Rely Only on This Prospectus . . . Unless We Left Something Out

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In a little-noticed part of a December 2013 opinion in the multidistrict Facebook IPO litigation, U.S. District Judge Robert Sweet ruled that plaintiffs could use prospectus language once thought to be a shield against antifraud litigation as a sword to parry an immateriality defense. In reaching this conclusion, Judge Sweet followed a 2010 opinion by U.S. District Judge Jed Rakoff interpreting similar language in litigation over Bank of America's acquisition of Merrill Lynch. Although the language remains common in securities disclosure documents, issuers and their counsel should consider carefully whether to continue including it.

Facebook IPO and Bank of America Acquisition of Merrill Lynch

Facebook's 2012 IPO prospectus explicitly instructed investors, "you should not rely on information in public media that is published by third parties." When investors sued Facebook for failure to disclose the potential impact of increasing mobile usage and product decisions in its registration statement, Facebook argued that news reports about this issue made such nondisclosure immaterial. See In Re Facebook, Inc., IPO Securities and Derivative Litigation, MDL No. 12-2389, slip op. at 77-78 (S.D.N.Y. Dec. 11, 2013). In addressing this argument, Judge Sweet ruled that news reports should not be considered for purposes of the materiality analysis. He explained, "A reasonable investor will not be charged to regard press reports as a reliable source of information after having read such advice."

To support this ruling, Judge Sweet cited a 2010 opinion by Judge Rakoff, which held that similar language asking investors not to rely on information outside of a proxy statement precluded the defendant from including news reports as evidence to show that misrepresentations were immaterial. In SEC v. Bank of America Corp, 677 F. Supp. 2d 717

(S.D.N.Y. 2010), the SEC claimed Bank of America violated proxy rules in its proxy statement seeking approval from shareholders for Bank of America's purchase of Merrill Lynch. The proxy statement explained that Merrill was prohibited from paying year-end bonuses without Bank of America's consent, but failed to mention that Bank of America had already consented in writing to payment of up to $5.8 billion in such bonuses.

Bank of America argued that shareholders already knew that Merrill would pay the bonuses because of widespread media reports, thereby rendering the alleged misrepresentations immaterial in the context of the "total mix" of information available to them. Judge Rakoff rejected this defense on the basis that the proxy statement included the nonreliance language. The disclaimer "totally changed the relevant mix of information for assessing materiality." He reasoned that, "Since the Bank itself warned investors not to rely on the media, it would be unreasonable for a shareholder to consider the media pronouncements to be part of the relevant mix of information." In light of the warning language in the proxy statement about outside information, the bank could not argue that news reports were part of the "mix" of information relevant to whether alleged misrepresentations in the proxy statement were material.

The Bank of America decision received considerable attention in the news media, including in The New York Times Dealbook and Business Insider. The following month, the SEC and Bank of America settled the case, along with other claims against Bank of America, for $150 million.

An Old Warning and a New Approach

For decades, offering documents in capital markets transactions have included warnings that investors should rely exclusively on the information contained in the prospectus. The following is a typical formulation, often placed toward the beginning of the document in bold type:

> *You should rely only on the information contained or incorporated by reference in this document. No one has been authorized to provide you with information that is different from that contained in, or incorporated by reference into, this document. Therefore, if anyone does give you information of this sort, you should not rely on it.*

Historically, securities lawyers have inserted these disclaimers to protect against the possibility that an agent of the issuer or underwriters might make an inaccurately positive comment about the company in the course of marketing the securities. In the event that the value of the securities declines after the deal closes, investors may sue the issuer or underwriters claiming that the statement violated Rule 10b-5 under the Exchange Act, Section 12(a)(2) of the Securities Act or state antifraud laws. The standard disclaimer may weaken these claims in two ways. First, the disclaimer suggests that the issuer should not have to take responsibility for the statement because investors have been warned that no information outside the offering document has been authorized. Second, in the event that a court does attribute the information to the issuer or underwriters, many of the relevant causes of action require the plaintiff to prove "reliance" on the misrepresentation or allow the defendant to rebut a presumption of reliance. If the investors have been specifically instructed not to rely on outside information, it may be harder for them to prove they actually did.

Judge Rakoff turned this logic on its head by ruling that the language issuers thought would impede plaintiffs' ability to prove reliance instead allowed them to exclude outside materials from the materiality analysis. In the wake of Judge Rakoff's decision, some issuers began revising their disclosure documents to remove the "reliance" language, and now limit the disclaimer to an alternative along the lines of the following:

> *We have not, and the underwriters have not, authorized anyone to give you any information other than in this prospectus and the information incorporated by reference herein. We take no responsibility for, and can provide no assurances as to the reliability of, any other information that others may give you.*

This alternative language addresses the concern in Judge Rakoff's decision that issuers should not be able to tell investors at the time of the offering not to look at outside information and then later claim that outside information was relevant to materiality. An issuer that used the revised language could presumably argue that outside news reports were part of the "mix" of information relevant to materiality. At the same time, the warning still seeks to mitigate litigation risk for statements outside of the prospectus by disclaiming responsibility for them and warning about their potential unreliability.

Despite Judge Rakoff's 2010 decision, other issuers—such as Facebook—have continued to take the traditional approach of a full warning against reliance.

A Way Forward

In light of the Facebook case following Judge Rakoff's reasoning, is it ever prudent for issuers to include the full disclaimer? Arguably, the traditional approach may still be better to weaken the reliance element of a fraud case because it explicitly warns against reliance. In the alternative approach, if a plaintiff argues that it relied on information outside of the prospectus, the issuer would be able to respond only that it had warned that it did not take responsibility for any outside information and that the information may not be reliable. The alternative warning potentially undercuts both the issuer's responsibility for the information and the reasonableness of an investor's reliance on it. Nevertheless, if other evidence suggests that the issuer indeed authorized the information—such as emails demonstrating that senior management approved the distribution—the alternative warning might provide less protection than the traditional one.

So which approach is better? In most circumstances—especially if the issuer receives heavy (or negative) media coverage, as in the Bank of America and Facebook cases—it is preferable to use the alternative approach. Under Judge Rakoff's reasoning, outside information could be included in the "mix" of information relevant to whether a particular misstatement or omission is immaterial. However, if the issuer receives little media coverage or expects difficulties controlling its agents' statements, the traditional language might be better. For these issuers, the risk of outside information being relevant to a materiality analysis is slight and it might be more important to hamper a prospective plaintiff's ability to prove reliance.

Of course, under either approach, the best defense is to avoid a lawsuit in the first place. Issuers, underwriters and their law firms must vigilantly monitor the professionals who might disseminate information outside of the traditional offering materials to decrease the chance of spreading misinformation. Furthermore, offering participants should draft comprehensive prospectus disclosure that highlights significant business issues and risks, including those mentioned in media reports.

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