

# Guidance on guidance claims featured in securities litigation

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When a public company's stock price declines significantly, securities class action litigation may follow. One common trigger for such lawsuits is a company missing or lowering its financial guidance. Recent studies show that guidance claims are on the rise, with at least one in four securities claims predicated, in part, on allegations related to a shortfall of prior expectations.

Given the frequency of these claims, it is useful for public companies to be aware of the types of claims that may be asserted and to consider, in consultation with their advisors, general practices that may help address litigation risk associated with so-called guidance claims. This article is intended to provide a high-level overview of the legal landscape and does not prescribe any particular approach or establish a standard of care.

## Background on financial guidance

Many public companies choose to issue some form of financial guidance, which may include revenue or earnings-per-share (EPS) projections for upcoming periods. Some companies also provide operational targets or key performance metrics relevant to their business or industry.

While securities laws do not require companies to provide guidance, some companies elect to do so to communicate management's expectations regarding future performance. Because guidance is inherently forward-looking, actual results may differ from projections for a variety of reasons.

## Legal principles governing guidance claims

Securities litigation often involves allegations made with the benefit of hindsight. Guidance statements, by their nature, are subject to later scrutiny. Courts evaluating these claims apply a well-established legal framework.

To prevail on a guidance claim, plaintiffs generally must show that the guidance was false or misleading when issued. This typically requires a showing that the guidance was not genuinely believed, lacked a reasonable basis, or was issued despite knowledge of undisclosed facts that seriously undermined its accuracy.

Courts have recognized that demonstrating a lack of genuine belief is a high bar, as beliefs are subjective and difficult to disprove without contemporaneous evidence. Plaintiffs may also attempt to show that there was no reasonable basis for the guidance or that management disregarded contrary undisclosed facts or trends.

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The Private Securities Litigation Reform Act (PSLRA) provides a "Safe Harbor" for forward-looking statements, including financial guidance. Under the Safe Harbor, forward-looking statements are generally not actionable if they are identified as such and accompanied by meaningful cautionary statements specifying important factors that could cause actual results to differ materially.

Additionally, claims based on forward-looking statements are barred unless plaintiffs can show that the speaker had actual knowledge that the statement was false. There are certain exceptions in which the Safe Harbor does not apply, such as when forward looking statements are included in a registration statement for an initial public offering. In addition to the Safe Harbor, the judicially created "bespeaks caution doctrine" is another that protects companies from fraud liability when their forward-looking statements are accompanied by sufficient, specific cautionary language.

The doctrine is premised on the idea that investors cannot reasonably rely on overly optimistic forecasts if they are provided with sufficient cautionary language. The bespeaks

caution doctrine can be useful with respect to statements that do not fully meet all of the Safe Harbor's requirements.

These legal standards can present significant challenges for plaintiffs. However, the persistence of guidance-based claims reflects the complexities involved in applying these standards in practice.

### What guidance claims look like

Guidance claims often arise after a company misses or lowers previously issued guidance, sometimes due to unforeseen developments. The underlying causes may include operational challenges, competitive pressures, product-related issues, regulatory actions, merger-integration difficulties, supply-chain disruptions, macroeconomic factors, or other unexpected events. Plaintiffs' lawyers may allege, with the benefit of hindsight, that executives knew or should have known about these issues at the time guidance was issued.

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To support their claims, plaintiffs may seek statements from former employees or other sources, sometimes presented as "confidential witnesses," whose perspectives may be negative or inconsistent with public statements. These accounts are often presented in litigation as conflicting with the company's prior disclosures.

### General considerations for mitigating guidance claim risk

There is no single approach or process that is required or appropriate for all companies or industries when preparing or issuing guidance. Companies may, in consultation with their advisors, consider whether to adopt practices that are tailored to their specific circumstances, business, and risk profile.

Courts have, in some cases, considered the existence of a robust process for preparing guidance as a relevant factor in evaluating claims, but there is no prescribed or universally applicable process.

Some companies may find it useful to document the methodologies, assumptions, and rationale underlying their guidance, and to clearly distinguish between different scenarios or versions of guidance (such as internal targets

versus public guidance). Marking drafts and tracking the individuals involved in the process may also be considered, depending on the company's practices and needs.

Guidance is ultimately a matter of judgment, even when based on rigorous analysis. Courts have recognized that framing guidance and related commentary as opinions — using language such as "we believe," "we expect," or "we anticipate" — can underscore the subjective and forward-looking nature of such statements. Identifying key assumptions and risks within the forward-looking context may also be considered as part of a company's disclosure practices.

Consistent use of forward-looking language and clear identification of risk factors may help maximize the protections of the Safe Harbor. Companies may also consider, in consultation with counsel, how to approach unscripted communications, such as responses to analyst questions, to avoid unvetted or overly optimistic statements.

### Reporting missed guidance or downward revisions

Developments leading to a guidance miss or revision may occur late in a reporting period and may not be known until after the period closes. In such cases, companies often address the issue in connection with the next regularly scheduled earnings release. Courts have generally held that there is no legal duty to update guidance, though there may be circumstances where a company determines, based on its specific facts and in consultation with counsel, that an update is appropriate.

When announcing a guidance miss, some companies choose to disclose the reasons for the miss and reference previously disclosed risks. Companies may also consider, in consultation with their advisors, how to communicate about missed guidance, including whether to avoid language that could be misconstrued as an admission of wrongdoing.

### Conclusion

Guidance-based securities claims are frequently asserted, but prevailing on such claims can be challenging for plaintiffs under the applicable legal standards. While no process can eliminate the risk of litigation following a guidance miss, companies may, in consultation with their advisors, consider practices that are appropriate for their circumstances.

This article is intended for general informational purposes only and does not constitute legal advice or a recommendation as to any particular approach. Companies facing questions about guidance or related disclosures should consult with experienced counsel to address their specific situation.

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## About the authors



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