No. 03-7978

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Michael M. Merritt, et al.,

Plaintiffs-Appellants,

v.

Merrill Lynch & Co., et al.,

Defendants-Appellees.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE,
IN SUPPORT OF APPELLANTS ON ISSUE ADDRESSED

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INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The district court in this case held that the provisions of the securities laws under which plaintiffs seek relief "do not require disclosure of publicly available information," and that therefore defendants' alleged failure to disclose information that appeared in the public domain could not be the basis for claims under the these provisions, even though the omitted information was alleged to be necessary to make other statements made by defendants not materially misleading. The district court did not address whether the undisclosed information was actually known to investors, or whether it was so widely disseminated in sources other than the prospectus at issue that its omission was not materially misleading to investors. The Securities and Exchange Commission, the agency responsible for the administration and enforcement of the federal securities laws, submits this brief as amicus curiae to urge that, contrary to the conclusion of the district court, the mere fact that information could be discovered somewhere in the public domain does not mean that the omission of that information from a prospectus or other statement is never materially misleading.

The district court's ruling in this regard departed from this Court's long established views, and is also contrary to authority of the Commission relying on those views. If accepted as a correct interpretation of the applicable law, the

district court's ruling would create substantial gaps in the fundamental protections extended to investors by the securities laws, and particularly by the Securities Act's registration and disclosure requirements, gaps that were not intended by Congress. Moreover, although this case is a private action, the principles enunciated by the district court and urged by the defendants could also restrict the disclosure obligations enforced by the Commission in its own proceedings. [1]

ISSUE ADDRESSED BY THE COMMISSION

Whether it is an absolute defense to a claim under the federal securities laws for failure to disclose information that the information was "publicly available," i.e., that the information could have been discovered somewhere in the public domain by an investor who knew of the need to look for it, and who had the resources to locate and the ability to analyze it, without regard to whether the information was sufficiently publicly disseminated in those other sources that the omission was not materially misleading.

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[1] The proposition that the failure to disclose "publicly available" information can never be actionable is not unique to this case; that position has increasingly been raised as a defense. For instance, the Fourth Circuit Court of Appeals recently rejected it as a defense to a claim under a state law that is similar to Section 12(a)(2) of the Securities Act of 1933, 15 U.S.C. 77l(a)(2). See Dunn v. Borta, 2004 U.S. App. LEXIS 9734 (4th Cir. May 19, 2004). And the Commission has submitted a brief urging its rejection in a case brought under Section 11 of the Securities Act, 15 U.S.C. 77k, Kapps v. Torch Offshore, Inc., No. 03-30227 (5th Cir.), which is awaiting decision.

THE DISTRICT COURT'S DECISION

Plaintiffs, investors in defendant Merrill Lynch Global Technology Fund, allege that defendants violated the federal securities laws by making statements without disclosing information necessary to prevent the statements from being materially misleading. See In re Merrill Lynch & Co., Inc. Research Reports Securities Litigation, 272 F. Supp.2d 243, 246 (S.D.N.Y. 2003). [2] The district court granted defendants' motion to dismiss on a variety of grounds, of which we address only one – relating to public availability of undisclosed information as a defense to a claim for material omissions.

The district court ruled that Sections 11 and 12(a)(2) of the Securities Act "do not require disclosure of publicly available information." Id. at 249-50. [3]

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[2] The other defendants are the Fund's directors; its investment adviser; Merrill Lynch & Co. Inc., the corporate parent of the adviser; and Merrill Lynch, Pierce, Fenner & Smith Inc. (Merrill Lynch), a broker-dealer affiliate of the Fund. 272 F.2d at 247-48.

[3] Section 11(a) of the Securities Act authorizes a private action when a registration statement "includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading," unless it is proved that at the time of acquisition, the person "knew of such untruth or omission." Section 12(a)(2) provides for liability when a security is offered or sold "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in light of the circumstances under which they were made,

(continued...)

Therefore, the court held, the defendants could not be held liable under Sections 11 and 12(a)(2) of the Securities Act "for failing to disclose that [Merrill Lynch] provided investment banking services to companies in the Fund's portfolio if that information was already public." Id. at 249. The information "was already public" at the time plaintiffs bought their shares because the complaint contained a spreadsheet representing that Merrill Lynch performed investment banking services for about a third of the companies whose securities were held by the Fund. Id. at 250. The information in the spreadsheet was obtained by examining public documents filed with the Commission, including Fund filings that disclosed the Fund's holdings at specific points in time, together with Commission filings for the companies in which the Fund invested, which disclosed the underwriting relationship. Id.

The district court also concluded that defendants did not have to disclose alleged inherent conflicts of interest arising from the fact that Merrill Lynch analysts issued research reports about issuers for which Merrill Lynch either provided investment banking services, or hoped to provide those services. Id. at 250-52. The court stated that "the information regarding the alleged conflict of

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[3](...continued)
not misleading (the purchaser not knowing of such untruth or omission)."

interest was public knowledge, and had been for years," citing a number of newspaper articles dating back to 1995. Id.

Finally, the district court ruled that defendants did not have to disclose that Merrill Lynch analysts "may have held contrary views regarding the stocks rated" because that information also "was public knowledge." Id. at 252 n.7. The court quoted a single newspaper article in which a Merrill Lynch analyst observed of a security that was being upgraded, "I think it's dead money for a while, but I want to differentiate it from all the pieces of [expletive] we have buys on." [4]

The district court applied this same reasoning to plaintiffs' claim under Section 34(b) of the Investment Company Act, 15 U.S.C. 80a-33(b), ruling that "[t]he alleged omissions are not material" because "the information allegedly withheld from the shareholders was a matter of public knowledge." Id. at 261. [5] Similarly, it dismissed plaintiffs' Section 10(b) and Rule 10b-5 claim on the ground, among others, that plaintiff had "failed to allege any facts and their

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[4] The district court observed that plaintiffs may have abandoned this allegation, but ruled that it would in any event not be viable for the reason stated.

[5] Section 34(b) makes it "unlawful for any person to make any untrue statement of a material fact in any registration statement, application, report, account, record or other document filed or transmitted pursuant to this title" or to "omit to state therein any fact necessary in order to prevent the statements made therein, in the light of the circumstances under which they were made, from being materially misleading."

particulars giving rise to" a duty to disclose allegedly omitted information, citing the section of the opinion containing the rulings discussed above. Id. [6] In a subsequent ruling on a motion to amend the complaint, the district court stated that the fund purchasers' "proposed amended complaint does not show that the information cited [in the district court's ruling] was not publicly available." In re Merrill Lynch & Co., Inc. Research Reports Securities Litigation, 2003 U.S. Dist. LEXIS 14175 at **10 (S.D.N.Y. 2003).

STANDARD OF REVIEW

The Commission's interpretation of the securities laws in a formal adjudication, including its interpretation in In re Richmark Capital Corp., No. 03-9994, 2003 SEC LEXIS 2680 (Nov. 7, 2003), aff'd sub nom. Richmark Capital Corp. v. SEC, 2004 U.S. App. LEXIS 2158 (5th Cir. Feb. 10, 2004), of when an omission is materially misleading, is entitled to Chevron deference, which is to say that the Commission's reasonable interpretation controls unless Congress has clearly and unambiguously addressed the question at issue. See, e.g., SEC v.

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[6] Rule 10b-5(b) makes it unlawful for any person, in connection with the purchase or sale of any security, "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."

Zandford, 535 U.S. 813 (2002); United States v. Mead Corp., 533 U.S. 218, 226-27 (2001).

ARGUMENT

The fact that information could be discovered somewhere in the public domain does not mean that it can never be materially misleading to omit that information from a disclosure document or other statement.

A. Both this Court and the Commission have recognized that mere public availability of information is not an absolute defense to a claim for failing to disclose "material" information.

The disclosure duties imposed by the federal securities laws, like all the substantive requirements of those laws, are embodied in the statutes and the regulations adopted thereunder, and issues about the scope of those duties must be resolved in accordance with the language of the applicable provisions. See, e.g., Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 173 (1994) (with respect to the issue of "the scope of conduct prohibited by §10(b), the text of the statute controls our decision"). Nothing in the language of the provisions relied on by plaintiffs in this case creates an absolute defense based on the fact that the information is "publicly available." Rather, each provision prohibits the failure to disclose any information necessary to make the information that is disclosed not materially misleading.

A fact is "material" "if there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision. Basic Inc. v. Levinson, 485 U.S. 224, 231, 234 (1988), quoting TSC Industries, Inc. v. Northway, 426 U.S. 438, 449 (1976). For an omission to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Id. at 231-32. In other words, the "role of the materiality requirement" is "to filter out essentially useless information that a reasonable investor would not consider significant, even as part of a larger 'mix' of factors to consider in making an investment decision." Id. at 234. A materiality challenge may be resolved on the pleadings if the plaintiff failed sufficiently to allege that the omissions were material misleading, and summary judgment may be granted if reasonable minds cannot differ on the question of whether they were so; otherwise, the issue is for the trier of fact. See TSC Industries, 426 U.S. at 438.

1. This Court has rejected the argument that public availability of information automatically means that the omission of that information from a disclosure document can never be materially misleading.

This Court has made it clear that in determining whether an omission is materially misleading, it looks beyond the simple fact that information might be available from some public source, if a shareholder knew to look for the information, and had the resources to obtain it and the ability to analyze it once obtained. Instead, it has long taken the view, with which the Commission agrees, that "the 'total mix' includes only information 'reasonably available to the shareholders.'" Koppel v. 4987 Corp., 167 F.3d 125, 131, 132 (2d Cir. 1999), quoting United Paperworkers International Union v. International Paper Co., 985 F.2d 1190, 1198 (2d Cir. 1993) (emphasis added); see also Press v. Quick & Reilly, Inc., 218 F.3d 121, 130 (2d Cir. 2000) (total mix of information includes information reasonably available to the shareholders).

As the Court has explained, the "purpose of looking at the sum of all information 'reasonably available' is to enable a registrant to rely on a 'reasonable belief that the other party already has access to the facts to excuse him from new disclosures which reasonably appear to be repetitive.'" Koppel, 167 F.3d at 132, citing Seibert v. Sperry Rand Corp., 586 F.2d 949, 952 (2d Cir. 1978). This approach strikes the correct balance between ensuring adequate disclosure, on the

one hand, and avoiding the repetition of information that will not be useful to investors because it is already available to them, on the other. Application of this principle, however, requires rejection of any bright line rules, and instead requires a case-specific analysis of whether publicly available information is so widely disseminated in other sources that its omission from defendant's disclosure was not materially misleading.

This Court reviewed and synthesized its prior decisions on when the public availability of information excuses further disclosure of that information in United Paperworkers International Union v. International Paper Co., 985 F.2d 1190 (2d Cir. 1993), which was quoted in Koppel, and which was also a principal decision relied on by the Commission in its Richmark decision, which we discuss below. [7] The defendant company in United Paperworkers had included in its proxy statement a "rather glowing description" of its environmental policies, but it had not disclosed anything about its actual record of compliance with environmental

[7] While United Paperworkers was a proxy case, the definition of "material" is the same in the general antifraud provisions as in the provisions governing proxy solicitation. See Basic, 485 U.S. at 231-32 (Rule 10b-5), adopting definition of materiality from TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (proxy solicitation); In re Richmark Capital Corp., supra (applying United Paperworkers to securities fraud claim).

laws. [8] The Court concluded that the statement was "misleading absent a description of the Company's record of environmental derelictions or non-compliance." 985 F.2d at 1198. Defendants claimed, however, that the proxy statement was not misleading when read in conjunction with other information that was publicly available, including the company's 10-K Report, which had been filed with the Commission, as well as press reports of environmental claims made against the company. 985 F.2d at 1197.

The Court agreed with the broad proposition that "[i]n considering a claim of material omission in violation of Rule 14a-9 * * * the court ordinarily should not consider the proxy statement alone," and that the "total mix" of information included "other information reasonably available" to shareholders. 985 F.2d at 1198; see also id. at 1199 (the "total mix" of information "may also include 'information already in the public domain and facts known or reasonably available to the shareholders.'"). However, the Court cautioned, "not every mixture with the true will neutralize the deceptive," and even information actually sent to shareholders "need not be considered part of the total mix reasonably available to

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[8] Exchange Act Rule 14a-9 prohibits the inclusion in a proxy statement of any statement "which, at the time * * * it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading." 17 C.F.R. 240.14a-9.

them if the true is buried in unrelated discussions." 985 F.2d at 1198-99, citing, inter alia, Virginia Bancshares, Inc. v. Sandberg, 501 U.S. 1083, 1096 (1991). Nor does the mere fact that a company has filed documents containing relevant factual information with a regulatory agency mean that the company has made adequate disclosure – "Corporate documents that have not been distributed to the shareholders entitled to vote on the proposal should rarely be considered part of the total mix of information reasonably available to those shareholders." 985 F.2d at 1199.

The Court explained that when the subject of the proxy solicitation "has been widely reported in readily available media, shareholders may be deemed to have constructive notice of the facts reported," and a court should consider this in determining whether representations or omissions are materially misleading. Id. But "the mere presence in the media of sporadic news reports does not give shareholders sufficient notice" that statements sent directly to them by the company may be misleading, "and such reports should not be considered to be part of the total mix of information that would clarify or place in proper context" the company's statements. Id.

The Court ruled that the newspaper articles in this case were "few in number, narrow in focus, and remote in time," so that they were "properly

considered not to be part of the information that was reasonably available to shareholders." 985 F.2d at 1199. And, while the Form 10-K had been filed with the Commission, it had not been distributed to shareholders, and nothing in the proxy statement or annual report that was distributed to them would have put a "reasonable shareholder" on notice that "additional information" pertinent to the proxy issues was available in the Form 10-K. Thus, the information in the Form 10-K also was not part of the total mix of information reasonably available. Id.

The Court has provided additional guidance on when an omission is not material because the information is sufficiently disclosed in other places in its discussion of the "truth-on-the-market" defense to a fraud on the market claim under Rule 10b-5. See Ganino v. Citizen Utilities Co., 228 F.3d 154, 167-68 (2d Cir. 2000). The truth on the market defense asserts that "a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market." 228 F.3d at 167. Here again, as it had in United Paperworkers, the Court rejected the notion that mere public availability, without any consideration of the quality or nature of the disclosure, is sufficient to render a misrepresentation or omission immaterial. Rather, "the corrective information must be conveyed to the public with a degree of intensity

and credibility sufficient to counter-balance effectively any misleading information created by the alleged misstatements." Id.

2. Relying on this Court's decisions, the Commission has also rejected the contention that public availability is an absolute defense to liability for non-disclosure.

In an administrative decision handed down in November 2003, the Commission followed this Court's decisional law holding that public availability is not sufficient to render an omission of information that would otherwise have to be disclosed immaterial unless the information was already known or reasonably available to investors. See In re Richmark Capital Corp., supra. The Commission also agreed with the Court that merely because information was filed with the Commission did not mean that it was reasonably available. 2003 SEC LEXIS 2680 at *23-*24.

One issue in Richmark was whether the respondent broker-dealer had committed securities fraud when it failed to disclose an agreement that gave it a financial incentive to recommend certain securities to its customers. Respondent urged in its defense that the existence of the agreement had been disclosed in a press release, which resulted in the agreement being mentioned briefly in the Wall Street Journal and in an online news service report. The Commission rejected the claim that this disclosure had been adequate, citing United Paperworkers, 985 F.2d

at 1199, for the proposition that "the mere presence in the media of sporadic news reports" does not make them part of the "total mix" of available information.

The respondents also claimed that the agreement had been adequately disclosed in a registration statement filed by the other party to the agreement; respondents noted that this statement was "a public document." The Commission rejected this argument as well, observing that respondents' customers were not informed of the registration statement's existence, much less furnished with copies, and that under the circumstances, the filing of this document with the Commission did not place it in the "total mix" of information reasonably available to investors. The Commission again cited United Paperworkers, this time for the proposition that merely filing a document with a regulatory agency does not place the document in the"total mix" of information reasonably available to investors when the document was not distributed to shareholders or called to their attention.

3. The increased availability of information on the internet, including the Commission's electronic disclosure system, does not change the result in United Paperworkers and Richmark.

A recent district court decision has suggested that one aspect of the holding in United Paperworkers – that the mere fact that information is contained in a Commission filing does not mean it is part of the total mix of information available – is no longer valid because of the increased availability to the public through the

internet of filings on the Commission's Electronic Data Gathering Analysis and Retrieval ("EDGAR") system. See In re Keyspan Corp. Sec. Litig., 2003 U.S. Dist. LEXIS 20746 (E.D.N.Y. 2003). We believe the district court in that case was incorrect in disregarding this Court's precedent.

Keyspan involved, inter alia, a series of allegedly fraudulent omissions to disclose adverse information arising from the fact that a company that the defendant issuer had acquired was subject to regulation under the Public Utility Holding Company Act (PUHCA), 15 U.S.C. 79a et seq. 2003 U.S. Dist. LEXIS 20746, *5-*25. [9] The district court ruled that Commission filings made by the issuer should be considered part of the total mix of information reasonably available to investors, and that those filings made the alleged omissions not materially misleading. Id. at *43 n.6. The court thought that it was not bound by United Paperworkers, inter alia, because EDGAR has now made such filings more readily available than they had been in 1993, when United Paperworkers was decided. Id. This reasoning, however, misconceives the basis for the ruling in

[9] The case was brought under Section 10(b) and Rule 10b-5, and did not involve claims under Sections 11 or 12(a)(2) of the Securities Act.

United Paperworkers, which was also the basis for the Commission's decision in Richmark). [10]

Neither United Paperworkers nor Richmark suggests that some difficulty with locating or obtaining the relevant information was fundamental to the decision's holding that under the circumstances of each case, information that had been disclosed somewhere in the public domain was not part of the "total mix" of information available to investors. Rather, the reason was that the information should not be considered part of the total mix of available information, even though it could conceivably have been discovered by an investor who knew to look for it, because it had not been so widely distributed that it was not materially

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[10] The district court in Keyspan also sought to distinguish United Paperworkers on the ground that it involved affirmative misrepresentations rather than merely omissions to disclose. 2003 U.S. Dist. LEXIS 20746, *43 n. 6. We do not agree with that characterization, given this Court's express statements in United Paperworkers that the company's "rather glowing description" of its environmental policies was "misleading absent a description of the company's record of environmental derelictions or non-compliance," and that "in considering a claim of material omission" (emphasis added) the court is not ordinarily limited to the proxy statement alone. 985 F.2d at 1198. In any event, we do not see a distinction in this context between the failure to disclose information that corrects an affirmative misstatement and the failure to disclose information that renders statements made not misleading. Whatever difference there might be in these two situations, the relevant issue here is whether the omission of the information is materially misleading to investors.

misleading to omit it, nor had it been delivered to investors or called to their attention.

Investors should no more be expected to know all the information on EDGAR, or discoverable on the internet, than they would be expected to know all the information that could be found somewhere in the Library of Congress. Indeed, as noted, both this Court and the Supreme Court have held that even disclosure in the same document is insufficient if the disclosure is not made in a way that adequately informs investors. It is therefore unrealistic to suggest that investors are to be held responsible for knowing the entire contents of enormous databases.

To take only EDGAR, it includes filings from approximately 5100 registered investment companies and nearly 12,000 operating companies. These entities file over 100,000 documents each year. The average size of each document was calibrated at 75 pages of ASCII text in 1997 but has risen since that time. [11] This huge mass of information provides important disclosure to the securities markets for those who know that they need to look for specific information, and who have the training and capacity to obtain and digest it. The mere presence of this information in EDGAR, however, does not mean that every investor should be held

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[11] If the entire internet is included, the amount of potentially discoverable information increases even more.

to know all of it. In fact, there are companies that market their ability to analyze the information disclosed in EDGAR; the existence of these companies is evidence that investors cannot readily do all the necessary research for themselves, even though the information is available to them.

For instance, as noted, the district court held that the fact that Merrill Lynch provided investment banking services for about a third of the companies held by the Fund was publicly available because an investor could have obtained a list of the Fund's holding from Fund filings, and could then have discovered the identity of each company's investment bank from the company's filings. [12] The court observed that plaintiffs included such a list in their complaint, which demonstrated to the court that the information was publicly available. Plaintiffs explained in their brief in this Court that compiling the list was a substantial task that required the expenditure of $7000 to access the necessary computer software services, as well as 245 hours of professional and paraprofessional services to compile the information. Br. 31-32. And this was just one issue out of the indefinitely large number of issues that could confront an investor deciding whether to make a

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[12] We note that an investor could not have determined what the Fund's actual holdings were at the time of his purchase of shares in the Fund because the disclosure was required to be made twice a year. Section 30(e) of the Investment Company Act, 15 U.S.C. 80a-29(e); Rule 6-10(c)(1) of Regulation S-X, 17 C.F.R. 210.6-10(c)(1).

particular investment. The district court did not appear to consider whether information that requires this much effort to obtain should be considered part of the total mix of information reasonably available to investors.

The Commission has determined that for certain specific types of disclosure, it is sufficient that disclosure is made through an internet accessible medium, such as in a Commission filing, or on an issuer's webpage. For instance, Regulation FD, 17 C.F.R. 243.100-243.103, requires the prompt "public disclosure," by issuers of securities and those acting on behalf issuers, of material, nonpublic information that is being, or has been disclosed, to certain industry professionals or to holders of the security under circumstances in which it is reasonably foreseeable that the person will purchase or sell the security on the basis of the information. The Regulation further provides that one of the ways that an issuer may make "public disclosure" of that information is by filing a Form 8-K containing that information, which would then be accessible on EDGAR. Thus, the Commission made the judgment that disclosure of this sort of information through a Form 8-K sufficiently achieves the objectives of the Rule, namely to remedy the consequences of selective disclosure of material, nonpublic information to persons who are likely to trade on it. [13]

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[13] Thus, in the Adopting Release for the Rule, the Commission

(continued...)

In an adopting release amending Form N-1A, the Commission also recently made a determination that specified internet disclosure satisfies a specific requirement to disclose information in a mutual fund registration statement. The amendments, among other things, require a mutual fund to disclose in its statement of additional information ("SAI") any "ongoing arrangements to make available information about the fund's portfolio securities to any person." SEC Rel. No. 33-8427, 2004 SEC LEXIS 1153 (June 7, 2004), at *46-* 47. The fund need not disclose such an ongoing arrangement in the SAI, however, if it timely "makes [the information about its portfolio securities] available on its website" and "discloses in its prospectus the availability of the information on its website." Id. at *51-*52. The Commission expressly cautioned, however, that "[e]xcept where specifically provided by Commission rule, making information accessible on a website is not necessarily adequate disclosure under the federal securities laws." Id. at *53 n.60.

These carefully tailored rules permitting disclosure obligations to be satisfied by EDGAR filing or internet disclosure in certain circumstances do not

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[13](...continued)
explained that Form 8-K disclosure was permissible public disclosure "for purposes of Regulation FD." SEC Rel. No. 34-43154, 2000 SEC LEXIS 1672 (Aug. 15, 2000). It did not suggest that this disclosure would satisfy all other disclosure obligations required under the securities laws.

mean that any information that can be found in these sources automatically may be omitted from disclosure under all circumstances. [14]

B. With respect to Section 11 liability, the district court's "public availability" approach is inconsistent with the provisions governing securities registration.

One striking consequence of a rule that public availability of information always excuses further disclosure would be a serious disruption of the registration requirements of the Securities Act. Issuers and others who now have a duty to make disclosure in registered offerings could escape those obligations simply by showing that the omitted information could be found somewhere in the public domain. This result is plainly at odds with the Congressional purpose in enacting these requirements, including the Commission and express private right enforcement mechanisms contained in the Act.

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[14] We also note that, while the Commission has increasingly relied on internet availability to make certain types of disclosure, it is still not the case that all investors have access to the internet. As of March, 2004, for instance, nearly 75% of Americans have access to the internet from home. Press Release, Nielsen/Netratings, Three Out of Four Americans Have Access to the Internet (March 18, 2004) (available at www.nielsen-netratings.com). And in a February 2004 survey, only 22% of American aged 65 or older reported having access to the Internet. Susannah Fox, Older Americans and the Internet (March 25, 2004), issued by the Pew Internet & American Life Project, www.pewinternet.org.

"The primary innovation of the 1933 Act was the creation of federal duties – for the most part, registration and disclosure obligations – in connection with public offerings." Gustafson v. Alloyd, Co., 513 U.S. 561, 571 (1995). The Act requires issuers that wish to sell their securities to the public to file a registration statement with the Commission that contains mandatory disclosures of material information, and to deliver a copy of a prospectus that is part of the registration statement to investors. See Section 5, 15 U.S.C. 77e . Congress intended that the registration statement would contain "the basic information by which the public is solicited" to buy offered securities. H. R. Rep. 85, 73d Cong., 1st Sess. (1933), at 9.

The Act also creates remedies for failure to comply with the disclosure requirements governing the statutorily mandated registration statement, including Section 11, one of the express private remedies relied on by plaintiffs in this case, which was designed "to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering." Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983). A plaintiff who acquires a security issued pursuant to a registration statement need only show a material misstatement or prohibited omission to establish his prima facie case. Once he has done so, "[l]iability against the issuer

of a security is virtually absolute, even for innocent misstatements. Other defendants bear the burden of demonstrating due diligence." Id. [15]

The requirements of the Act would be substantially thwarted if any information that could be discovered in any public source could be left out of the mandatory disclosure document on the ground that it is automatically not material. Some of the consequences of allowing that omission have been discussed above. In addition, we note that if information is not material, then not only may it be omitted from a registration statement without creating liability, but, in addition, false statements about the information would not create liability. See Basic, 485 U.S. at 249 (Court rejects "the proposition that 'information becomes material by virtue of a public statement denying it'") (internal quotation marks omitted).

Thus, under the logic of the district court's reasoning, it would have been lawful, without regard to any other facts and circumstances, for defendants to have misstated facts, to have omitted facts required to be stated by statute or regulation, as well as to omit facts necessary to make the statements they did make not

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[15] In addition to the issuer, other possible defendants include every person who signed the registration statement, directors of the issuer, and the underwriter of the security.

The Act also provides Commission-enforced remedies for material misstatements and omissions in a registration statement. See Section 8(d), 15 U.S.C. 77h(d).

misleading, so long as they could show that an alert and diligent investor with sufficient knowledge could have found corrective or supplementary information in other sources. Furthermore, holding the investor responsible for knowing any information he could have found upon further investigation contradicts the express statutory provision in Section 11 that a plaintiff may recover unless it is proven that he "knew" of the untruth or omission.

The flaw in the district court's approach with respect to Securities Act disclosure and prospectus delivery requirements is also demonstrated in another way. Generally, information required to be included in a prospectus may not be incorporated by reference from other Commission filings or other documents. General Instruction D.1.(a) to Form N1-A (mutual funds); Securities Act Rule 411(a), 17 C.F.R. 230.411(a) (all issuers). However, under some circumstances, the Commission does permit issuers that meet certain requirements to incorporate into the prospectus by reference specified information from other filings made by the issuer with the Commission. [16] In those instances, the Commission requires the

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[16] In the narrow circumstances when incorporation by reference of information in another document is permitted in a mutual fund prospectus, the Commission also requires actual delivery of the incorporated document. General Instruction to Form N-1A D.1.(a), Items 6(f) and 8(b). The Commission does permit mutual funds to incorporate by reference into their prospectuses an SAI, which they are not required to deliver to investors with the prospectus, but the (continued...)

prospectus to identify the document that is incorporated by reference and to explain to investors how they may obtain a copy of the incorporated documents.

These detailed rules concerning what companies may rely on incorporation by reference, and the circumstances under which that incorporation is permitted, would be entirely displaced if any information in a Commission filing is deemed sufficiently disclosed to all investors that the failure to include that information in a prospectus can never be a material omission. Under that view, the entire contents of EDGAR (or perhaps the internet) would be deemed incorporated into each prospectus – indeed, into every statement made by anyone about the issuer's

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[16](...continued)

information that may be incorporated from an SAI does not include any information that is required to be included in the prospectus. General Instruction to Form N-1A D.1(b). Moreover, the funds are required to inform investors of the existence and availability of the SAI in their prospectuses. Form N-1A, Item 1(b).

Issuers that meet certain criteria – those that have timely filed required reports with the Commission and that are widely followed in the marketplace – may omit from their prospectuses information that is found in other Commission filings, but they are required to state that these other documents are incorporated by reference. Item 12(a) of Form S-3; see SEC Rel. No. 33-6499, 1983 SEC LEXIS 315(Nov. 17, 1983), Section IV.B.1. They are also required to state that they will provide copies of any incorporated documents at no cost to any person to whom a prospectus is delivered, upon written or oral request. Item 12(c) of Form S-3. In addition, they must disclose that materials filed with the Commission may be obtained from the Commission's Public Reference Room and from EDGAR on the Commission's website. See, e.g., Note to Item 12(c)(1) of Form S-3.

securities. The incorporation would not be by reference, however, as there would be no indication in the prospectus or other statement to that effect, but would arise merely from the fact that the curative information existed in the database. The severe adverse consequences for the disclosure and prospectus delivery purposes of the Securities Act are obvious.

C. The decisions relied upon by the district court do not support its conclusion that public availability of omitted information is an automatic defense to liability for its omission.

The district court cited three decisions in support of the conclusion that the relevant provisions of the securities laws "do not require disclosure of publicly available information." One of those decisions was from this Court, Seibert v. Sperry Rand Corp., 586 F.2d 949, 952 (2d Cir. 1978), which was cited for the proposition that "there is no duty to disclose information to one who reasonably should already be aware of it." Seibert was cited in United Paperworkers, 985 F.2d at 1199, and the proposition quoted is, of course, consistent with the views expressed by the Court in that decision. The second decision was Klein v. Gen. Nutrition Cos., 186 F.3d 338, 343 (3d Cir. 1999), which held that an omission is not material if the omitted information is "obvious." Again, this decision appears

to be consistent with the rule followed by this Court, as information that is "obvious" would be either known or reasonably available to investors. [17]

The third decision cited by the district court is Wielgos v. Commonwealth Edison, Co., 892 F.2d 509 (7th Cir. 1989), a case under Section 11 of the Securities Act. Certain remarks in Wielgos seem to be the genesis for the idea that there is never a duty to disclose information that is publicly available, and so it is necessary to take a close look at what the Seventh Circuit did, and what it did not, say in that case.

The two issues in Wielgos concerned whether defendant's disclosure complied with certain Commission regulations. 892 F.2d at 512. The court did not resolve either of those issues on the ground that an issuer can never have a duty to disclose information that is in the public domain. 892 F.2d at 517 ("Our case may be decided, however, without regard to materiality.") Rather, it decided the case based on the application of the specific language of the governing regulations to the allegations in the complaint. 892 F.2d at 512-17. Before specifically addressing each issue before it, however, the Wielgos court offered its thumbnail view of the general way in which the securities disclosure regime works. See 892

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[17] The court in Klein stated that "A determination of 'materiality' takes into account considerations as to the * * * [information's] availability in the public domain * * *. Federal securities laws do not require a company to state the obvious." 186 F.3d at 342-43.

F.2d at 515, 517. The district court seems to have treated the Wielgos court's dicta as laying down the absolute rule, not tied to any specific language of any of the relevant provisions, that the securities laws never require disclosure of any information that is publicly available.

This reading of the case is erroneous. In stating, for instance, that issuers do not have to disclose hazards of a business that are "apparent to all serious observers and most casual ones," the court was not asserting that any information that could be found anywhere in a public source could be omitted. Nor should the statement that "[i]t is pointless and costly to compel firms to reprint information already in the public domain" be read to mean that the omission of any conceivably discoverable information cannot be materially misleading. Rather, as this Court explained in United Paperworkers, 985 F.2d at 1199, whether information is considered to be in the "public domain" for these purposes turns on whether it is so widely disseminated that it is known or reasonably available to investors.

CONCLUSION

For the foregoing reasons, this Court should rule in accordance with the legal principles urged in this brief.

Respectfully submitted,

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