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Risk Factors in Your Form 10-Q

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On its face, Form 10-Q does not require the inclusion of risk factors unless there have been "material changes" from the risk factors contained in the previous Form 10-K. Yet a lot of respected companies, including Apple, Procter & Gamble and United Technologies, choose to include risk factors in every Form 10-Q. Is it a good practice?

The basic structure of the SEC's integrated disclosure system contemplates that a company's ongoing disclosure package includes its most recent Form 10-K and all subsequently "filed" Form 10-Qs, Form 8-Ks and proxy statements. If the disclosure is contained in one of those filings, the market is on notice, and the disclosure should be effective for subsequent statements. From a traditional Rule 10b-5 litigation perspective, repeating risk factors in a Form 10-Q adds no substantive value, although it may call less attention to minor changes made from filing to filing and may be more comforting to a judge.

But not all aspects of securities law are that buttoned-down. In particular, the so called "safe harbor for forward-looking statements" has its own set of requirements. One of the requirements is that written forward-looking statements be "accompanied" by a "meaningful cautionary statement." There are a few cases that have held that the requirement to be "accompanied" is satisfied by a cross-reference to some other document, but this concept has not been widely accepted, and we are concerned that it is inconsistent with the plain meaning of the word "accompany" as well as the overall structure of the safe harbor. As a result, we believe that the conservative course is to read the "accompanied" requirement as requiring inclusion of the meaningful cautionary statement in the same document as the forward-looking statements.

Form 10-Qs are required to contain forward-looking statements. For example, the liquidity disclosure required by Regulation S-K, Item 303 should discuss how a company expects to meet its future liquidity needs, an inherently forward-looking disclosure. Other required disclosures, including disclosure of "known trends and uncertainties," also are likely to be forward-looking. And, the definition of what constitutes a forward-looking statement is quite broad, so statements that typically would not be perceived as "forward-looking" are eligible for the protection of the safe harbor, including, for example, statements regarding goals and objectives.

Risk factors and the meaningful cautionary statement needed to perfect the safe harbor serve different purposes and must fulfill different requirements. But they are similar. Risk factors are described in Regulation S-K, Item 503(c) as the "most significant factors that make the offering speculative or risky." The language required for the safe harbor is described as a "meaningful cautionary statement identifying important factors that could cause actual results to differ materially from those in the forward looking statement." The leading cases make it clear that the cautionary language is not required to align perfectly with the ultimate cause of the problem, but certainly greater specificity and broader coverage make it easier for a judge to conclude that language is "meaningful." In

theory, the required cautionary language is in most instances a subset of well-crafted risk factors.

As a result, risk factors contained in a Form 10-Q, with either a proper introduction or an appropriate cross-reference, can substitute for, or at least supplement, the required meaningful cautionary statement. And, given that they almost always are more robust, risk factors may be more protective. Moreover, their presence in a document could favorably factor into the availability of the bespeaks caution doctrine and other traditional defenses that remain viable today.

There also may be some benefit for oral forward-looking statements, such as those in earnings calls. For oral forward-looking statements, in order to get the benefit of the safe harbor, a company must refer the listener to a "readily available written document" that includes a meaningful cautionary statement. The gold standard for readily available documents is an SEC-filed document, so virtually all companies refer listeners to an SEC filing. Note that the referral should be to a specific SEC-filed document, not to "risk factors contained in our SEC filings." A referral to a recent Form 10-Q containing an updated set of risk factors is much easier than a referral to, say, "our 2012 Form 10-K, as updated by our 2013 first quarter Form 10-Q and . . . all as filed with the SEC and available on our website." (Please remember that the materials on a company's website, including in all likelihood audio and video files, are written statements for purposes of the safe harbor, and the company must meet the "accompanied" requirement in order to perfect the safe harbor.)

As a result, while a robust meaningful cautionary statement may accomplish what a company needs, we believe there are solid benefits available from including risk factors in each Form 10-Q, even if not required, and believe that companies would be well-advised to consider that approach.

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