No. 13-317

In The Supreme Court of the United States

HALLIBURTON CO. AND DAVID LESAR, PETITIONERS

v.

ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND, INC., RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF FORMER SEC CHAIRMEN WILLIAM H. DONALDSON AND ARTHUR LEVITT, JR. AS AMICI CURIAE SUPPORTING RESPONDENT

EDWARD LABATON
LABATON SUCHAROW LLP
140 BROADWAY
NEW YORK, NY 10005
(212) 907-0850

JAMES A. FELDMAN
Counsel of Record
5335 WISCONSIN AVE., NW
WASHINGTON, DC 20015
(202) 730-1267
WEXFELD@GMAIL.COM

MEYER EISENBERG
2000 PENNSYLVANIA AVE., NW
WASHINGTON, DC 20006
(202) 974-1594

QUESTION PRESENTED

Amici will address the following question:

Whether the proposition that the market prices of actively traded securities generally reflect publicly available information is a premise of the federal securities laws and regulations.

TABLE OF CONTENTS

Interest of the Amici 1

Statutes and Rules Involved.. 3

Summary of Argument 3

Argument.. 7

I. Congress fashioned the securities laws on the premise that market prices reflect publicly available information 8

II. SEC rules have long relied on market prices generally reflecting publicly available information 11

A. The SEC's selective disclosure prohibition, like other insider trading prohibitions, is premised on the need to maintain the relationship between publicly available information and market prices.. 11

B. The Commission's integrated disclosure and shelf registration regulations operate on the same premise 13

C. Other rules also are premised on the fact that market prices generally reflect publicly available information.. 18

D. If the premise of these regulations is mistaken, the logical response would be further and more burdensome disclosure requirements 20

III. Section 10(b) and Rule 10b-5 were intended to and do have a broader scope than Section 18(a).. 22

Conclusion 25
Appendix: Statutory and Regulatory provisions 1a

TABLE OF AUTHORITIES

Cases:

Basic, Inc. v. Levinson, 485 U.S. 224 (1988) 3
Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299 (1985).................................. 7
Dura Pharmaceuticals v. Broudo, 544 U.S. 336 (2005).. 7
Erica P. John Fund, Inc. v. Halliburton Co., 131 S. Ct. 2179 (2011)... 7
Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).. 24
J.I. Case Co. v. Borak, 377 U.S. 426 (1964) 7
Merck & Co., Inc., v. Reynolds, 559 U.S. 633 (2010).. 7
SEC v. Zandford, 535 U.S. 813 (2002) 24
Schleicher v. Wendt, 618 F.3d 679 (7th Cir. 2010).. 3
Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007)... 7

Statutes and Regulations:

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1797 19
Securities Act of 1933, 15 U.S.C. 77 *et seq* 13
15 U.S.C. 77e.. 13
15 U.S.C. 77f 13
Securities Exchange Act of 1934, 15 U.S.C. 78 *et seq*. 8

***Statutes and Regulations* (cont.):**

15 U.S.C. 78b 8
15 U.S.C. 78b(3) 8-9
15 U.S.C. 78b(4) 9
15 U.S.C. 78j 6, 23, 24
15 U.S.C. 78j(b) 24
15 U.S.C. 78m 14
15 U.S.C. 78r(a) 6, 22, 23, 24
17 C.F.R. 229.1 *et seq* 14
17 C.F.R. 230.415(a)(1)(x) 16, 17
17 C.F.R. 230.415(a)(5) 16
17 C.F.R. 230.424(b)(2) 16
17 C.F.R. 239.13 14
17 C.F.R. 239.13(b)(1) 14
17 C.F.R. 240.10b-5...................................3, 6, 22, 23
17 C.F.R. 240.13(d)... 19
17 C.F.R. 240.15c2-12(b)(5)(i)(C) 18
17 C.F.R. 243.100 11

Miscellaneous:

H.R. Rep. No. 1383, 73rd Cong. 2d Sess. (1934) 9
H.R. Rep. No. 910, 100th Cong. 2d Sess. (1988) 12
S. Rep. No. 1455, 73rd Cong. 2d Sess. (1934) 9
Securities Investor Protection Act of 1991: Hearing Before the Subcomm. On Securities of the Senate Comm. On Banking, Housing and Urban Affairs, 102d Cong. 1st Sess. (1991) 7
45 Fed. Reg. 5972 (Jan. 24, 1980)....................... 15, 16
46 Fed. Reg. 41902 (Aug. 18, 1981) 16

Miscellaneous **(cont.):**

47 Fed. Reg. 11380 (Mar. 16, 1983) 15

48 Fed. Reg. 46801 (Oct. 14, 1983) 15

48 Fed. Reg. 52889 (Nov. 23, 1983) 16, 17, 18

65 Fed. Reg. 51716 (Aug. 24, 2000) 11, 12, 13

72 Fed. Reg. 73534 (Dec. 27, 2007).................... 14, 15

75 Fed. Reg. 33100 (June 10, 2010)................... 18, 19

76 Fed. Reg. 34579 (June 14, 2011)................... 19, 20

Milton Cohen, *"Truth in Securities" Revisited*, 79 Harv. L. Rev. 1340 (1966).............................. 14

Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Sta. L. Rev. 385 (1990) 8

Instructions to SEC Form S-3, https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&ved=0CCcQFjAA&url=https%3A%2F%2Fwww.sec.gov%2Fabout%2Fforms%2Fforms-3.pdf&ei=XI_uUsSFBIKsyAHt9IH4Dg&usg=AFQjCNFQP2nobmFhfVBXMILnyQyhDLUKPQ&sig2=rUWNv9kN-pefJ5Y5SILh4A&bvm=bv.60444564,d.aWc 15

In The Supreme Court of the United States

No. 13-317

HALLIBURTON CO. AND DAVID LESAR, PETITIONERS

v.

ERICA P. JOHN FUND, INC., FKA ARCHDIOCESE OF MILWAUKEE SUPPORTING FUND, INC., RESPONDENTS

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF FORMER SEC CHAIRMEN WILLIAM H. DONALDSON AND ARTHUR LEVITT, JR. AS AMICI CURIAE SUPPORTING RESPONDENT

INTEREST OF THE AMICI

William H. Donaldson served as Chairman of the Securities and Exchange Commission (2003-2005, appointed by President George W. Bush).[1] He has

---

[1] The parties have consented to the filing of all briefs of amici curiae. No counsel for a party authored this brief in whole or in part, and no counsel for a party or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than amici curiae or their counsel made a monetary contribution to its preparation or submission.

also served as Chairman and CEO of the New York Stock Exchange; Chairman, President and CEO of Aetna Inc.; and Co-Founder, Chairman and CEO of Donaldson Lufkin and Jenrette (DLJ). He was the founding Dean and tenured Professor of Management at the Yale Graduate School of Management.

Arthur Levitt, Jr., served as Chairman of the Securities and Exchange Commission (1993-2001, appointed by President William J. Clinton). He has also served as Chairman of the American Stock Exchange and Chairman of the New York City Economic Development Corporation.

In the view of amici, the system of federal securities regulation is based in large part on the need to foster the confidence of investors in the integrity of securities prices and the securities markets. In particular, investors require confidence that the prices of actively traded securities reflect honest and public disclosures of information, as required by the securities laws. The SEC has long based disclosure requirements—as well as limitations on those requirements to make them less burdensome—on the well-founded premise that the prices of actively traded securities generally reflect publicly available information. Petitioners attack that premise. But if it were now to be rejected, the consequence would logically be a movement toward an increased and more burdensome set of regulatory and disclosure requirements to ensure the integrity of the securities markets and investor confidence in them.

STATUTES AND RULES INVOLVED

Pertinent statutes and rules are reproduced in an appendix to this brief. App., *infra*, 1a-5a.

SUMMARY OF ARGUMENT

The SEC and this Court have long recognized that private enforcement of the securities laws under Rule 10b-5, 17 C.F.R. 240.10b-5, and other provisions is essential to protection of the integrity of the nation's securities markets. Amici agree with that assessment, and believe that overruling *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), would disserve that important purpose. The premise underlying the *Basic* presumption is a limited form of the efficient capital markets hypothesis, *i.e.*, the proposition that the market prices of actively traded securities generally reflect publicly available information. *See Schleicher v. Wendt*, 618 F.3d 679, 682 (7th Cir. 2010) (Easterbrook, J.) ("When someone makes a false (or true) statement that adds to the supply of available information, that news passes to each investor *through the price of the stock.* And since all stock trades at the same price at any one time, every investor effectively possesses the same supply of information."). Amici will address the ways in which that key premise underlies the system of federal securities regulation and SEC rules.

I. Congress recognized from the very beginning of federal securities regulation the need to prevent the manipulation of securities prices through false or misleading disclosures. Accordingly, the reporting and disclosure regimes put in place by the federal securities laws have always been based in part on the need to ensure that truthful information is dis-

closed to the public so that such information can be reflected in securities prices. If that goal is achieved, securities prices will be more fair and will be perceived by investors to be more fair—fulfilling a key purpose of the securities laws and a crucial element in assuring the fairness and safeguarding the integrity of the securities markets.

II. The SEC has promulgated regulations that are specifically based on the premise that securities prices generally reflect publicly available information. For example, Regulation FD requires public, not selective, disclosure of material information to market analysts and others by officials and employees of public corporations. The rationale of that rule, like the rationale of the other rules regulating insider trading, is that selective disclosures destroy investor confidence, because some individuals are able to use selectively disclosed information to take unfair advantage of market prices that generally reflect only publicly available information. The regulation was designed to maintain the integrity of market prices by prohibiting such disclosures.

The SEC in a number of areas has also relied on the fact that market prices of securities reflect publicly available information to *decrease* the burden on firms under the securities laws. Thus, key SEC regulations governing integrated disclosure permit firms with significant public float to register their offerings using an abbreviated form that permits incorporating prior disclosures by reference, rather than repeating the same information. The justification for the integrated disclosure is that the market price will already have incorporated the previously

disclosed information, so that no further repetition or elaboration on that information is necessary.

Similarly, "shelf registration" rules permit firms to register securities for sale up to three years in advance of sale. Firms can thus take advantage of favorable opportunities to sell securities quickly with only a brief further disclosure about the specific securities being sold. Shelf registration rules are based on the premise that there is no need at the time of sale for disclosure of all of the information disclosed when the security was registered, because the market price of the security at the time of sale will already reflect the disclosures in the shelf registration. The only information that has to be specifically disclosed at the time of sale is the new information about the particular sale, which the market can be expected easily and quickly to absorb. Other rules, too, requiring disclosures by municipal bond issuers and beneficial owners of securities-based swaps are also premised on the close relationship between market prices and publicly available information.

If the SEC could not rely on market prices of actively traded securities generally to reflect publicly available information, then the rationale of all of these regulations—and, indeed, a grounding principle of federal securities regulation generally—would be called into doubt. Markets for actively traded securities today are widely covered by analysts administering trillions of dollars in mutual funds, pension funds, IRA accounts, and other pools of assets. If such markets cannot be expected to efficiently incorporate material information into the prices of securi-

ties, the logical result would be consideration of additional regulatory requirements to foster informational efficiency and investor confidence. These could include further and more burdensome regulations requiring securities issuers to select, highlight, and repeat particularly important information for investors. Such requirements would foster the ability of market prices to operate efficiently and to reflect important publicly available information, but they would also increase expenses for firms. Moreover, regulations that have *eased* the burdens on securities issuers in reliance on the informational efficiency of markets would have to be reconsidered in favor of the possibility of more stringent requirements for disclosing, highlighting, and publicizing material information.

III. Section 18(a) of the Securities Exchange Act, 15 U.S.C. 78r(a) creates a right of action against those who make false or misleading statements in certain SEC filings. Petitioners' amici argue that the supposed "eyeball" reliance requirements of Section 18(a) should be applied to Rule 10b-5 actions. The scope of Section 18(a), however, is much narrower than that of Section 10(b) and Rule 10b-5, because Section 18(a) extends liability only to those who actually make false or misleading statements in SEC filings. It does not extend, as does Section 10(b) and Rule 10b-5, to false and fraudulent statements and other manipulative devices and contrivances that are *not* filed with the SEC. To limit the action under Rule 10b-5 to the narrow scope of Section 18(a) would be to undercut a key provision of the Act, in violation of Congress's express intent.

ARGUMENT

The SEC and this Court have long recognized that "meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought . . . by the Department of Justice and the [SEC]." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007); *see*, *e.g.*, *Bateman Eichler, Hill Richards, Inc. v. Berner,* 472 U.S. 299, 310 (1985) ("[W]e repeatedly have emphasized that implied private actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action' ") (quoting *J.I. Case Co. v. Borak,* 377 U.S. 426, 432 (1964)).[2] Amici agree, and need not repeat those points.

In this brief, amici address the reliance of federal securities laws and regulations on the core premise of the fraud-on-the-market doctrine: that the market

---

[2] In recent years alone, the Commission has informed the Court of its view that private actions serve an essential role in its filings in this Court in *Erica P. John Fund, Inc. v. Halliburton Co.*, 131 S. Ct. 2179 (2011), *Merck & Co., Inc., v. Reynolds*, 559 U.S. 633 (2010), *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007), and *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005). As then-Chairman Richard Breeden explained in congressional testimony, the SEC "does not have adequate resources to detect and prosecute all violations of the federal securities laws," private actions therefore "perform a critical role in preserving the integrity of our securities markets," and such actions are "also necessary to compensate defrauded investors." *Securities Investor Protection Act of 1991: Hearing Before the Subcomm. On Securities of the Senate Comm. On Banking, Housing and Urban Affairs*, 102d Cong. 1st Sess. 15-16 (1991).

prices of actively traded securities, which are widely covered by investment advisors and analysts, generally reflect publicly available information. Rejecting that premise would undermine the rationale of many existing rules and suggest the need for more expensive and burdensome disclosure and publicity requirements, to ensure that markets incorporate publicly available information more reliably and efficiently into the prices of actively traded securities.

I. CONGRESS FASHIONED THE SECURITIES LAWS ON THE PREMISE THAT MARKET PRICES REFLECT PUBLICLY AVAILABLE INFORMATION

The close relationship between market prices and publicly available information—including in particular the need to protect the integrity of market prices from the influences of false and fraudulent information—has been a cornerstone of federal securities regulation from the beginning. Indeed, Congress made its concern with the integrity of market prices explicit when it enacted the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. 78 *et seq*.

1. Section 2 of the Act, entitled "Necessity of regulation," 15 U.S.C. 78b, "focuses almost exclusively on the critical importance of market prices." Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 Sta. L. Rev. 385, 391 (1990). A key goal of the Act was to "insure the maintenance of fair and honest markets." 15 U.S.C. 78b. But Congress found that "the prices of securities on [securities exchanges and over-the-counter markets] are susceptible to manipulation and control, and the dissemination of such prices gives rise

to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities." 15 U.S.C. 78b(3). In particular, false and fraudulent information disseminated by market participants has an effect on securities prices, at least until the truth ultimately comes out. Congress found that the result of that distortion of market prices can be to produce "widespread unemployment and the dislocation of trade, transportation, and industry, and [to] burden interstate commerce and adversely affect the general welfare." 15 U.S.C. 78b(4). The system of federal securities regulation was designed in part to combat threats to the integrity of market prices, *i.e.*, to ensure that honest, not fraudulent, information is reflected in market prices, on which investors may then rely.

The committee reports on the Exchange Act reflect the need to ensure that market prices reflect honest, not fraudulent, information. As the House Report explained, "[t]he idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers . . . brings about a situation where the market price reflects as nearly as possible a just price." H.R. Rep. No. 1383, 73rd Cong. 2d Sess. 11 (1934). Although "[t]he disclosure of information materially important to investors may not instantaneously be reflected in market value, . . . truth does find relatively quick acceptance on the market." *Ibid*. *See* S. Rep. No. 1455, 73rd Cong. 2d Sess. 68 (1934) ("Insofar as the judgment of either [buyer or seller] is warped by false, inaccurate, or incomplete information regarding the corporation, the market price fails to reflect the normal operation of the law of supply and demand.").

2. Congress's concerns in the 1930s are, if anything, even more cogent today. In many ways, modern markets have increased the possibilities for fraud and manipulation by means of false, deceptive, or fraudulent information that infects the market and is quickly reflected in market prices.

On the New York Stock Exchange alone, average daily trading volume has increased from 1.5 million shares in 1930-1939 to 1.975 billion shares in 2005-2009; even more shares trade on the NASDAQ, which did not exist in the 1930s.[3] Ticker tapes have been replaced by instantaneous transmission of news and high-speed trading. The growth of the markets and technology since the 1930s have tightened the relationship between information flow and market price.

Moreover, the modern tax code and other incentives encourage individuals to rely on the integrity of the markets. For instance, the nation's private retirement funding and college savings regime rests on tax-favored vehicles, such as IRAs, 401(k) plans, and 529 plans. These plans typically employ passive investment strategies and make routine purchases of well-diversified portfolios on a periodic (*e.g.*, pay-period) basis. Typically, the investor does not exercise individual discretion or have specific knowledge of the securities being purchased, let alone the opportunity for "eye-ball" reliance on an issuer's statements. The massive funds that are invested in reg-

---

[3] The New York Stock Exchange volume was extracted from the tables at http://www.nyse.com/financials/1022221393023.html. The NASDAQ numbers can be found at http://www.nasdaqtrader.com/Trader.aspx?id=marketshare.

istered securities each month through these plans are predicated on the integrity of the market and of securities prices.

II. SEC RULES HAVE LONG RELIED ON MARKET PRICES GENERALLY REFLECTING PUBLICLY AVAILABLE INFORMATION

Consonant with Congress's purpose, the SEC has long relied on the principle that market prices of actively traded securities generally reflect publicly available information in fashioning regulations. It has actively worked to foster the relationship between prices and information, so that investors may continue to invest with confidence in the integrity of market prices.

A. The SEC's Selective Disclosure Prohibition, Like Other Insider Trading Prohibitions, is Premised on the Need to Maintain the Relationship Between Publicly Available Information and Market Prices

Regulation FD ("Fair Disclosure"), promulgated by the Commission in 2000 and codified at 17 C.F.R. 243.100 *et seq.*, addresses selective disclosure of information by securities issuers. It "provides that when an issuer . . . discloses material nonpublic information" to securities market professionals and others in a similar role, "it must make public disclosure of that information" as well. 65 Fed. Reg. 51716 (Aug. 24, 2000).

The Commission expressly based the rationale for Regulation FD on the need to maintain the close relationship between securities prices and publicly available information:

> We believe that the practice of selective disclosure leads to a loss of investor confidence in the integrity of our capital markets. *Investors who see a security's price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.*

Ibid. (emphasis added). As the Commission explained, "[s]elective disclosure has an adverse impact on market integrity that is similar to the adverse impact from illegal insider trading." *Ibid.* As with insider trading, "investors lose confidence in the fairness of the markets when they know that other participants may exploit 'unerodable informational advantages' derived not from hard work or insights, but from their access to corporate insiders." *Ibid.* Because publicly available information is generally reflected in market prices, but private information is generally not, the integrity (and perceived integrity) of the markets depends on material information becoming publicly available.

The Commission also drew for support on a congressional report noting that "[t]he investing public has a legitimate expectation that *the prices of actively traded securities reflect publicly available information* about the issuer of such securities." 65 Fed. Reg. at 51716 n.6 (quoting H.R. Rep. No. 910, 100th Cong. 2d Sess. 8 (1988)) (emphasis added). Indeed, the Commission expressed sufficient confidence in the fact that publicly available information will be reflected in the market price that it did not require any particular or special type of publicity. Instead,

it permitted issuers to make the necessary disclosure "by filing or furnishing a Form 8-K [ordinarily used to report important matters], or by disseminating information 'through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, nonexclusionary distribution of the information to the public.'" *Id.* at 51723. So long as the information is reasonably available to the public, the Commission relied on the fact that it will be reflected in the prices of actively traded securities, whose integrity the public will be entitled to rely on.

B. The Commission's Integrated Disclosure and Shelf Registration Regulations Operate on the Same Premise

The SEC has adopted two important sets of regulations, dealing with integrated disclosure and shelf registration. Both have *eased* disclosure burdens on firms on the express premise that market prices of actively traded securities generally incorporate publicly available information.

1. *Integrated Disclosure.* Under the Securities Act of 1933, 15 U.S.C. 77 *et seq.*, issuers must file a registration statement disclosing a wide variety of information before offering a security for sale. 15 U.S.C. 77e, 77f. The registration statement must disclose not only very substantial information about the offering itself, but also very extensive and detailed information about the issuer, its current and past financial position, management's analysis of the financial condition of the issuer and its operations, a variety of types of transactions with interested parties, disagreements with its accountants, and many

other items. *See* 17 C.F.R. 229.1 *et seq*. Under the Exchange Act, virtually all publicly traded firms must make periodic disclosures of some of this same information. 15 U.S.C. 78m; 17 C.F.R. 229.1 *et seq*.

The SEC undertook a years-long project to integrate the disclosures required under the two statutes, thus substantially easing the burdens on firms and the process of capital formation. *See generally* Milton Cohen, *"Truth in Securities" Revisited*, 79 Harv. L. Rev. 1340 (1966) (proposing and discussing details of integrated disclosure). As ultimately approved in the 1980s and since amended, large, publicly traded companies may use an abbreviated form (Form S-3) to register a new offering under the Securities Act. *See* 17 C.F.R. 239.13. For the most part, an issuer may use the abbreviated form only if it has a sufficiently large "float" of publicly traded securities (currently $75 million) and satisfies certain other conditions. 17 C.F.R. 239.13(b)(1).[4] The abbreviated registration form requires disclosure of information about the proposed offering, such as the number of shares, the selling price, etc. But the abbreviated form does not require full disclosure of all of the information about the firm, its business, etc., ordinarily required when a new offering is made. Instead, the abbreviated form, "*in reliance on the efficient market theory*, allows maximum use of incorporation by reference of Exchange Act reports and

[4] The "[p]ublic float has for many years been used as an approximate measure of a stock's market following and, consequently, *the degree of efficiency with which the market absorbs information and reflects it in the price of a security*." 72 Fed. Reg. at 75356 (emphasis added).

requires the least disclosure to be presented in the prospectus and delivered to investors" for firms that that have "widespread following in the marketplace." 47 Fed. Reg. 11380, 11382, 11384 (Mar. 16, 1983) (emphasis added); *see* Instructions to Form S-3, Items 11 and 12.

As the Commission explained in a recent revision of the integrated disclosure rules, "integrated disclosure has, since its inception, been premised on the idea that a company's disclosure in its registration statement can be streamlined *to the extent that the market has already taken that information into account*." 72 Fed. Reg. 73534, 73536 (Dec. 27, 2007). An early proposal noted that "more extensive disclosure requirements" for firms whose securities are already actively traded are not necessary because "information concerning the issuer is generally available in the marketplace *and is properly reflected in the price of the securities being distributed*." 45 Fed. Reg. 5972, 5975 (Jan. 24, 1980) (emphasis added).[5] The point of the regulation is not that average investors can be expected to look up and find all of the information in each of the prior documents; the SEC recognized that a crucial document, the Form 10-K, "has not been primarily designed for delivery to shareholders" and "has a structure and technical quality which, though useful for analytical purposes, is not generally considered to be as readable as the

[5] *See also* 48 Fed. Reg. 46801, 46803 (Oct. 14, 1983) ("Form S-3, for example, is available only to reporting companies who are well followed in the marketplace; it relies on the efficient market theory in allowing maximum use of incorporation by reference of Exchange Act reports.").

annual report to shareholders." *Id*. at 5974. Instead, as the Commission in a slightly later release noted, the abbreviated form "is predicated on the Commission's belief that the market operates efficiently" for companies which "are widely followed by professional analysts," because the previously disclosed information "has already been disseminated *and accounted for by the market place*." 46 Fed. Reg. 41902, 41904 (Aug. 18, 1981) (emphasis added).[6]

2. *Shelf Registration*. Ordinarily, securities have to be registered under the Securities Act at the time an offering is made. But under the "shelf registration" rule adopted in 1983, *see* 48 Fed. Reg. 52889 (Nov. 23, 1983), securities may be registered "for an offering to be made on a continuous or delayed basis in the future," with sale permitted up to three years after the registration is effective for widely traded firms that use Form S-3. 17 C.F.R. 230.415(a)(5). At any time during that period, the registrant may immediately offer the securities for sale by disclosing only the details of the particular offering being made—*i.e.*, the number of shares, price, etc. *See* 17 C.F.R. 230.424(b)(2).

Shelf registration gives issuers great flexibility, because it "enables a registrant to time its offering to

[6] *See also* 46 Fed. Reg. 41902, 41904 (Aug. 18, 1981) ("Proposed Form S-3 *recognizes the applicability of the efficient market theory to the registration statement framework* with respect to those registrants which usually provide high quality corporate reports, including Exchange Act reports, and whose corporate information is broadly disseminated, because such companies are widely followed by professional analysts and investors in the market.") (emphasis added).

avail itself of the most advantageous market conditions." 48 Fed. Reg. at 52891. Registrants can thus "obtain lower interest rates on debt and lower dividend rates on preferred stock." *Ibid*. The "rule also permits variation in the structure and terms of securities on short notice, enabling registrants to match securities with the current demands of the marketplace." *Ibid*. "[B]ecause only a single registration statement need be filed for a series of offerings," the "[s]implification of the . . . registration process also . . . reduc[es] costs." *Ibid*.

Aside from specialized categories of securities for which shelf registration had historically been permitted, the Commission permits shelf registration only for the securities of the large, actively traded firms that can take advantage of Form S-3 and the abbreviated integrated disclosure rules. 17 C.F.R. 230.415(a)(1)(x); *see* 48 Fed. Reg. at 52893-94. Because the market prices of those actively traded securities generally reflect publicly available information, the Commission determined that the only additional information that is needed at the time of sale concerns the details of the specific offering. As the Commission explained, the rule "*recognize[s] the applicability of the efficient market theory* to those companies which provide a steady stream of high quality corporate information to the marketplace and whose corporate information is broadly disseminated." 48 Fed. Reg. at 52892 (emphasis added). Thus, "at the time [the] registrants determine to make an offering of securities, a large amount of information already has been disseminated to and digested by the marketplace," and the new information about the particular offering can be quickly and easi-

ly incorporated in prices. *Ibid.* For firms with less actively traded securities, the assumption that market prices generally reflect publicly available information is less justifiable, and the Commission accordingly does not generally permit such firms the benefits of shelf registration.

C. Other Rules Also Are Premised on the Fact That Market Prices Generally Reflect Publicly Available Information

Other rules too are premised on the proposition that market prices of actively traded securities generally reflect publicly available information.

1. *Municipal securities disclosures.* In 2010, the SEC amended its rules to require municipalities that issue bonds to disclose certain events in a timely manner. Those events include delinquencies, defaults, adverse tax decisions, ratings changes, certain other facts indicating financial stress, and bankruptcy. See 17 C.F.R. 240.15c2-12(b)(5)(i)(C).[7] The purpose of the new rules is to promote "the informational efficiency of the municipal bond market," *i.e.*, to make more information publicly available so that it can be reflected in the prices of municipal bonds. 75 Fed. Reg. 33100, 33150 (June 10, 2010). As the Commission explained, "[i]nformational efficiency helps investors efficiently allocate capital, since it helps to ensure *that a security's price ac-*

---

[7] The rule requires brokers, dealers and underwriters to obtain undertakings by a municipal issuer to make the required disclosures. 17 C.F.R. 240.15c2-12(b)(5)(i). The effect is to require the disclosures by the municipality itself.

curately reflects important information." *Ibid*. (emphasis added).

The theory of the new disclosures is not that each investor in a municipal security is expected to consult the SEC's records to determine if the issuer of the security has made a relevant disclosure. Rather, the expressed basis for the new rules is that "the municipal security's *price serves to convey aggregate information* to investors," thereby "facilitating investment decisions." 75 Fed. Reg. at 33150 (emphasis added).

2. *Beneficial Ownership of Security-Based Swaps*. SEC regulations have long "require[d] a person who is the beneficial owner of more than five percent of certain equity securities to disclose information relating to such beneficial ownership." 76 Fed. Reg. 34579, 34581 (June 14, 2011) (footnote omitted); *see* 17 C.F.R. 240.13(d). In 2011, the Commission reexamined its rules regarding a particular kind of ownership—security-based swaps—in the light of certain changes made by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1797. The Commission concluded that the beneficial-interest disclosure requirements should be extended to security-based swaps, since such swaps can give their owners an interest essentially similar to that of stock purchasers.

The Commission determined that the benefits of the new rule would outweigh its costs. In its view, the rule would contribute to market efficiency, because the newly disclosed information, like the information disclosed under the existing rules requir-

ing reporting of beneficial ownership, would be reflected in the market prices of securities. As the Commission explained, the new disclosures "may contribute to market efficiency because it could help facilitate *the accurate pricing* of securities." 76 Fed. Reg. 34588 (emphasis added). "The transparency provided by the application of [the new] rules should help the market accurately price securities," and also "may enable purchasers and sellers of securities to receive a benefit by avoiding costs, if any, associated with participation in transactions based on mispriced securities." *Ibid.* Without the rule, "the pricing of a security would not readily reflect, if at all, ownership interests in the issuer derived from security-based swaps." *Ibid.* The justification for the disclosures is thus based on the need to ensure that highly relevant information is made public *so that it will affect the market price.*

D. If the Premise of These Regulations Is Mistaken, the Logical Response Would be Further and More Burdensome Disclosure Requirements

The Commission's rationale for many regulations, including all of the regulations discussed above, would be called into question if the premise underlying them is mistaken. No one doubts that information, if it is sufficiently highlighted and brought to the attention of market professionals and the public, will be reflected in the prices of actively traded securities. If public disclosures in SEC filings cannot be relied on to filter into market prices, the alternative would be to require such disclosures to be more prominently displayed, more easily available and understandable, and more extensive, so that the

markets could operate more efficiently. Indeed, without such steps (and especially with a weakening of private enforcement that overruling *Basic* would lead to), the result would be substantially decreased protection for investors.

In some cases, such as the integrated disclosure regulations permitting abbreviated disclosures for actively traded firms, the result could be to weaken the *de*regulatory requirements that have eased the burden on firms. If the Commission's premise that past disclosures in periodic Exchange Act filings are incorporated into market prices is wrong, then the Commission logically would have to require further and more direct disclosures to ensure that they are so incorporated. The same conclusion follows with respect to the shelf registration rules. If disclosures in a shelf registration regarding the firm and its condition are not incorporated into the market prices of the firm's securities, the alternative would be to require new and more widely publicized disclosures at the time a new security is sold, once again to ensure the integrity of market prices.

The same principle would require consideration of more extensive disclosure requirements that are more likely to be incorporated in market prices with respect to the other regulations discussed above. At present, firms may choose a variety of different methods to make disclosures to comply with the rule forbidding selective disclosures. But if market prices of actively traded securities did not generally incorporate publicly available information, consideration would have to be given to further steps to ensure that the market did become aware of the infor-

mation. Firms could be required to make disclosures in a particular way, to repeat the disclosures in several media, to select and highlight the most material disclosures that are most relevant to the market, or to take other steps to ensure that the information that had been selectively disclosed reached the public and the market. Similarly, the Commission would have to consider similar more extensive disclosure requirements with respect to the municipal securities disclosures and beneficial ownership requirements discussed above, as well as their analogues throughout the system of securities regulation.

In short, the proposition that market prices of actively traded securities generally reflect publicly available information is a key premise of the system of federal securities regulation. Congress designed the system to operate under that assumption and to ensure the integrity of the publicly available information that is incorporated into security prices. The Commission too has long relied on the same premise and has designed the disclosure system based on it. This Court's recognition in *Basic* that investors too rely on that premise is well-supported and should be reaffirmed.

III. SECTION 10(b) AND RULE 10b-5 WERE INTENDED TO AND DO HAVE A BROADER SCOPE THAN SECTION 18

Amici Joseph A. Grundfest et al. argue that, because the remedy under Section 18(a) of the Exchange Act, 15 U.S.C. 78r(a), is asserted to be "most analogous" to the remedy under Rule 10b-5, the reliance requirement (and the precise incidents of that

requirement that a few courts have found) under Section 18(a) should be imported into the Rule 10b-5 context. Grundfest Amici Br. 16; *see also* Pet. Br. 35. In particular, they argue that, because Section 18(a) requires proof that the plaintiff acted "in reliance upon" a "false or misleading" "statement in any application, report, or document filed" with the SEC," 15 U.S.C. 78r(a), that same reliance element should be imported into Rule 10b-5. Amici further argue that, because some lower courts have construed the Section 18(a) reliance requirement to require direct proof of reliance on an individual basis by each plaintiff, Rule 10b-5 should be construed to require the same type of proof. Amici Br. 19-20.

Even assuming that the decisions cited by amici—two from the Second Circuit and two from the Southern District of New York, none of which focused closely on reliance under Section 18(a)—correctly construed Section 18(a), the argument confuses the different purposes and scope of Section 18(a) and Section 10(b) of the Act. Section 18(a) provides a remedy only against "[a]ny person" who "shall make or cause to be made" a materially "false or misleading" "statement in any application, report, or document filed" under the Exchange Act or in an undertaking in a registration statement filed with the SEC. 15 U.S.C. 78r(a). Section 18(a) therefore does not apply to private, non-reporting companies or to statements made orally or in press releases, e-mail blasts, or any other communications that are not filed with the SEC. It also applies only to those who "make or cause to be made" the false statement in the SEC filing; it does not by its terms extend to

others who may make use of a false statement to defraud investors.

Section 10(b) extends much further. Section 10(b) makes it illegal "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 78j. It extends not merely to false or misleading statements in filings with the Commission, but also to statements (or other "device[s] or contrivance[s]") in any other medium, oral or written, that are "manipulative or deceptive." 15 U.S.C. 78j(b). Rule 10b-5 was promulgated "pursuant to the power conferred by Section 10(b)," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976), and "is coextensive with the coverage of Section 10(b)." *SEC v. Zandford*, 535 U.S. 813, 816 n.1 (2002). To limit an action under Section 10(b) and Rule 10b-5 to the precise scope and incidents of an action under Section 18(a) would conflict with Congress's express intent to create a *broader* remedy under Section 10(b) that could address a much wider range of misconduct and fraud. It should be rejected.

CONCLUSION

The decision of the court of appeals should be affirmed.

Respectfully submitted.

EDWARD LABATON
LABATON SUCHAROW LLP
140 BROADWAY
NEW YORK, NY 10005
(212) 907-0850

JAMES A. FELDMAN
COUNSEL OF RECORD
5335 WISCONSIN AVE., NW
WASHINGTON, DC 20015
(202) 730-1267
WEXFELD@GMAIL.COM

MEYER EISENBERG
2000 PENNSYLVANIA AVE., NW
WASHINGTON, DC 20006
(202) 974-1594

FEBRUARY 5, 2014

APPENDIX

APPENDIX

1. Section 78(b) of Title 15 of the United States Code provides:

> For the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors, and principal security holders, to require appropriate reports to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto, and to impose requirements necessary to make such regulation and control reasonably complete and effective, in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and Federal Reserve System, and to insure the maintenance of fair and honest markets in such transactions:
>
> (1) Such transactions (a) are carried on in large volume by the public generally and in large part originate outside the States in which the exchanges and over-the-counter markets are located and/or are effected by means of the mails and instrumentalities of interstate commerce; (b) constitute an important part of the current of in-

terstate commerce; (c) involve in large part the securities of issuers engaged in interstate commerce; (d) involve the use of credit, directly affect the financing of trade, industry, and transportation in interstate commerce, and directly affect and influence the volume of interstate commerce; and affect the national credit.

(2) The prices established and offered in such transactions are generally disseminated and quoted throughout the United States and foreign countries and constitute a basis for determining and establishing the prices at which securities are bought and sold, the amount of certain taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and the value of collateral for bank loans.

(3) Frequently the prices of securities on such exchanges and markets are susceptible to manipulation and control, and the dissemination of such prices gives rise to excessive speculation, resulting in sudden and unreasonable fluctuations in the prices of securities which (a) cause alternately unreasonable expansion and unreasonable contraction of the volume of credit available for trade, transportation, and industry in interstate commerce, (b) hinder the proper appraisal of the value of securities and thus prevent a fair calculation of taxes owing to the United States and to the several States by owners, buyers, and sellers of securities, and (c) prevent the fair valuation of collateral for bank loans and/or obstruct the effective operation of the national banking system and Federal Reserve System.

> (4) National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets, and to meet such emergencies the Federal Government is put to such great expense as to burden the national credit.

2. Section 78(j)(b) of Title 15 of the United States Code provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> *   *   *   *   *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. Section 78(r)(a) of the Title 15 of the United States Code provides:

> (a) Persons liable; persons entitled to recover; defense of good faith; suit at law or in equity; costs, etc.

Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78*o* of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisdiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant.

4. 17 C.F.R. 240.10b-5 (Rule 10b-5) provides:

§ 240.10b–5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) 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, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.