. Mass. 1999) ("Instead, the Class' only quibble with the statement is the *implicit* meaning that they attribute to the phrase 'broad product line.' The Court holds, however, that the phrase is incapable of supporting such an inference, as any reasonable investor would recognize the phrase simply as bullish corporate grandstanding.").

239. *In re* Moody's Corp. Sec. Litig., 599 F. Supp. 2d 493, 507 (S.D.N.Y. 2009) ("Optimistic statements, however, 'may be actionable upon a showing that the defendants did not genuinely or reasonably believe the positive opinions they touted . . . or that the opinions imply certainty.'" (quoting Lapin v. Goldman Sachs Grp., Inc., 506 F. Supp. 2d 221, 239–40 (S.D.N.Y. 2006))); *id.* at 509 ("Moreover, even if the above mentioned statements asserting independence were ones of intention or desire, they also 'imply certainty,' and therefore fall into the limitation on the general rule . . . ."); *Scritchfield*, 274 F. Supp. 2d at 182 ("Cornell's forecast that LOA would have 100,000 customers by the end of 2000 is a forward-looking statement and does not purport to be based on any factual information, whether or not properly calculated, available at that time. It is a naked prediction unsupported by any facts, and would not be deemed material by a reasonable investor. It is not actionable."); *id.* at 187 ("Likewise, Cornell's prediction of $15 million in revenues by the end of 2000 is just that—a naked and unsupported prediction, which is unactionable . . . .").

240. *See supra* Part IV.A.

241. *See supra* Part IV.A.

(2) whether the opinion was expressed in such a way as to imply any facts (including the apparent authoritativeness of the speaker); and (3) whether the opinion was accompanied by its complete factual basis, thereby preventing it from implying any false material facts.[242]

In addition, the *reasonable implication* test bolsters the delicate balance between ensuring honest markets and encouraging the appropriate level of disclosure.[243] On one hand, by acknowledging that some opinions are reasonably understood as implying false material facts and by allowing these opinions to form the basis of securities fraud claims, the *reasonable implication* test incentivizes honesty of market participants. On the other hand, by recognizing that some opinions are not reasonably understood as implying false material facts and by characterizing these opinions as immaterial as a matter of law, the *reasonable implication* test encourages company actors to speak freely about their evaluations and inferences, without fear that unreasonable implications could lead to liability.

4. Builds on Materiality Tests Proposed by Other Scholars

The *reasonable implication* test, to be applied when analyzing the materiality of statements of opinion, builds on the scholarly work to date on the element of materiality. Scholars addressing the materiality–puffery quandary, albeit not limiting their analyses to statements of opinion, have proposed various "materiality tests" to aid courts in drawing the line between those statements that are immaterial as a matter of law and those that are potentially material. These various proposed materiality tests circle around the same point: Because allegedly puffing statements are sometimes expressed when access to information is unequal, investors can infer false material facts from them. For example, Professor O'Hare, recognizing that allegedly puffing statements are often made to investors when there are information asymmetries,[244] argues that the court should examine the following factors to determine whether an allegedly puffing statement is immaterial as a matter of law: (1) the vagueness of the statement; (2) whether the statement is forward-looking or characterizing present facts; and (3) whether other factors are present that affect significance to investors.[245] Similarly, Professor Langevoort, in the context of

242. *See infra* Part IV.C.5.
243. *See supra* Part IV.A.
244. O'Hare, *supra* note 12, at 1717–19.
245. *Id.* at 1737.

half-truths (where, by definition, some information is withheld from investors), argues that the first step is to "assess[] the normal inference that flows from a particular statement."[246] Professor Hoffman argues that, once a statement has been identified as "puffery," courts should presume that the statement implied false factual claims that were relied upon, with the burden shifting to the speaker to rebut that presumption by showing one of the following: (1) The speaker did not intend to mislead; (2) most of the audience did not rely on the statement; or (3) the statement did not imply any false facts.[247]

This Article proposes that, at least in the context of statements of opinion, this central point should itself be elevated to the level of a "materiality test." Indeed, the *reasonable implication* test proposed in this Article asks that very question—Does the opinion reasonably imply an allegedly false, material fact?

Moreover, again not confining their analyses to statements of opinion, scholars have decried the difficulty of determining whether an allegedly puffing statement implies any false, material facts.[248] Yet, in the context of opinions at least, well-developed bodies of precedent analyze that very question in the contexts of defamation and common law fraud. Courts applying the *reasonable implication* test can therefore draw from these deep bodies of law to analyze this issue in the securities fraud context.

5. Informed by Comparable Test Applied in Defamation Context

The *reasonable implication* test proposed in this Article to differentiate immaterial opinions from those that are potentially material in securities fraud cases is informed by the comparable *pure–mixed opinion* test applied in defamation cases. The rich precedent developed in the context of defamation is an instructive guide on the application of this Article's proposed *reasonable implication* test in securities fraud cases.

As in the contexts of securities fraud and common-law fraud, some statements of opinion are not actionable in defamation, while others are potentially actionable.[249] In the defamation context, however, the distinction between these two types of opinions is not

246. Langevoort, *supra* note 13, at 99.
247. Hoffman, *supra* note 14, at 1444.
248. *E.g.*, *id.* at 1440 ("Unfortunately, neither courts nor regulators can easily determine when puffery implies facts that are false.").
249. Milkovich v. Lorain Journal Co., 497 U.S. 1, 18–19 (1990); RESTATEMENT (SECOND) OF TORTS § 566 (1977).

premised on the concept of materiality. Rather, it is premised on whether the opinion is "mixed"—and thus actionable because it implies an undisclosed defamatory fact—or "pure"—and thus nonactionable because it does not imply any undisclosed defamatory facts.[250] At least for evaluative opinions, this distinction is compelled by the First Amendment's protection of free expression.[251] Scholars are divided on whether the First Amendment compels a similar distinction for deductive opinions.[252] As a practical matter, however, this pure–mixed distinction applies to both deductive and evaluative opinions in defamation cases because the *Second Restatement of Torts* and most state courts have incorporated the pure–mixed distinction into the elements of defamation without distinguishing between evaluative and deductive opinions.[253]

The defamation precedent developed with respect to the distinction between pure and mixed opinions might seem, at first glance, to be inapposite to the distinction between material and immaterial opinions in the securities fraud context. In fact, the pure–mixed distinction and the material–immaterial distinction share a similar underlying policy and a similar focus on the opinion's effect on a reasonable listener, justifying further examination of the dividing line in defamation cases between pure and mixed opinions.

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250. *Milkovich*, 497 U.S. at 18–19; RESTATEMENT (SECOND) OF TORTS § 566 (1977).

251. *Milkovich*, 497 U.S. at 19 (citing the "breathing space" that "[f]reedoms of expression require in order to survive" (quoting Phila. Newspapers, Inc. v. Hepps, 475 U.S. 767, 772 (1986))).

252. *Compare* Sowle, *supra* note 119, at 575–77 (arguing that pure deductive opinions should not be immunized); Chen, *supra* note 119, at 375 (arguing that the *Restatement*'s protection of pure deductive opinions goes further than required by *Milkovich*); KEETON, *supra* note 118, § 113 (arguing that a distinction could be made between evaluative opinions and deductive opinions, with the First Amendment's protection for pure opinions applying only to evaluation opinions); *with* RESTATEMENT (SECOND) OF TORTS § 566 cmt. c (1977) (asserting that First Amendment protection of "pure" opinion extends to all opinions).

253. King, *supra* note 119, at 906 (recognizing that the "uncertain . . . constitutional underpinnings of the section 566 rule may prove to have more academic than practical importance" because state courts have widely adopted the rule, if not as a matter of constitutional law, then as a matter of state law); KEETON, *supra* note 118, § 113 (explaining that the *Restatement* takes the position "that the publication of a derogatory opinion that is a pure opinion of either the deductive or evaluative variety is no longer actionable, however dishonest the publisher might be in expressing that opinion"); RESTATEMENT (SECOND) OF TORTS § 566 (1977) (applying the pure–mixed distinction to both evaluative and deductive opinions).

a. Comparable Policies Underlie the Distinction Between Pure and Mixed Opinions and Between Material and Immaterial Opinions

The balancing test underlying the distinction between pure and mixed opinions is comparable to the balancing test underlying the distinction between material and immaterial opinions. When crafting the pure–mixed standard to distinguish between opinions that are actionable in defamation and those that are protected by the First Amendment, the Supreme Court carefully balanced the Constitution's protection of freedom of expression with society's interest in preventing and compensating defamatory attacks on citizens' reputations.[254] The Supreme Court described this balance as follows:

> The numerous decisions discussed above establishing First Amendment protection for defendants in defamation actions surely demonstrate the Court's recognition of the Amendment's vital guarantee of free and uninhibited discussion of public issues. But there is also another side to the equation; we have regularly acknowledged the "important social values which underlie the law of defamation," and recognized that "[s]ociety has a pervasive and strong interest in preventing and redressing attacks upon reputation." . . . We believe our decision in the present case holds the balance true.[255]

As discussed above,[256] the materiality element of securities fraud accomplishes a similar balance between encouraging disclosure by insulating immaterial statements from liability and promoting fair and honest markets by imposing liability on material misrepresentations.[257]

Additionally, both the materiality analysis in securities fraud and the *pure–mixed opinion* distinction in defamation focus on the effect of the statement on a reasonable, objective listener. The materiality analysis focuses on whether there is "a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."[258] An investor cannot recover in

254. *Milkovich*, 497 U.S. at 22–23.
255. *Id.* at 22–23 (citation omitted).
256. *See supra* Part IV.A.
257. *See* Couture, *supra* note 145, at 28–29; *see also* Hoffman, *supra* note 14, at 1398.
258. Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (citations omitted) (internal quotation marks omitted).

securities fraud for a misrepresentation that he or she subjectively found important if a reasonable investor would not have done so, and a speaker cannot escape liability by contending that he or she did not consider the statement important if a reasonable investor would have done so. Similarly, the distinction between a pure and a mixed opinion focuses on whether "the recipient draws the reasonable conclusion that the derogatory opinion expressed in the comment must have been based on undisclosed defamatory facts."[259] A subject of the statement cannot recover in defamation if a recipient unreasonably interpreted an opinion as implying undisclosed defamatory facts if a reasonable recipient would not have so interpreted it, and a speaker cannot escape liability by contending that he or she unreasonably interpreted true facts to reach his opinion if a reasonable recipient of the opinion would have interpreted it as implying defamatory facts.[260]

b. The Pure–Mixed Opinion *Distinction Depends on Whether the Opinion Implies a Defamatory Fact*

The distinction between a nonactionable "pure" opinion and an actionable "mixed" opinion depends on whether the opinion implies any "undisclosed defamatory facts as the basis for the opinion."[261] Stated another way, the key is whether the "expressions of opinion could be interpreted as including false assertions as to factual matters."[262] Pure opinions do not imply any undisclosed defamatory facts, while mixed opinions do.[263]

One key to assess whether an opinion implies any undisclosed defamatory facts is whether the opinion's complete factual basis is stated by the speaker or assumed by both parties. If the complete factual basis of an opinion is stated or assumed, the opinion is unlikely to imply the existence of other unstated defamatory

259. *See* RESTATEMENT (SECOND) OF TORTS § 566 cmt. c (1977).

260. *See id.* ("The defendant cannot insist that the undisclosed facts were not defamatory but that he unreasonably formed the derogatory opinion from them.").

261. *Id.*

262. Masson v. New Yorker Magazine, Inc., 501 U.S. 496, 515 (1991). *See also* Milkovich v. Lorain Journal Co., 497 U.S. 1, 20 (1990) (explaining that the distinction depends on whether the opinion "contain[s] a provably false factual connotation"); Biospherics, Inc. v. Forbes, Inc., 151 F.3d 180, 184 (4th Cir. 1998) ("*Milkovich* directs that an opinion may constitute actionable defamation, but only if the opinion can be reasonably interpreted to declare or imply untrue facts.").

263. RESTATEMENT (SECOND) OF TORTS § 566 cmt. b (1977).

facts.[264] The D.C. Circuit explained the rationale as follows: "Because the reader understands that such supported opinions represent the writer's interpretation of the facts presented, and because the reader is free to draw his or her own conclusions based upon those facts, this type of statement is not actionable in defamation."[265] On the other hand, if the opinion's complete factual basis is not stated, the opinion may imply the existence of unstated defamatory facts.[266]

As an example of a pure opinion, the Fourth Circuit dismissed a defamation claim premised on the opinion that "investors will sour on 'Sugaree'" because "the article clearly disclosed the factual bases for its view."[267] The *Restatement* gives the following further example and explanation of a pure opinion:

> A writes to B about his neighbor C: "He moved in six months ago. He works downtown, and I have seen him during that time only twice, in his backyard around 5:30 seated in a deck chair with a portable radio listening to a news broadcast, and with a drink in his hand. I think he must be an alcoholic." The statement indicates the facts on which the expression of opinion was based and does not imply others. These facts are not defamatory and A is not liable for defamation.[268]

As an example of a mixed opinion that is potentially actionable as defamatory, the Supreme Court in *Milkovich* cited the

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264. *Id.*; Chapin v. Knight-Ridder, Inc., 993 F.2d 1087, 1093 (4th Cir. 1993) (noting that when "the bases for the . . . conclusion are fully disclosed, no reasonable reader would consider the term anything but the opinion of the author drawn from the circumstances related"); Standing Comm. on Discipline v. Yagman, 55 F.3d 1430, 1439 (9th Cir. 1995) ("A statement of opinion based on fully disclosed facts can be punished only if the stated facts are themselves false and demeaning."); Phantom Touring, Inc. v. Affiliated Publ'ns, 953 F.2d 724, 730–31 (1st Cir. 1992) (when statement provides factual bases for its conclusion, it is a "personal conclusion" rather than a statement of fact subject to a defamation claim).

265. Moldea v. New York Times Co., 15 F.3d 1137, 1144–45 (D.C. Cir. 1994).

266. RESTATEMENT (SECOND) OF TORTS § 566 cmt. b (1977) ("The second kind of expression of opinion, or the mixed type, is one which, while an opinion in form or context, is apparently based on facts regarding the plaintiff or his conduct that have not been stated by the defendant or assumed to exist by the parties to the communication.").

267. *Biospherics, Inc.*, 151 F.3d at 185 ("[T]hese three sentences state the factual basis for the entire article and Biospherics does not challenge their accuracy. Its failure to do so dooms its challenge to this statement.").

268. RESTATEMENT (SECOND) OF TORTS § 566 illus. 4 (1977).

following: "In my opinion John Jones is a liar."[269] As the Court explained, this opinion is potentially actionable because it "implies a knowledge of facts which lead to the conclusion that Jones told an untruth."[270] The *Milkovich* Court then applied this standard to the allegedly defamatory statements before it, including the statement that "[a]nyone who attended the meet . . . knows in his heart that Milkovich and Scott lied at the hearing after each having given his solemn oath to tell the truth."[271] The Court reasoned: "The dispositive question in the present case then becomes whether a reasonable factfinder could conclude that the statements in the Diadiun column imply an assertion that petitioner Milkovich perjured himself in a judicial proceeding. We think this question must be answered in the affirmative."[272] As another example, the *Restatement* juxtaposes the following illustration of a mixed opinion with the illustration of a pure opinion cited in the preceding paragraph: "A writes to B about his neighbor C: 'I think he must be an alcoholic.' A jury might find that this was not just an expression of opinion but that it implied that A knew undisclosed facts that would justify this opinion."[273]

A second key to distinguishing pure and mixed opinions is to recognize that some opinions—such as hyperbole and mere verbal abuse—"cannot reasonably be understood to be meant literally and seriously."[274] With respect to hyperbole, the Supreme Court explained that "[t]his provides assurance that public debate will not suffer for lack of 'imaginative expression' or the 'rhetorical hyperbole' which has traditionally added much to the discourse of our Nation."[275] For example, the characterization of a developer's negotiating position as "blackmail" was not actionable because "the word was no more than rhetorical hyperbole, a vigorous epithet used by those who considered [the] negotiating position extremely unreasonable."[276] Similarly, the definition of a *union scab* as a traitor was not actionable because it was "merely

269. Milkovich v. Lorain Journal Co., 497 U.S. 1, 18 (1990).
270. *Id.* at 18–19.
271. *Id.* at 4–5.
272. *Id.* at 21.
273. RESTATEMENT (SECOND) OF TORTS § 566 illus. 3 (1977).
274. *Id.* § 566 cmt. e (1977); *Milkovich*, 497 U.S. at 19–20 (explaining that mere hyperbole is not actionable in defamation because it "cannot 'reasonably [be] interpreted as stating actual facts' about an individual").
275. *Milkovich*, 497 U.S. at 20 (quoting Hustler Magazine, Inc. v. Falwell, 485 U.S. 46, 50 (1988)); *Hustler Magazine*, 485 U.S. at 50 (ad parody "could not reasonably have been interpreted as stating actual facts about the public figure involved").
276. Greenbelt Coop. Publ'g Ass'n, Inc. v. Bresler, 398 U.S. 6, 13–14 (1970).

rhetorical hyperbole, a lusty and imaginative expression of the contempt felt by union members."[277] As a close corollary, verbal abuse by angry speakers is unlikely to imply any defamatory facts when "it is obvious that the speaker has lost his temper and is merely giving vent to insult."[278] For example, "when, in the course of an altercation, the defendant loudly and angrily calls the plaintiff a bastard in the presence of others, he is ordinarily not reasonably to be understood as asserting the fact that the plaintiff is of illegitimate birth."[279]

c. The Defamation Precedent on Mixed–Pure Opinions Informs the Proposed Reasonable Implication *Test*

First, as explained above, applying the *pure–mixed opinion* test in defamation cases, courts have frequently held that opinions accompanied by their factual basis (whether stated by the speaker or assumed by both parties) are not actionable in defamation because they do not connote false facts.[280] Drawing from this defamation precedent, courts should similarly hold for purposes of securities fraud that an opinion based on fully disclosed or mutually assumed facts is immaterial as a matter of law because no reasonable investor would interpret the opinion as implying any unstated material facts. If an opinion is accompanied by accurate factual statements that provide the basis for the opinion, the opinion would fail the proposed *reasonable implication* test because it would not reasonably imply any unstated facts.[281] Thus, the opinion would be immaterial as a matter of law.

Indeed, a few courts have already recognized in the securities fraud context that whether an opinion is accompanied by its factual basis is relevant to whether the opinion is material.[282] For example,

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277. Old Dominion Branch No. 496, Nat'l Ass'n of Letter Carriers v. Austin, 418 U.S. 264, 284–86 (1974).

278. RESTATEMENT (SECOND) OF TORTS § 566 cmt. e (1977).

279. *Id.*

280. *See supra* Part IV.C.5.b.

281. *Cf.* RESTATEMENT (SECOND) OF TORTS § 539(1) (1977) ("A statement of opinion as to *facts not disclosed* and not otherwise known to the recipient may, *if it is reasonable to do so*, be interpreted by him as an implied statement (a) that the facts known to the maker are not incompatible with his opinion; or (b) that he knows facts sufficient to justify him in forming it." (emphasis added)).

282. *E.g.*, Payne v. DeLuca, 433 F. Supp. 2d 547, 599 (W.D. Pa. 2006) ("The press release dated April 27, 2000, included several statements which we consider puffery. Mr. DeLuca is quoted as saying, 'The recent contract awards demonstrate our excellent reputation with a diverse range of clients and our broad and sophisticated skill base. Our April announcement of the acquisition of

Judge Lynch in the Southern District of New York rejected a securities fraud claim based on the opinion that "Winstar was fully funded" because the defendants disclosed the basis for their opinion:

> Plaintiffs' contention that "there was no reasonable good faith basis to conclude with confidence that Winstar was fully funded" also misrepresents the reports at issue, because the reports clearly disclose the basis for defendants' claim that Winstar was fully funded. . . . Considering all the circumstances, plaintiffs cannot prevail on a claim that defendants recklessly failed to disclose the lack of a reasonable basis for optimistic statements regarding Winstar's future funding if defendants' reports plainly disclosed the basis for their statements.[283]

The precedent on this issue in the defamation context should help courts apply the *evaluation–inference* test.

Further, courts in the securities fraud context already recognize the necessity of assessing the impact of an alleged misrepresentation on the "total mix of information" available to investors.[284] This total mix analysis is comparable to the defamation analysis of whether an opinion is accompanied by its factual basis.[285] Indeed, the weighty precedent in the defamation context to determine whether certain facts were stated or assumed could help guide courts as they perform a similar analysis in the securities fraud context.[286]

W & H Pacific, Inc., . . . provides further evidence of the success of our diversification strategy.'" (emphasis removed)); Limantour v. Cray Inc., 432 F. Supp. 2d 1129, 1147 (W.D. Wash. 2006) ("To the extent these [factual] statements (most of which are not alleged to be false) have any effect, they raise an inference in Defendants' favor that there was a factual basis for the positive statements concerning 2004 earnings.").

283. *In re* Salomon Analyst Winstar Litig., No. 02-Civ-6171, 2006 WL 510526, at *12 (S.D.N.Y. Feb. 28, 2006).

284. Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988).

285. *See supra* Part IV.C.5.b.

286. *E.g.*, DAVID A. ELDER, DEFAMATION: A LAWYER'S GUIDE § 8.2 (2010) (citing cases) ("Where the defendant does not express or state the underlying facts, they may nonetheless be 'assumed facts.' This assumption of facts might be justified for a number of reasons—some third party has stated them, the specific or specialized knowledge of the recipient, i.e., 'knowledgeable listeners' due to the publicity given the facts by the local media, a prior press release issued by defendant, the demonstrated presence of the facts in the public domain in the area of publication, or prior articles or editorials in the same newspaper.").

Finally, as explained above, mere hyperbole or verbal abuse is not actionable in defamation because it "cannot 'reasonably [be] interpreted as stating actual facts' about an individual."[287] Courts, when drawing the line between nonactionable puffery and potentially material opinions for purposes of securities fraud, can similarly draw on this rich defamation precedent to identify those opinions that are so hyperbolic that they do not reasonably imply any false, material facts.

6. Consistent with Comparable Test Applied in Common Law Fraud Context

Although the *Second Restatement of Torts* does not articulate a test to differentiate between opinions potentially actionable at common law and mere puffery,[288] a close study of the examples cited in the *Restatement* commentary shows that they are consistent with the *reasonable implication* test proposed in this Article.

The tension between potentially actionable opinions and immaterial puffery exists in common-law fraud, as in securities fraud. The *Restatement* does not articulate a test to differentiate between potentially actionable opinions and mere puffery, instead merely recognizing that "some allowance must be made for puffing or depreciation by an adverse party."[289] To exemplify this "some allowance," the commentary states that the opinion that a bond is a "good investment" is potentially actionable,[290] while a dealer's opinions that an automobile he is selling is a "dandy," a "bearcat," a "good little car," "the pride of our line," or "the best in the American market" are mere puffery.[291]

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287. Milkovich v. Lorain Journal Co., 497 U.S. 1, 19–20 (1990) ("This provides assurance that public debate will not suffer for lack of 'imaginative expression' or the 'rhetorical hyperbole' which has traditionally added much to the discourse of our Nation." (quoting Hustler Magazine, Inc. v. Falwell, 485 U.S. 46, 50 (1988))); *Hustler Magazine*, 485 U.S. at 50 (Ad parody "could not reasonably have been interpreted as stating actual facts about the public figure involved."); Greenbelt Coop. Publ'g Ass'n, Inc. v. Bresler, 398 U.S. 6, 13–14 (1970); Old Dominion Branch No. 496, Nat'l Ass'n of Letter Carriers v. Austin, 418 U.S. 264, 284–86 (1974).

288. RESTATEMENT (SECOND) OF TORTS § 539 cmt. a (1977) (merely recognizing that "some allowance must be made for puffing or depreciation by an adverse party").

289. *Id.*

290. *Id.*

291. *Id.* § 542 cmt. e.

First, the *Restatement* classifies the opinion that a bond is a "good investment" as potentially actionable.[292] The commentary clarifies that this opinion is not mere puffing "*if* the vendor knows that the interest on the bond has for years been in default and the corporation that issued it is in the hands of a receiver."[293] The commentary explains that "such a statement is so far removed from the truth as to make it a fraudulent misrepresentation of the character of the bond."[294] This result is consistent with the proposed *reasonable implication* test. If the "bond is a good investment" opinion were allegedly false because the bond was merely a mediocre investment, the opinion would be immaterial as a matter of law because no reasonable investor would infer a specific quality of investment from such a vague statement. If, on the other hand, the opinion were allegedly false because the bond is in default, the opinion would be potentially material because a reasonable investor would interpret this opinion as implying that the bond was not in default. Therefore, the *Restatement* commentary and this Article's proposed *reasonable implication* test reach the same result.

On the other hand, the *Restatement* classifies as nonactionable puffery a dealer's opinions that an automobile he is selling is a "dandy," a "bearcat," a "good little car," "the pride of our line," or "the best in the American market."[295] The *Restatement*'s commentary does not explain why these opinions were allegedly false. Instead, it merely concludes that these opinions are immaterial as a matter of law:

> It is common knowledge and may always be assumed that any seller will express a favorable opinion concerning what he has to sell; and when he praises it in general terms, without specific content or reference to facts, buyers are expected to and do understand that they are not entitled to rely literally upon the words.[296]

However, in a separate section, the *Restatement* recognizes that even statements that might otherwise seem like puffery can be actionable if they are fantastic:

> The habit of vendors to exaggerate the advantages of the bargain that they are offering to make is a well recognized fact. An intending purchaser may not be justified in relying

292. *Id.* § 539 cmt. a.
293. *Id.* (emphasis added).
294. *Id.*
295. *Id.* § 542 cmt. e.
296. *Id.*

> upon his vendor's statement of the value, quality or other advantages of a thing that he is intending to sell as carrying with it any assurance that the thing is such as to justify a reasonable man in praising it so highly. *However, a purchaser is justified in assuming that even his vendor's opinion has some basis of fact, and therefore in believing that the vendor knows of nothing which makes his opinion fantastic.*[297]

Therefore, it is reasonable to conclude that, consistent with the *reasonable implication* test proposed in this Article, the aforementioned opinions about the car would be potentially material if the car were, in fact, inoperable. Although no reasonable investor would interpret these opinions as statements of fact about the car's relative quality, a reasonable investor would infer that the car is at least operable.

V. CONCLUSION

In sum, this Article proposes a new analytical framework to apply to statements of opinion in securities fraud cases. First, this Article agrees with most courts having addressed the issue that statements of opinion are only false if both objectively unreasonable and subjectively disbelieved.[298] The dual-falsity requirement recognizes that there is "something special" about opinions, which reflect the speaker's mental processes, and that this "something special" merits the heightened protection afforded by the subjective falsity requirement. Additionally, in light of the consequent necessity of differentiating between statements of fact and statements of opinion, this Article proposes the following novel *evaluation–inference* test: Does the statement express the speaker's evaluation or inference of facts?[299] This test, which draws on comparable precedent in the defamation and common law fraud contexts, pinpoints those statements that contain the aforementioned "something special." Further, this Article responds to courts' unsound materiality analyses of opinions by proposing the following new *reasonable implication* test to distinguish statements that are immaterial as a matter of law from those that are potentially material: Does the opinion reasonably imply an allegedly false, material fact?[300] Comparable precedent developed in the defamation *pure–mixed opinion* context and in the common-

297. *Id.* § 539 cmt. c (emphasis added).
298. *See supra* Part III.D.
299. *See supra* Part III.E.
300. *See supra* Part IV.C.

law fraud *puffery–opinion* context should guide courts as they apply the *reasonable implication* test in the securities fraud context. Securities fraud jurisprudence would benefit from identifying the "something special" about statements of opinion, recognizing how an opinion can be *false*, and distinguishing opinions that reasonably imply material facts from opinions that are mere puffery.