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## **Demanding Substance Or Form? The SEC's Plain English Handbook As A Basis For Securities Violations**

J. Scott Colesanti\*

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# Demanding Substance Or Form? The SEC's Plain English Handbook As A Basis For Securities Violations\*

J. Scott Colesanti

## Abstract

In 1998, the United States Securities and Exchange Commission (“SEC” or “Commission”) released a style manual titled “The Plain English Handbook.” The culmination of a drive by its Chairman, Arthur Levitt, the Handbook drew upon the rules of grammar, best industry practice, and even the support of billionaire Warren Buffett in calling for a layman’s translation of corporate disclosure documents. To varying degrees, commentators noted the significance of the Handbook. Initial textual studies provided mixed results. The press marveled at its novelty but securities regulation experts were less sanguine, chiding Commission members for naming themselves “language czars of the universe.” Meanwhile, the cause of corporate disclosure—a mission long defined by federal case law—continued its second phase as the SEC, the courts, and stock issuers sought to strike a balance between financial expertise and consumer satisfaction. From this effort came the separate but related causes of evaluating substantive content and delivering it in good faith. These causes eventually morphed, however, forcing jurists to locate further authority animating the remedial securities laws. Consequentially the Handbook, at times, tipped this balance of corporate disclosure.

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\*Associate Professor of Legal Writing, Hofstra University Maurice A. Deane School of Law. Professor Colesanti has taught Securities Regulation each year since 2000. He is a former co-editor of The Business Law Professor Blog, which carries over 100 of his substantive Posts. Professor Colesanti has designed and taught numerous law school courses domestically and abroad. He has presented on numerous panels addressing the response of the securities laws to the economic crisis and, in 2012, he will publish articles on the Madoff debacle, and the use of wiretaps in insider trading investigations. Professor Colesanti previously served for a decade each as a securities regulator and an industry arbitrator.

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In 1998, the United States Securities and Exchange Commission (“SEC” or “Commission”) released a style manual titled “The Plain English Handbook.” The culmination of a drive by its Chairman, Arthur Levitt, the Handbook drew upon the rules of grammar, best industry practice, and even the support of billionaire Warren Buffett in calling for a layman’s translation of corporate disclosure documents.

To varying degrees, commentators noted the significance of the Handbook. Initial textual studies provided mixed results. The press marveled at its novelty but securities regulation experts were less sanguine, chiding Commission members for naming themselves “language czars of the universe.”

Meanwhile, the cause of corporate disclosure—a mission long defined by federal case law—continued its second phase as the SEC, the courts, and stock issuers sought to strike a balance between financial expertise and consumer satisfaction. From this effort came the separate but related causes of evaluating substantive content and delivering it in good faith. These causes eventually morphed, however, forcing jurists to locate further authority animating the remedial securities laws. Consequentially the Handbook, at times, tipped this balance of corporate disclosure.

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Accordingly, this Article traces the gradual yet impressive growth in importance of a nearly 15-year-old exhortation. To be sure, the authoritative value of a style manual is a topic of great moment: In the fall of 2012, changes implemented by the controversial federal healthcare law required insurers to publish marketing materials in “plain language.” Further, the Commission itself is gradually expanding the Handbook’s application to additional mutual fund disclosures, proxy materials, and investment adviser communications. Those commenting on the rule’s primacy will undoubtedly note the lessons of indirect agency rulemaking. Of more immediate consideration, this Article seeks to examine the subtle means by which a call for simplicity may have become grounds for violations of securities law, in the eyes of the government and others. Ultimately, the SEC’s continuing emphasis on simplicity begs the question of which shareholder communications are being read at all.

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#### INTRODUCTION

In 1998, the United States Securities and Exchange Commission (“SEC” or “Commission”) adopted a seemingly harmless style manual

titled “A Plain English Handbook” (“Handbook”).<sup>1</sup> The manual was designed to urge issuers of public securities to create more meaningful disclosures in documents such as prospectuses. Released by the Commission’s Office of Investor Education and Assistance, the eighty-three-page document was specifically targeted at corporate agents tasked with creating a broad spectrum of public disclosures in the hopes of generating simpler and clearer documents for investors.<sup>2</sup>

As late as 2002, practitioners were unsure as to whether the Handbook had resulted in increased litigation.<sup>3</sup> But in subsequent years, the Handbook has seemingly crept into the judicial psyche in cases evaluating corporate America’s efforts at meaningful investor communication.<sup>4</sup> In sum, defendants facing accusations brought by the SEC or private investors need to be more concerned than ever with the simplicity and clarity of customer communications, and for more than just reputational reasons.<sup>5</sup>

Accordingly, this Article analyzes both the morphing of a style manual into a legislative authority, as well as the wisdom of that transformation. Part I provides a detailed schematic of the Handbook, the contents of which range from the substantive to the technical. Part II summarizes the distinctly American view of the regulation of corporate disclosure, revealing case law and other, nearly commensurate authority organized around two distinct eras.

Part III discusses cases from recent years that hold the Handbook on higher ground than a style manual, and perhaps portend stricter discipline yet to come. In turn, Part IV provides analysis of the Handbook’s influence on case law to date. The article concludes by offering thoughts on the paternalism attending all regulatory efforts at ratcheting up the communications of corporate management, when such

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1. See Plain English Disclosure, Securities Act Release No. 7497, Exchange Act Release No. 39,593, Investment Company Release Act No. 23,011, 63 Fed. Reg. 6370 (Feb. 6, 1998). As used in this Article, “Plain English” connotes the Commission-imposed standard dating from 1998, while “plain English” connotes the more generic, time-honored standard of clear and concise writing.

2. See OFFICE OF INVESTOR EDUC. & ASSISTANCE, SEC. & EXCH. COMM’N, A PLAIN ENGLISH HANDBOOK: HOW TO CREATE CLEAR SEC DISCLOSURE DOCUMENTS 4 (1998), available at <http://www.sec.gov/pdf/handbook.pdf>.

3. See, e.g., Michael G. Byers, Note, *Eschew Obfuscation — The Merits of the SEC’s Plain English Doctrine*, 31 U. MEM. L. REV. 135 (2000).

4. See *infra* notes 82–97 and accompanying text.

5. See *infra* notes 82–97 and accompanying text.

efforts largely ignore the commensurate duty of the layman to understand his investments.

### I. THE HANDBOOK'S SPECIFICS

*The Handbook's twelve chapters gravitate towards a truly substantive nature (e.g., structuring management's prognostication; the use of a zero baseline in a graphic disclosing the most recent quarterly revenue numbers). Most importantly, the Handbook—in both the several appendices and the text—includes concrete examples of statutorily required filings and caveats that would ideally become the standards in customer communications.*

#### A. BACKGROUND AND STATED MISSION

The terse prologue to the Handbook is at once calming and alarming:

This handbook shows you how you can use well-established techniques for writing in plain English to create clearer and more informative disclosure documents. We [SEC personnel] are publishing this handbook only for your general information. Of course, when drafting a document for filing with the SEC, you must make sure it meets all legal requirements.<sup>6</sup>

An accompanying Acknowledgement expresses appreciation to advisors and reviewers, including various Commission staffers, unnamed “[c]orporate officials and lawyers, the American Bar Association,” and even billionaire investor Warren Buffett.<sup>7</sup> The brief Acknowledgement concludes with a note of thanks to then SEC Chairman Arthur Levitt, who was said to have “made [the Handbook] possible by putting plain English at the top of his agenda so that investors might better understand their investments.”<sup>8</sup>

In turn, Chairman Levitt added an introduction that reiterates the need to continue the fight.<sup>9</sup> The Handbook's initial pages also include the thoughts of congratulated financier Buffett, who writes that though

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6. SEC. & EXCH. COMM'N, *Prologue to A PLAIN ENGLISH HANDBOOK*, *supra* note 2.

7. *See id.* at *Acknowledgments*.

8. *Id.*

9. *See id.* at 3.

the drafter of disclosures occasionally “fails to get the message across,” he suspected that, at times, “a less-than-scrupulous issuer doesn’t want us to understand a subject it feels legally obligated to touch upon.”<sup>10</sup>

#### B. HANDBOOK OUTLINE

The Handbook’s twelve chapters vary greatly in purpose. Corporations are encouraged to first assemble experienced drafters who will initially weigh the length and due date of the planned document.<sup>11</sup> Chapters Three and Four describe the need to know both audience and content.<sup>12</sup> Chapters Five and Six form the gist of the document, offering tips on effective prose (“[u]se the active voice . . .”)<sup>13</sup> while displaying successfully redrafted phrases common to prospectuses.<sup>14</sup> Stylistically, the broad spectrum of suggestions reveals support for simple words, short sentences, and commonly defined terms.<sup>15</sup> Noteworthy here is the citation to Aristotle’s *Rhetoric*, “Clearness is secured by using the words that are current and ordinary.”<sup>16</sup>

Chapter Seven (“Design the Document”) is a lengthy display of such basics as characters, fonts, charts, colors, and graphics.<sup>17</sup> Meanwhile, Chapters Eight, Nine, and Ten offer proofreading and other post-production tips.<sup>18</sup> Chapter Eleven adds a reading list referencing, among other authors, Bryan Garner, William Strunk, Jr., and E.B. White.<sup>19</sup>

The Handbook becomes much more serious in its first Appendix. “Summary of the Plain English Rules” explains rules applicable to the entire prospectus, as well as those technically limited to preparation of the document’s “Cover and Back Pages, Summary and [Statement of] Risk Factors.”<sup>20</sup> More daunting still is the immediately following cover page from a 1997 sample prospectus, introduced with the caveat that the issuer “relied on the SEC rules that were in effect at that time.”<sup>21</sup>

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10. *Id.* at 1.
  11. *See id.* at 7–8.
  12. *See id.* at 9–13.
  13. *Id.* at 19.
  14. *Id.* at 18.
  15. *Id. passim.*
  16. *Id.* at 30.
  17. *Id.* at 37–54.
  18. *Id.* at 55–60.
  19. *Id.* at 61–62.
  20. *Id.* at 65–67.
  21. *Id.* at 70.



At times, the Handbook shifts gears dramatically, moving from lighthearted references to works like “Plain English for Lawyers,”<sup>22</sup> to the demand that time must flow forward in all “graphics showing information” over a span of years.<sup>23</sup> Indeed, for every set of airy style suggestions there appears to be a random, substantive concern. Notably, liability is (in the estimation of the Commission) simply not a concern: The SEC, in its proposing release,<sup>24</sup> expressly discounted the fear among issuers that plain English would “increase liability.”<sup>25</sup>

### C. ENABLING SEC RULEMAKING

Along with the publication of the Handbook, the contemporaneous adoption of SEC Rule 421 highlighted the cause of clarity, at least regarding one specific document: the Prospectus.<sup>26</sup> The Rule appears in relevant part below:

Rule 421 — Presentation of Information in Prospectuses . . .

b. You must present the information in a prospectus in a clear, concise and understandable manner. You must prepare the prospectus using the following standards:

1. Present information in clear, concise sections, paragraphs, and sentences. Whenever possible, use short, explanatory sentences and bullet lists;
2. Use descriptive headings and subheadings;
3. Avoid frequent reliance on glossaries or defined terms as the primary means of explaining information in the prospectus. Define terms in a glossary or other section of the document only if the meaning is unclear from the

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22. *See id.* at 31.

23. *Id.* at 52.

24. Plain English Disclosure, Securities Act Release No. 7380, 63 SEC Docket 1487 (Jan. 14, 1997).

25. *Id.* at 6 (“[W]e know of no case that has held anyone liable under Section 11 [of the Securities Act] for clearly disclosing material information to investors.”). The Release simultaneously disclosed that internal SEC review revealed “that no case [reviewed] required the use of specific legal language or turned on the use of legal language.” *Id.* at 42 n.45.

26. 17 C.F.R. § 230.421 (2010).

context. Use a glossary only if it facilitates understanding of the disclosure; and

4. Avoid legal and highly technical business terminology.<sup>27</sup>

Academics would later acknowledge the authoritative effect of the Handbook, noting its requirements ranged from avoiding “jargon and highly technical business terminology” to adding “increased white space in prospectuses in order to make the information more readable.”<sup>28</sup> It was also noted that Chairman Levitt did not stop with the amendments to Rule 421. With the adoption of other rules in 1998, plain English thus became legally required of all prospectuses issued by both corporations and investment companies (i.e., mutual funds).<sup>29</sup> Further, foreign registrants were warned *ab initio* that the plain English expectations were expected of them as well.<sup>30</sup> In the words of a foremost SEC historian, “It was as if Strunk and White, authors of the leading work on English Usage, were made czars of the securities regulatory universe.”<sup>31</sup>

It was readily accepted by observers that the Commission had refocused its storied review of documents prepared by corporate America.<sup>32</sup> What was not as easily concluded (even years after the

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27. To the same end were contemporaneous amendments to SEC Rules 461 (effective date of prospectus) and 481 (mutual fund prospectuses). 17 C.F.R. §§ 230.461, 230.481. As was commented by the authors of a leading text, “[t]echnically, only the cover pages, summary and risk factors sections” were covered by the amendments, “but the new communications philosophy [was] strongly encouraged by the SEC’s staff.” JOHN C. COFFEE, JR. & HILLARY A. SALE, *SECURITIES REGULATION: CASES AND MATERIALS* 208 (11th ed. 2009).

28. THOMAS LEE HAZEN, *PRINCIPLES OF SECURITIES REGULATION* 80 (2d ed. 2006). Professor Hazen termed a “fifth common deficiency” in disclosure requirements to be “the registrant’s failure to make the prospectus readable and understandable by the investing public.” *Id.* at 79–80.

29. JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* 650 (3d ed. 2003).

30. *See* International Disclosure Standards, Securities Act Release No. 7745, Exchange Act Release No. 41,936, 70 SEC Docket 1474 (Sept. 28, 1999).

31. SELIGMAN, *supra* note 29, at 650.

32. THOMAS LEE HAZEN, *SECURITIES REGULATION: CASES AND MATERIALS* 271 (7th ed. 2006) (“In reviewing SEC filings, the Division of Corporate Finance will now do a plain English check in addition to its other review process.”); *see also* Ford Lacy, *Frequently Asked Questions Concerning the Plain English Rule of the U.S. Securities and Exchange Commission*, FINDLAW (Mar. 26, 2008), <http://library.findlaw.com/>

promulgation of the Handbook) was the extent to which that new SEC review would reach content as well as form.<sup>33</sup> The ultimate scope and legal authority of the Handbook presented a true challenge to corporate America, whose attention to the written and spoken words for investors had been both amplified and forced since the post-Depression legislative reforms of the 1930s.

## II. BACKGROUND: ERAS OF STATUTORY DISCLOSURE

*The federal disclosure standards, commencing with the New Deal legislation of President Franklin Delano Roosevelt (“FDR”), have progressed through two discernible time periods.*

### A. THE POST-STATUTORY PERIOD (1933-1980)

To say that disclosure is central to American securities regulation understates both our past and present. The autopsy of the Great Depression had, in part, identified an embarrassingly low level of comprehension with regards to the nature of stock market investments.<sup>34</sup> Indeed, the debacle’s leading chronicler wrote a short list of causes for the nation’s unprecedented economic doldrums, listing five factors including “the poor state of economic intelligence.”<sup>35</sup>

#### 1. Legislative History

In renouncing a role for the federal government as guarantor of investments, FDR presented to Congress the first of the federal

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1998/Jan/1/126423.html (“I believe the SEC in a very ‘un-Plain English way’ has ‘backdoored’ Plain English into the entire prospectus. Because of this it is likely over time that Plain English will appear throughout all SEC filings.”).

33. HAZEN, *supra* note 32, at 272 (acknowledging that “the consequences of noncompliance ha[d] not yet been fully explored,” while adding that it was “conceivable that an investor might sue under the antifraud provisions [of the Securities Acts] claiming that the disclosures although complete were too obscure to be readily understandable”).

34. *See, e.g.*, JOHN KENNETH GALBRAITH, *THE GREAT CRASH: 1929*, 168–94 (7th ed. 1997).

35. *Id.* at 182 (“[I]t seems certain that the economists and those who offered economic counsel in the late twenties and thirties were almost uniquely perverse. In the months and years following the stock market crash, the burden of reputable economic advice was invariably on the side of measures that would make things worse.”).

securities laws with the instruction that each and every security sold in interstate commerce be described in informed detail. As FDR's 1933 speech to Congress explained:

The Federal Government cannot and should not take any action that might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties that they represent will earn a profit. . . . There is however an obligation upon us to insist that every issue to be sold in interstate commerce shall be accompanied by full publicity and information.<sup>36</sup>

Even before FDR's famed presentation of the first federal securities law to Congress, the stage for enforced disclosure had been set. The much-followed hearings of the Pecora Commission<sup>37</sup> had highlighted the lack of information available to investors who had rushed to buy ill-fated foreign bonds in the years preceding the Great Depression.<sup>38</sup>

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36. CHARLES R. GEISST, *WALL STREET: A HISTORY* 228 (1997) (citation omitted).

37. A prosecutor from New York, Ferdinand Pecora ("Pecora"), as counsel to the United States Senate Banking Committee, revived a languishing federal commission and spearheaded the drive to hold Wall Street executives accountable for the Great Depression. See Ron Chernow, Op-Ed., *Where is Our Ferdinand Pecora?*, N.Y. TIMES, Jan. 6, 2009, at A25, available at <http://www.nytimes.com/2009/01/06/opinion/06chernow.html?pagewanted=all>. Pecora's famed (and eponymous) hearings contributed directly to the Securities Act of 1933. See MICHAEL PERINO, *THE HELLHOUND OF WALL STREET: HOW FERDINAND PECORA'S INVESTIGATION OF THE GREAT CRASH FOREVER CHANGED AMERICAN FINANCE* 235–36 (2010) (crediting Pecora's commission work with "laying the groundwork for the securities legislation that would be offered in the new Congress").

38. One fateful exchange between Pecora and the president of the securities affiliate of a large national bank had yielded the testimony that prospectuses attending the sale of Latin American bonds to American investors had belied internal bank memoranda questioning the soundness itself of the host country:

Pecora: "Do you find any mention in [the prospectus] whatsoever . . . of the bad credit record of Peru which is embodied in the information I have read into the record from your files?"

Bank President: "No; I do not see anything."

Pecora: "No statement of information . . . was given to the American investing public . . . concerning the bad debt record of Peru and its being a bad moral and political risk?"

Bank President: "No sir," . . . .

Foremost among those seminal pieces of legislation were the Securities Act of 1933<sup>39</sup> and the Securities Exchange Act of 1934<sup>40</sup> (collectively, “the Securities Laws”). As has been dutifully recounted, the early days of the Securities Laws cultivated a “symbolic . . . shift of political power.”<sup>41</sup>

The decades immediately following this New Deal legislation afforded numerous opportunities for the judiciary to curtail a burgeoning and distinctly American view of the infectiousness of corporate communications. To the contrary, the courts seemed eager to further the progressive view that company disclosures be held to the highest (albeit unprecedented) standards. A 1966 Supreme Court decision heralded the prospectus, stating that it, “in accord with the congressional purposes, specifically requires prominent emphasis be given . . . to material adverse contingencies.”<sup>42</sup> Moreover, the registration statement was effectively deemed sacrosanct in 1968 by a New York court finding all signatories liable for the flawed prospectus of a failed manufacturer of bowling alleys.<sup>43</sup> Likewise, case law paved the way for the view that myriad faulty disclosures rose to the level of corporate theft—in terms of both specific admissions by the board to minority shareholders,<sup>44</sup> and obligatory statements by an expanding class of corporate “insiders” to the public at large.<sup>45</sup> Thus, whether via SEC enforcement actions or private class actions, corporate management was duly warned of the legal consequences of inadequate disclosure. Concurrently, the SEC reiterated the drive for best communications, even if to the middlemen of the stock purchase. Significantly, the famed “Wheat Report” of

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PERINO, *supra* note 37, at 236. At another point, Pecora’s dogged questioning yielded the confession from an expert at the same bank that such bonds had been rushed to the market because “there was a chance to earn some underwriting fees.” *Id.* at 235.

39. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2006 & Supp. IV 2011).

40. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78pp (2006).

41. William O. Douglas, *Protecting the Investor*, 23 YALE REV. 521, 522 (1934), available at [http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1930/1934\\_0300\\_Douglas\\_Protect.pdf](http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1930/1934_0300_Douglas_Protect.pdf).

42. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 753 (1975) (citations omitted).

43. *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968).

44. *See Speed v. Transamerica Corp.*, 235 F.2d 369 (3d Cir. 1956).

45. *See SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968).

1969<sup>46</sup> concluded that wider dissemination of the preliminary prospectus to stockbrokers was warranted.<sup>47</sup>

## 2. Paternalism and Its Consequences

Indeed, at seemingly every opportunity, the Supreme Court held that the animating purpose of the securities laws was the implementation of a policy of “full disclosure.”<sup>48</sup>

Subsequently, the SEC and the courts clarified that not only lies, but also good faith misstatements, could form the basis for liabilities (both civil and criminal) under the new supervisory regime.<sup>49</sup> The collateral damage of the joint assault on investor communications was the image of the investor itself—the more the mystified masses needed clarity, the lesser regard in which they were held. Thus flourished patronizing literature, aiming to subject each innovation to continuing simplification scrutiny<sup>50</sup> or to cause outright questioning of the retail consumer’s rationality.<sup>51</sup>

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46. See SEC Announces Disclosure Policy Study Report, Securities Act Release No. 4963, Exchange Act Release No. 8568, 1969 WL 96983 (Apr. 14, 1969) (announcing the release of the report titled “Disclosure to Investors – A Reappraisal of Administrative Policies under the ‘33 and ‘34 Acts” and citing SEC Disclosure Study Proposed, Securities Act Release No. 4885, Exchange Act Release No. 8197, 1967 WL 88872 (Nov. 29, 1967)).

47. FRANCIS M. WHEAT, SEC. & EXCH. COMM’N, DISCLOSURES TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE ‘33 AND ‘34 ACTS 45–64 (1969), available at [http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1960/1969\\_Wheat\\_CH02.PDF](http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1960/1969_Wheat_CH02.PDF).

48. See, e.g., *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976) (stating that the Securities Act of 1934 “was intended principally . . . to impose regular reporting requirements on companies whose stock is listed on national securities exchanges”); *Santa Fe Indus. v. Green*, 430 U.S. 462, 476 (1977).

49. See, e.g., Securities Act of 1933, 15 U.S.C. § 77(k), (l) (2006) (stating private causes of action for material misstatements and/or omissions in registration statements and prospectuses without requiring the pleading of reliance or intent).

50. See, e.g., Use of Electronic Media, Securities Act Release No. 7856, Exchange Act Release No. 42,728, Investment Company Act Release No. 24,426, 2000 WL 502290 (Apr. 28, 2000) (warning issuers utilizing websites that “investors may be unable to view the issuer’s communications in an appropriate context”).

51. See JOHN C. COFFEE, JR. & HILLARY A. SALE, SECURITIES REGULATION: CASES AND MATERIALS 232 (11th ed. 2009) (stating that investors “tend to believe that they are more knowledgeable or skillful than in fact they are”) (citing Brad M. Barber & Terrance Odean, *The Courage of Misguided Convictions*, 55 FIN. ANALYSTS J. 41 (Special Issue On Behavioral Finance 1999)).

Overall, disclosure—and the attendant civil remedies occasioned by the failure thereof—originally and consistently meant that the government was “taking the side of the helpless, the suckers, the underdogs.”<sup>52</sup>

More importantly, Wall Street was simply too large (and its legally required filings too voluminous) for the SEC to rely solely on discipline to encourage proper disclosure. Therefore, the Commission’s arsenal had to resort, at times, to informal discipline, “No-Action Letters,” and outright compromise to maintain desired standards.<sup>53</sup> One former Commissioner explained the Commission’s gradual abandonment of the carrot for the stick (and concomitant growth in private enforcement of disclosure obligations) in this manner:

All these [Advisory] devices can be praised as innovative and flexible administrative techniques for effectuating a government mandated disclosure policy with the least possible disruption of the business world. This is the kind of informal process that the independent regulatory agencies were intended to create. But the very flexibility and extra-statutory nature of these devices turned them into instruments of perceived rigidity and oppression as the SEC’s prosecutorial image grew more pronounced and liability imposed in private actions grew even greater . . . .<sup>54</sup>

In sum, a zero-tolerance approach was simply not practicable. As FDR’s non-guaranty had augured, the exponential growth of public companies (and their required SEC filings) had simply outpaced regulatory efforts.<sup>55</sup> It was noted that the Commission’s Division of Corporation Finance, the department responsible for reviewing filings by public companies,<sup>56</sup> shrunk by nearly a third between 1962 and 1980

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52. See Douglas, *supra* note 41, at 522. Douglas, who later became an SEC Chairman (1937–39), also described the adoption by Congress of the first federal securities law as signifying that “the money-changers [were] being driven from the temples.” *Id.*

53. See ROBERTA S. KARMEL, REGULATION BY PROSECUTION: THE SECURITIES & EXCHANGE COMMISSION VS. CORPORATE AMERICA 318 (1982).

54. *Id.* at 319.

55. See JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 266–67 (3d ed. 2003) (noting an SEC “backlog in its examination” of corporate financial reports by the late 1940s).

56. *About the Division of Corporation Finance*, SEC, <http://www.sec.gov/divisions/corpfm/cfabout.shtml> (last modified June 5, 2012).

while the number of filings actually tripled.<sup>57</sup> Perhaps fortuitously for the SEC, federal courts began to scrutinize SEC actions centering on disclosures not readily comprehensible by the investing public and/or more accurately targeted by other bodies of regulation.<sup>58</sup>

Consequently, the experts began to signal the need for updated or “continuous” disclosure<sup>59</sup> (i.e., disclosure duties extending beyond the distribution of the prospectus<sup>60</sup>). Such broadening of required communications was inspired, in part, by a mistrust of the investor. Simply put, skepticism abounded in the late 1960s and 1970s, as pundits openly decried the value of sharing all information with the masses or the utility in basing such egalitarianism on a sole document. A future law school dean questioned the utility of punishing “insider trading,”<sup>61</sup> stating, among other things, that the offense provided perhaps the best available form of price disclosure.<sup>62</sup> Separately, the author of a best-selling book decrying the science of stock picking was pointed in his criticism of the regulatory emphasis on equality, proposing that there existed ample evidence of the “enormous difficulty of translating known information about a stock into an estimate of true value” while declaring that success was often tied to the efforts of individuals with “superior intellect and judgment.”<sup>63</sup> A law professor who had worked as an SEC

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57. See Karmel, *supra* note 53, at 262.

58. See *SEC v. Chi. Helicopter Indus.*, No. 79-C0469, 1980 U.S. Dist. LEXIS 17214, at \*10 (N.D. Ill. Jan. 18, 1980) (finding that the SEC’s construction of Rule 10b-5 to require disclosure of allegedly illegal conduct “would never succeed in its purpose of bringing such disclosure to the shareholders”), *vacated*, *SEC v. Chi. Helicopter Indus.*, No. 7-C0469, 1980 U.S. Dist. LEXIS 17022 (N.D. Ill. March 7, 1980).

59. See generally Milton H. Cohen, “*Truth in Securities*” Revisited, 79 HARV. L. REV. 1340 (1966).

60. Proposed Amendments to Annual Report Form, Securities Act Release No. 6176, Exchange Act Release No. 16,496, 19 SEC Docket 186 (Jan. 15, 1980) (“These changes are designed both to facilitate the integration of these two systems [i.e., 1933 Act and 1934 Act disclosure] into the single disclosure system long advocated by many commentators and to reduce current impediments to combining informal shareholders communications, such as annual reports to shareholders, with official Commission filings.”).

61. Defined only by case law, “insider trading” describes the unlawful practice of using confidential corporate information obtained in breach of a duty owed to either the corporation or its source. See *United States v. O’Hagan*, 521 U.S. 642, 643 (1997).

62. See HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET passim* (1966).

63. BURTON G. MALKIEL, *A RANDOM WALK DOWN WALL STREET: THE TIME-TESTED STRATEGY FOR SUCCESSFUL INVESTING* 190 (6th ed. 1996).



accountant coined the phrase “The Myth of the Informed Layman.”<sup>64</sup> The “myth” referenced the unproven idea that investors were actually reading the formal document (laden with jargon and technicalities) prior to stock purchases. The professor concluded that he had “reluctantly come to the conclusion that the Securities Act of 1933 [was] not operating as it should and that the prospectus [had] become a routine, meaningless document which [did] not serve its purpose.”<sup>65</sup>

#### B. THE PERIOD OF ACCOMMODATION (C. 1980-PRESENT)

Meanwhile, the prior era’s tolerance of litigation meant that more cases would travel up to the higher courts, at times resulting in SEC policies being blessed, negated, or altered. To wit, commencing in the 1980s, the nation’s highest court elucidated that omissions, non-events, and half-events might also mandate disclosure under the securities laws. In 1985, the Supreme Court held that a company in the midst of preliminary merger discussions had a duty to disclose the same to the public, thus broadening the notion of materiality.<sup>66</sup> That landmark Supreme Court decision was arguably more significant in blessing the fraud on the market theory, which inherently presumes that equal access to information precedes the most efficient of marketplaces:

“The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business. . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. . . .”<sup>67</sup>

The upshot from such thinking is that investors who can prove faulty disclosures often need not simultaneously prove reliance thereon.

Despite such occasional doctrinal victories, the Commission’s ensuing stance can still be characterized as accommodating: Disclosures prior to an offering of securities remained subject to review, while corrections to published filings—in lieu of litigation—remained the SEC

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64. Homer Kripke, *The Myth of the Informed Layman*, 28 BUS. LAW. 631 (1973).

65. *Id.* at 631.

66. *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

67. *Id.* at 241–42 (quoting *Peil v. Speiser*, 806 F.2d 1154, 1160–61 (3d Cir. 1986)).

action of choice.<sup>68</sup> Besides, Supreme Court case law giveth and taketh away—it was the high bench that had recognized that corporate statements could, on occasion, be protected by the First Amendment.<sup>69</sup>

To be sure, the most recent time period of communication regulation emphasized that the very mission of mandatory disclosure was being more deeply questioned by observers.<sup>70</sup> And commentators continued to note the questionable utility of forcing issuer information into the hands of investors (whether sophisticated or unsophisticated).<sup>71</sup> At times, a judicial counter-movement ensued, punctuated by the meteoric growth of complex derivative investments (which often defied simple or concise description).<sup>72</sup> As former SEC Chairman Richard Breeden stated in the Congressional hearings on the need to reform the “roll-up process” in limited partnerships, “I have taken a look at some of the documents filed with us in these roll-up transactions and I would like to meet the person who can understand all of the disclosures in some of those documents.”<sup>73</sup>

Paradoxically, in the years 1980 through the present, the federal courts, in the preambles to countless decisions addressing complex claims presented by a complex market, have remained steadfastly true to the cause of disclosure advanced during the New Deal.<sup>74</sup>

At the same time, Congress has acted to shield management speaking in good faith. The prime evidence of this protection is found

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68. See, e.g., Karmel, *supra* note 53, at 321 (noting the Commission’s then administrative remedies, which were said to be based upon “[t]he ability to compel issuers to correct filings”) and at 291 (noting the then possibility that “[a] disclosure statement [could] be approved without the necessity of compliance with [bankruptcy reorganization] provisions of the federal securities laws”).

69. See *First Nat’l Bank of Bos. v. Bellotti*, 435 U.S. 765 (1978).

70. See *supra* notes 63–69 and accompanying text.

71. See Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 692–95 (1984) (identifying as “[p]oorly supported rationales for mandatory disclosure” the notions that the process benefits both sophisticated and unsophisticated investors). Mr. Easterbrook went on to become Chief Judge of the 7th Circuit Court of Appeals. See <http://www.law.uchicago.edu/faculty/easterbrook>.

72. See H.R. REP. NO. 102-254 (1991).

73. *Id.* at 11 (comments of SEC Chairman Richard Breeden).

74. See, e.g., *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 299 (S.D.N.Y. 2003) (reiterating the “fundamental purpose” of the Securities Acts “to substitute a philosophy of full disclosure for the philosophy of *caveat emptor*” while unequivocally stating that “[e]very IPO at issue here is governed by the regulatory framework created by these Acts”).

in the “safe harbors” of the Private Securities Litigation Reform Act of 1995.<sup>75</sup>

The resulting mixed paradigm has been said to rely upon distinctions between “hard” and “soft” confidential information. “Affirmative disclosure requirements” have been generically identified in the following situations:

- (i) Where expressly required by SEC rules;
- (ii) Where pertaining to the required “Management Discussion” of forward-looking information;
- (iii) Where selective or inadvertent disclosure of material information has occurred;
- (iv) Where there exists a “duty to correct” or a “duty to update”; and
- (v) Where leaked information (or marketplace rumors) are attributed to the issuing company.<sup>76</sup>

The dual structure signaled that circumstances (as opposed to the New Deal mission) might define disclosure obligations. The scholars thus noted that significant disclosures might simply be beyond the investor’s ken.<sup>77</sup> Meanwhile, other authorities cried out for simplicity in pleadings<sup>78</sup> or condemned prolix legal documents outright.<sup>79</sup>

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75. See Private Securities Litigation Reform Act of 1995 § 102, 15 U.S.C. § 78u-5 (2006) (“Application of Safe Harbor for Forward Looking Statements”).

76. MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW 307 (4th ed. 2007).

77. See, e.g., LARRY D. SODERQUIST & THERESA A. GABALDON, SECURITIES LAW 182–83 (2d ed. 2004) (describing the mandatory disclosures of “stabilization” trading by underwriters as undercut by two related problems: (1) investors not understanding “stabilization,” and (2) investors watching market quotes having no way of learning that the practice is taking place).

78. See, e.g., FED. R. CIV. P. 8(a), (d) (mandating averments that are “short and plain,” and “simple, concise, and direct”); *Higgs v. Carver*, 286 F.3d 437, 439 (7th Cir. 2002) (Posner, J.) (“All that’s required to state a claim in a complaint filed in a federal court is a short statement, in *plain* (that is, ordinary, non-legalistic) *English*, of the legal claim . . . .”) (emphasis added) (quoting *Kirksey v. R.J. Reynolds Tobacco Co.*, 168 F.3d 1039, 1041 (7th Cir. 1999)).

79. See, e.g., RICHARD C. WYDICK, PLAIN ENGLISH FOR LAWYERS 2 (3d ed. 1994) (noting a “new intensity” in criticism of legal writing starting in the 1970s); ANTONIN SCALIA & BRYAN A. GARNER, MAKING YOUR CASE: THE ART OF PERSUADING JUDGES

Overall, conflicting goals and means presaged an era where drafters would rush to any form of guidance issued by an expertise federal agency.

### III. THE EMERGING HANDBOOK CASE LAW

*The Handbook thus may have been predestined for a primary role given the courts hunger for guidance. A few cases from recent years edify both the dangers and efficacy of the Handbook. In 2005, a California case reminded that a Rule 10b-5 violation (i.e., securities fraud)<sup>80</sup> could be premised upon drafting choices in an IPO prospectus.<sup>81</sup> In 2010, the Third Circuit clarified that audit opinions issued by third parties would also be subject to plain English review at the Commission.<sup>82</sup> In between, an SEC-commissioned study convened investor focus groups to evaluate the progress that had been made in simplifying corporate communications with the public. The study revealed mixed news when it concluded, “Overall, there were relatively few comments about specific language in the three [annual report] documents that made them difficult to use, and more issues with the length, text density and formatting of the documents.”<sup>83</sup>*

*Finally, in the landmark Dodd-Frank reform act of 2010,<sup>84</sup> the plain English requirements were expressly extended to client brochures authored by investment advisers, registered professionals who, in general, have been nudged as of late toward the center of the SEC radar screen.*

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24 (2008) (noting that in a recent Supreme Court case an appellant had taken seventeen pages to “discuss peripheral matters before setting forth the legal rule that governed the case”).

80. “Securities fraud” is wholly defined and largely combated (either by the SEC or private plaintiff) via Rule 10b-5. Rule 10b-5 is a generic prohibition that (through successive sub-divisions) outlaws fraudulent schemes, misstatements, and practices in connection with the purchase or sale of securities. *See* 17 C.F.R § 240.10b-5 (2010).

81. *In re* Netflix, Inc. Secs. Litig., No. C 04-2978 WHA, 2005 U.S. Dist. LEXIS 30992, at \*18 (N.D. Cal. Nov. 18, 2005) (“[P]laintiffs allege that defendants ‘buried’ their churn definition in press releases and SEC filings, and sometimes obscured it by not stating it in ‘plain-English.’”).

82. *See* Malack v. BDO Seidman, LLP., 617 F.3d 743, 750 (3d Cir. 2010).

83. ABT SRBI INC., FINAL REPORT: FOCUS GROUPS ABOUT PLAIN ENGLISH DOCUMENTS 15 (May 2008).

84. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, § 1032, 124 Stat. 1376, 2006–07 (2010).

## A. THE CASE LAW'S EARLY YEARS

Early after its passage, opportunistic litigants began attempting to use the plain English standard as a sword.<sup>85</sup> In a 1999 insurance action, the plaintiffs' brief cited the Handbook for the premise that the defendant insurance company had improperly described its conversion from mutual insurer to stock insurer in a written plan.<sup>86</sup> While the resulting decision did not list the Handbook as guidance, the case was ultimately decided in favor of the plaintiffs.<sup>87</sup> Tellingly, the court stated, "The officers of Provident Mutual breached their duty of disclosure because the policyholder information statement they disseminated unfairly describe[d] the plan of conversion and thus prevented policyholders from making an informed vote on the plan."<sup>88</sup>

In a 2001 footnote, the Eighth Circuit Court of Appeals criticized a poorly written plea agreement for not following the Handbook's guidance on brevity.<sup>89</sup> In highlighting one sentence in the plea agreement that exceeded fifty words, the Court noted that "as part of its 'Plain English' reforms, [the Commission] recommends that sentences in the plain English sections of prospectuses should be limited to twenty-five to thirty words."<sup>90</sup>

Over time, the Handbook and its attendant themes rose to the level of outcome determinacy. Interestingly, one of the earliest cases to rely heavily upon the SEC's plain English crusade appeared in a bankruptcy decision.<sup>91</sup> In a case centering on the terms of a "Mirror Loan Note," the

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85. See *infra* notes 86-120 and accompanying text.

86. See Brief for Appellants at 26, *Butler v. Provident Mut. Life Ins. Co.*, 42 Pa. D. & C.4th 484 (Pa. Commw. Ct. 1999) (No. 0562 CD 1999), 1999 WL 33940642 (appellants' brief contesting appellees' use of the Handbook to support its claim).

87. *Butler v. Provident Mut. Life Ins. Co.*, 42 Pa. D. & C.4th 484, 505 (Ct. Com. Pl. 1999).

88. *Id.* The court more fully explained as follows:

A statement can be non-fraudulent but still be unfair. Therefore, to fairly describe the proposed conversion, the information statement must not generalize the risks of the plan while specifying its benefits, must not omit information needed to give a balanced discussion to critical components of the plan, and must not fail to explain certain important words and phrases. The court finds that the information statement Provident provided to policyholders did all those things.

*Id.* 498.

89. See *United States v. Taylor*, 258 F.3d 815, 819 n.3 (8th Cir. 2001).

90. *Id.*

91. *In re Nutritional Sourcing Corp.*, 398 B.R. 816 (Bankr. D. Del. 2008).

court was challenged to find a definition of “trade creditor.”<sup>92</sup> The definition offered by the debtor limited repayment to a finite list of providers of certain grocery goods for resale; the objectors to the plan proposed a broader construction that included *any* trade creditor.<sup>93</sup> In denying the arguments that the term “trade creditor” had an unambiguous meaning and that the term was supplemented by a trade usage definition, the court looked to prior filings submitted by the debtor company to the Commission.<sup>94</sup> From these filings, the bench gleaned (by virtue of absence of explanation) the debtor’s intent:

SEC disclosure documents are required to be written in plain English to assist the public’s interpretation of those documents.<sup>95</sup> Though the language in . . . SEC filings [by the debtor company] does not prove what the contracting parties took the term “trade creditor” to mean when they executed the Mirror Loan Note, if the term was meant to assume its grocery industry meaning, under the plain English rule, [the debtor] should have indicated the distinction in its SEC filings. It is logical to assume that not all potential investors . . . were versed in the grocery industry; as such, [the debtor] had the burden to take that into account in drafting their SEC filings. That [the company] did not provide an explanation of the term “trade creditor” makes me seriously question whether that term really was meant to cover only providers of grocery and other merchandise for resale as [the debtor’s official] contends.<sup>96</sup>

As a result, the court rejected a proposed settlement on the basis of its unfairness to the broader class of creditors.<sup>97</sup> Of significance is the court’s reasoning not only in turning to the SEC filings of a public company debtor but, in turn, finding 1) prospective interpretative guidance in those filings,<sup>98</sup> and 2) universal definition in the presence of a failure to specifically define an operative term.<sup>99</sup> In sum, the fate of a

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92. *Id.* at 825,

93. *Id.* at 822.

94. *Id.* at 820.

95. Plain English Disclosure, Securities Act Release No. 7497; 63 Fed. Reg. 6370, 6371 (Feb. 6, 1998).

96. *In re Nutritional Sourcing Corp.*, 398 B.R. at 829.

97. *Id.* at 838 (“Though the definition serves the interests of the Plan Proponents, it is not in the interests of the ‘non-goods’ trade creditors.”).

98. *See id.*

99. *Id.* at 829 (“That [the debtor] did not provide an explanation of the term ‘trade creditor’ [in the SEC filings] makes me seriously question whether that term was [really] meant to cover only providers of grocery and other merchandise for resale as [debtor] contends.”).

public company placed into bankruptcy was in large part decided by the writing protocol of its securities regulator.

#### B. TAKING CENTER STAGE

Years later, in a California securities fraud action, the court overtly utilized the SEC plain English standards to uphold the disclosure of a company accused of hiding the ball.<sup>100</sup> In the *Netflix* case, a shareholder class alleged that the entertainment distribution company had led investors to believe that the churn rate (i.e., the ratio of cancelled subscribers to continuing subscribers) was a common parlance, when it was in fact a unique term.<sup>101</sup> Additionally, the plaintiffs alleged that the defendants had “buried” the churn definition in press releases and SEC filings (and one public appearance) by not stating it in plain English.<sup>102</sup>

Although the court ultimately found that disclosure could have been clearer, the subject information was not found to rise to the level of “misleading” because it was adequately and repeatedly disclosed.<sup>103</sup> The court used the occasion to expand upon plain English by stating its support for the general adage that “a public release, filing or prospectus can be misleading even though every sentence therein is literally true.”<sup>104</sup> Regarding the specific allegations concerning the churn rates, the court held that “[t]here are no Plain-English definitions of these financial measures. They are, like all statistics, artificial *constructs*.”<sup>105</sup> Such constructs being unique to the company (termed “builder of the financial measure”), and frequently disclosed, they did not constitute fraudulent statements.<sup>106</sup> It was also found that the statements did not support the claims regarding violation of more pointed SEC regulations; most importantly, the plaintiffs were said to have not cited any SEC statute or regulation barring this unique form of disclosure (i.e.,

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100. *In re. Netflix, Inc. Secs. Litig.*, No. C 04-2978 WHA, 2005 U.S. Dist. LEXIS 30992, at \*28 (N.D. Cal. Nov. 18, 2005).

101. *Id.* at \*26–29.

102. *Id.* at \*21–24.

103. *Id.* at \*28–29.

104. *Id.* at \*26 (citing *SEC v. C.R. Richmond & Co.*, 565 F.2d 1101, 1106–07 (9th Cir. 1977)).

105. *Id.* at \*28–29.

106. *Id.*

although plain English was factored in, a Rule 421 analysis was not triggered).<sup>107</sup>

Thus, *Netflix* showcases a federal court utilizing plain English to excuse a form of corporate disclosure alleged to constitute securities fraud. Noteworthy is that the analysis arguably could have been unnecessary, had the Commission not previously established a standard for corporate statements that valued the statements' ultimate communicative effect upon the lay reader.<sup>108</sup>

More recently—and perhaps inevitably—the Handbook took center stage in one of the many mortgage crisis cases stemming from the recession that started in 2008. In *Malack v. BDO Seidman*, the Third Circuit was asked to consider approval of the plaintiff-friendly “fraud created the market” theory of securities fraud.<sup>109</sup> The theory provides a controversial but expedient alternative to the statutory “fraud on the market theory” (which eliminated the reliance requirement for class action plaintiffs).<sup>110</sup> One ground for such expansion relies on the proposal that registered securities, having been described in a registration statement filed with the SEC, carry their own aura of marketability.<sup>111</sup>

The putative plaintiff shareholder class in *Malack* sought damages from the accounting firm that had provided the audit opinions necessary to complete the SEC filings.<sup>112</sup> The theory posited Rule 10b-5 violations caused by inadequate audits, which enabled SEC registration (which, in turn, made the subject notes marketable to the public).<sup>113</sup> While acknowledging as a foregone conclusion that the SEC “will consider whether the applicable disclosure items are explained in sufficient detail and with sufficient clarity,”<sup>114</sup> the Court negated the possibility of an SEC “merit” review qualifying all registered securities as marketable.<sup>115</sup>

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107. *Id.* at \*26.

108. *See, e.g.*, JOHN C. COFFEE, JR. & HILLARY A. SALE, *SECURITIES REGULATION: CASES AND MATERIALS* 98–100 (11th ed. 2011) (describing the “traditional attitude” of the SEC in strictly prohibiting communications prior to the prospectus “arousing and stimulating” investor interest).

109. *Id.* at 747–49.

110. *See* *Basic Inc. v. Levinson*, 485 U.S. 224, 241–42 (1988).

111. *Malack*, 617 F.3d at 747–49. The “fraud created the market” theory was first accepted by *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981).

112. *Id.* at 744.

113. *Id.* at 745.

114. *Id.* at 750 (quoting 1 THOMAS LEE HAZEN, *TREATISE ON THE LAW OF SECURITIES REGULATION* § 3.7[2] (Thomson West 6th ed. 2010)).

115. *See generally* *Malack v. BDO Seidman, LLP*, F.3d 743, 752 (3d Cir. 2010).



The *Malack* court noted that “[t]he SEC does not read all of the publicly available information about an offering and then determine the legitimate price for the security . . . [n]or does [it] endorse any of the documents involved in the issuance of securities.”<sup>116</sup>

Despite not accepting the notion that the SEC guaranteed investments, the *Malack* court did unquestionably accept the idea that SEC plain English review regarding quality of communications attended all registration statement filings.<sup>117</sup> Thus, while stymieing the attempt by a plaintiff class to substitute SEC registration as proof of reliance, the Third Circuit nonetheless reaffirmed the expectation that the Commission would inveigle examination of the comprehensibility of disclosure with the question of registration itself. In essence, the *Malack* court fulfilled the promise—that a new, substantive review awaited countless registrations to come—when the agency’s chair had publicly warned, “[W]e’re dead serious about [P]lain English.”<sup>118</sup>

Additionally, other cases from the last decade are evidence of the Handbook’s significance in encouraging a more equitable reading of documents—whether or not such reading expressly relied on the Handbook or not.<sup>119</sup> Not surprisingly, buoyed by courts deciding cases in and out of the field of securities, the SEC succeeded in adding a requirement to Congress’ 2010 reforms of the financial services industry obligating those specifically bearing the title of “investment adviser” to likewise be held to the dictates of plain English.<sup>120</sup>

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116. *Id.* at 750 (quoting *Joseph v. Wiles*, 223 F.3d 1155, 1165–66 (10th Cir. 2000)).

117. *Id.* at 750.

118. *See, e.g.*, Christopher Cox, Chairman, SEC, Keynote Address to the Center for Plain Language Symposium: Plain Language and Good Business (Oct. 12, 2007), available at <http://www.sec.gov/news/speech/2007/spch101207cc.htm>.

119. *See, e.g.*, *Charles v. Pepco Holdings, Inc.*, 314 F. App’x 450, 454 (3d Cir. 2008) (Ambro, J., dissenting) (stating that the required notice of conversion of plaintiff’s pension plan to a “cash balance” plan was inadequate because it failed to state in plain English that the new plan could reduce some benefits); *see also* *DeBlasio v. Merrill Lynch & Co.*, No. 07 Civ 318(RJS), 2009 WL 2242605, at \*5 (S.D.N.Y. July 27, 2009) (noting that the New York Stock Exchange suggests that its member firms make disclosures accompanied by a “concise document, preferably on one or two pages, written in plain English, and referring customers to places where additional and more detailed disclosure is available”).

120. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub L. No. 111-203, §956, 124 Stat. 1376, 1905–06 (2010).

#### IV. ANALYSIS OF HANDBOOK INFLUENCE

Regardless of the wisdom of the approach (or the generational approaches attending it), it has been made manifestly clear that the mandates of public disclosure in the distinctly American model of financial regulation impose strict, often unforgiving requirements on public corporations and their agents. That such agents are continually subject to lawsuits and SEC penalties is not surprising. Experts have long and frequently opined that plain English has become a de facto area of review within the Commission.<sup>121</sup> However, perhaps the growing utilization of a style manual to complete the regulatory mission is still a bit unexpected.

In sum, irrespective of the Commission's pronounced scope and the optimal utility of the Handbook, plain English has seeped into the prosecutorial and judicial consciences and become a concrete factor in cases alleging shortcomings by company management. The following four observations seem supported:

*1. Starting outside of securities law, plain English commenced serving a substantive role.*

That role may have been a surprise, but it definitely filled a void in the judicial psyche.<sup>122</sup> Criminal courts, civil litigation, and specialty courts all evidenced a willingness to adopt the English standard boldly put forth by an administrative agency in the last millennium.<sup>123</sup> And such adoption did not rely on the SEC's statutory changes to Rule 421.

*2. Within the field of securities law, the role of plain English is speeding to encompass more documents and obligations.*

Noteworthy is the recent SEC expansion of its 1998 "pilot." Amendments to the rules governing the required filings of the nation's 10,000 investment advisers took effect in 2010.<sup>124</sup>

Further, in 2010, the SEC finalized rules extending plain English to both mutual fund disclosure documents<sup>125</sup> and the filings attending asset-

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121. See, e.g., 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 3.7[2] (Thomson West 6th ed. 2010).

122. See *supra* note 86 and accompanying text.

123. See *supra* Part VI.

124. Amendments to Form ADV, Investment Advisers Act Release No. 3060, 17 C.F.R. pt. 275, 279 (Aug. 12, 2010).

backed securitization.<sup>126</sup> It is thus clear that, regardless of the import any one circuit accords SEC review of documents, Wall Street's primary regulator has once again raised expectations concerning the efforts devoted to customer communications.

*3. On a granular level, there exist legal doctrines surviving at the cusp between dogma and law that may be shaped by plain English.*

"Fraud created the market" is a theory that may one day enjoy increased popularity throughout the circuits;<sup>127</sup> if that day arrives, it will likely be due to the presumption of marketability that is linked to a plain English analysis.

Likewise, an array of related defenses, theories, and hypotheses are intrinsically tied to the degree of government review of corporate disclosures.<sup>128</sup> Thus, as Commission involvement with investor communications is both broadened and more publicized, the very heart of securities fraud claims will not go untouched.<sup>129</sup>

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125. See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Securities Act Release No. 8861, Investment Company Act Release No. 28,064, 72 Fed. Reg. 67,790 (proposed Nov. 30, 2007) (requiring "key information to appear in plain English in a standardized order at the front of the mutual fund statutory prospectus").

126. See Asset-Backed Securities, Securities Act Release No. 9117, Exchange Act Release No. 61,858, 75 Fed. Reg. 23,328 (proposed Apr. 7, 2010) ("Today, we also remind issuers of the importance of providing disclosure in compliance with our plain English rules"); see also Paul Wilkinson, *Asset Backed Securities: Disclosure Regulation or Substantive Legislation?*, PAUL WILKINSON BLOG (Oct. 28, 2009), <http://paulwilkinson.com/2009/10/28/asset-backed-securities-disclosure-regulation-or-substantive-legislation/>.

127. See *supra* notes 64, 106–09 and accompanying text.

128. See *supra* Parts II and III.

129. See, e.g., *In re Netflix, Inc. Secs. Litig.*, No. C 04-2978 WHA, 2005 U.S. Dist. LEXIS 30992, at \*24–29 (N.D. Cal. Nov. 18, 2005) (using Plain English to resolve the question of whether a "churn" calculation had been effectively communicated, and ultimately dismissing plaintiff's complaint); *Malack v. BDO Seidman, LLP*, 617 F.3d 743 (3d Cir. 2010) (finding Plain English to fail to justify the controversial "fraud created the market theory"); *In re PEC Solutions, Inc. Secs. Litig.*, 125 F. App'x 490 (4th Cir. 2005) (denying plaintiff's claims of fraud via misleading annual report statements about the issuer's financial health in light of the "plain English" disclosure of the risk factors); *DeBlasio v. Merrill Lynch & Co.*, No. 07 Civ 318(RJS), 2009 WL 2242605 (S.D.N.Y. July 27, 2009) (noting the necessity that "cash sweep program" disclosures be written in plain English); Wilkinson, *supra* note 126 (highlighting the

4. *On a national level, the persisting emphasis on the mission of investor disclosure serves to perhaps obfuscate the problems attending an ever-complicating marketplace.*

The history of the attempts by Congress and the SEC to evince an omnipotent scrutiny of issuers and their communicative efforts has resulted foremost in supply side regulation that, regrettably, fails to value the duties of the investor. This omission is startling, particularly given the attention to preemptive layman education currently attending regulatory remedies overseas.<sup>130</sup>

In his 2002 book, former SEC Chairman Levitt told of an aggressive plan to not only bring clear communications to the public, but also of the need to avoid corporate accounting disasters by simplifying an ever expanding set of disclosures:

Companies now need to translate only certain portions of the prospectus . . . into plain English. By extending the plain English rule to footnotes and possibly other disclosure documents, investors of all sophistication levels will be able to decipher the meaning of corporate legalese. This would be a time-consuming effort. It took the SEC three years to get companies to adopt plain English in prospectuses. But it would be one of the most pro-investor steps the SEC could take to avoid future [accounting frauds such as] Enrons.<sup>131</sup>

Levitt is often heralded as one of the greatest SEC Chairs and a champion of the small investor.<sup>132</sup> But his characterization of market communication exchanges, at times, reveals a lingering paternalism that

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interrelated nature of substantive and “technical” analyses in the context of disclosures to investors in asset-backed securities).

130. See, e.g., J. Scott Colesanti, *Harmony or Cacophony: A Preliminary Assessment of the Responses to the Financial Crisis at Home and in the EU*, 1 Harv. Bus. L. Rev. Online 60, 62–63 (Apr. 8, 2011), <http://www.hblr.org/?p=1112> (“While the SEC appears poised to remain true to its aged crusade to shield the sheep investor from slaughter, the EU perhaps invites more useful debate on the role of the purchaser in the ever-complicating bazaar.”).

131. ARTHUR LEVITT WITH PAULA DWYER, TAKE ON THE STREET: WHAT WALL STREET AND CORPORATE AMERICA DON’T WANT YOU TO KNOW, WHAT YOU CAN DO TO FIGHT BACK 157 (Pantheon Books 2002).

132. See, e.g., *An Interview with Arthur Levitt*, CHARLIE ROSE (Mar. 2, 2001), available at [www.charlierose.com/guest/view/2134](http://www.charlierose.com/guest/view/2134).

serves to obfuscate the need for investor accountability.<sup>133</sup> Regrettably, at the present time, such accountability attends foreign efforts at financial crisis remedies but has escaped attention in American reforms.<sup>134</sup> Perhaps more tellingly, Levitt's hope for a palpable expansion of SEC Rule 421 belies both the purely exhortatory nature of much of the Handbook, as well as the ability of the public to even readily comprehend communications from the Commission.<sup>135</sup>

Clearly, repeat efforts at forcing the corporate author's hand reveal a mistrust of America's public companies. On some level, such mistrust is possibly justified in light of the nagging persistence of pernicious fraud. Yet, even the casual observer of government regulatory measures must question the wisdom of a protocol that largely ignores the responsibilities of the end user at moments of import.<sup>136</sup>

Of relevant note is a 2008 study commissioned by the SEC which convened paid focus groups in four cities to study the progress of the plain English initiative.<sup>137</sup> While the report is at times hopeful,<sup>138</sup> the reader cannot help but gaze at the lay investors' shock when confronting annual corporate shareholder reports.<sup>139</sup> Like the Handbook, the report is freely available on the SEC website. However, both documents may

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133. LEVITT, *supra* note 131, at 82 (noting that “[s]mall investors often can’t resist . . . hyperbole.”).

134. *See supra* note 130 and accompanying text.

135. In more recent times, SEC Chairs have noted the expansion of the Handbook's initial reach. *See* Christopher Cox, Chairman, SEC, Speech Before the Subcommittee on Contracting and Technology and the Committee on Small Business, U.S. House of Representatives: Plain Language — The Benefits to Small Business (Feb. 26, 2008), available at <http://www.sec.gov/news/testimony/2008/ts022608cc.htm> (“The SEC has many plain English initiatives underway. Our plain English requirements now apply to both offering documents and periodic reporting by public companies. They apply to mutual fund disclosure, which benefits millions of ordinary Americans. And they apply to our own communications to (sic) the public.”).

136. *See, e.g.*, Jake Zamansky, *SEC Struggles with Investor-Protection Rules*, FORBES (Jan. 24, 2012, 1:20 PM), <http://www.forbes.com/sites/jakezamansky/2012/01/24/sec-struggles-with-investor-protection-rules/> (asserting that the SEC had “failed to change the ‘accredited investor’ rule in the most important ways”).

137. ABT SRBI INC., *supra* note 83.

138. *Id.* at 10 (“[I]t’s getting there . . .”).

139. *See id.* at 6 (“‘You almost need an accounting degree and a business degree to understand everything that’s in [t]here’. . . . ‘I’d have to take a week’s vacation to read this.’”).

foremost beg the question of to whom any disclosure—plain, complicated, short or long—is directed.<sup>140</sup>

### CONCLUSION: ON SIMPLICITY AND CORPORATIONS

The call for more securities industry disclosure documents to be subjected to plain English standards sounds louder than ever. In 2011, both existing and newly registered investment advisers were tasked with providing clients with “brochure supplements written in plain English.”<sup>141</sup> In years to come, the addition of investment products seems likely to trigger more plain English requirements.<sup>142</sup>

Thus, as the age of mandatory disclosure enters its third phase (i.e., post-Dodd Frank), the SEC’s traditional reliance on New Deal reformism, expedient common law, and the nation’s unique vision of fairness will not necessarily expand in meaningful fashion to embrace novel forms of corporate evasiveness. Consequentially, robust enforcement programs may become expediently centered on the written word itself. The resulting dual-edged sword is that the government will only be able to cabin bad faith reduced to formal writings, perhaps pushing more questionable forms of disclosure further from regulatory reach.

Decades ago, William O. Douglas warned (presciently) that the Securities Act is ultimately only as beneficial as the corporations it seeks to demystify:

To understand [the Act], we must “turn back the clock” to simpler days. We must unscramble our large forms of organization. We must start anew to bring back into business organization a simplicity

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140. See Kripke, *supra* note 64, at 633.

141. Amendments to Form ADV; Extension of Compliance Date, Investment Advisers Act Release No. 3129, 100 SEC Docket 374 (Dec. 28, 2010) (to be codified at 17 C.F.R. pts. 275, 279). The investment adviser brochure supplement relays background information on the registered investment adviser. See generally Charles F. Hertlein, Jr., *Attention Investment Advisers: Plain English Brochure Rule Adopted*, NAT’L LAW REVIEW (Aug. 17, 2010), available at <http://www.natlawreview.com/article/attention-investment-advisers-plain-english-brochure-rule-adopted> (describing the newly required “Part 2” of the brochure obligating the writer to describe 19 items in narrative format).

142. See, e.g., *supra* notes 29, 125–26 and accompanying text.

and directness consistent more with our beginnings than with our  
present status . . . .<sup>143</sup>

Significantly, the call for a more grass roots approach to legalese has spread to other regulated fields, such as health insurance. One of the less controversial aspects of the 2009 Health Care Reform law<sup>144</sup> is the requirement that, starting in September 2012, insurers use “plain language and 12-point type” in marketing materials.<sup>145</sup>

Perhaps most importantly, the responses to the malingering economic crisis call out for a reevaluation of the “wolves/sheep” metaphor introduced contemporaneously with the federalizing of securities regulation.<sup>146</sup> Specifically, the continuing emphasis on the simplification of corporate disclosures<sup>147</sup> arguably belies a leviathan financial services marketplace ever distancing itself from its clients. Further, a rush to loudly discipline transgressors—long a staple of American securities regulation<sup>148</sup>—forestalls a rethinking of these isolated camps. While true reformers perhaps hope for a shift away from decades-old paternalism, the pragmatists might find solace in practicalities within reach: Ensure that all future attempts by the Commission to improve communications come with the clear warning that such guidelines do not have the weight of statute for purposes of liability.<sup>149</sup> To forgo the lesson of the Plain English Handbook is to readily accept that a litigious culture facing a complex market may be forced to rely on style manuals to regulate disputes.

143. Douglas, *supra* note 41 at 529–30.

144. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

145. Wendell Potter, *This Just In, Insurers Required To Speak Plain English*, THE CTR. FOR PUB. INTEGRITY (Feb. 13, 2012), available at <http://njtoday.net/2012/02/13/analysis-this-just-in-insurers-required-to-speak-plain-english/> (noting that the change, which was intended to compel those offering health care benefits to provide consumers with “more clearly written information about what their benefit plans cover,” had been actively opposed by lobbyists for the industry).

146. Douglas, *supra* note 41.

147. See generally J. Scott Colesanti, *Financial Regulatory Reform and the Retail Investor*, N.Y. L.J., Aug. 18, 2009 (noting that the 2009 proposed regulatory reform of the White House advocated granting the SEC even more “expanded authority to promote transparency in investor disclosures”).

148. See Yin Wilczek, *FINRA Sanctions in 2011 Jump 51 Percent to \$68 Million*, *Report Says*, 44 SEC. REG. & L. REP. 565 (Mar. 19, 2012).

149. See, e.g., 17 C.F.R. § 243.102 (2010) (expressly stating that civil liability cannot be tied to a Regulation FD violation).