

Bulldog II: SJC Eliminates First Amendment Challenge to Securities Violations Found by the Massachusetts Securities Division

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A decision by the Massachusetts Supreme Judicial Court (“SJC”) on September 22, 2011, lays to rest the Secretary of the Commonwealth’s finding that a hedge fund manager, Bulldog Investors General Partnership (“Bulldog”), and its principals, violated the Massachusetts Securities Act through its operation of an interactive website that provided investment information to all visitors. In this decision, the SJC rejected the hedge fund’s argument that the Secretary’s order violated the hedge fund’s First Amendment right to communicate information to consumers.

The Bulldog facts are straightforward. Bulldog maintained an interactive website through which any visitor could view an opening page, a “press room” containing links to news articles and a printable brochure that described its funds. After clicking a button confirming the visitor’s agreement that the information provided was not a solicitation, the visitor was invited to complete a registration form that sought the visitor’s contact information. A Massachusetts resident completed this form and a Bulldog employee responded with an email that attached more detailed information on Bulldog’s funds, including press articles, a presentation about Bulldog’s investment philosophy, managers, investment vehicles, and performance, and a letter that, among other things, compared fund returns to the S&P 500. At no point, did Bulldog confirm that the Massachusetts resident was financially accredited.

The Division charged Bulldog with violating the Massachusetts Securities Act by offering unregistered securities. The hearing officer found that Bulldog engaged in such violations and the Secretary of the Commonwealth adopted this finding.

Bulldog filed two actions in state court challenging the administrative decision. The first action (“Bulldog I”) claimed that its contacts with Massachusetts were insufficient to permit the Secretary to exercise personal jurisdiction over it. This claim was rejected in an SJC decision entered on July 2, 2010. The second action (“Bulldog II”) challenged the constitutionality of the Massachusetts regulations that prohibit general solicitation and advertising by those offering unregistered securities. Specifically, Bulldog argued that the First Amendment protected its right to maintain its website and communicate with any interested person, such as a named plaintiff, Leonard Bloness.

The SJC rejected Bulldog's argument. At the outset the SJC found that Bulldog's communications were commercial speech and, as such, were subject to First Amendment scrutiny under *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n of N.Y.*, 447 U.S. 557(1980). Under *Central Hudson*, the SJC found that the restriction on Bulldog was part of a broader disclosure requirement and therefore subject only to the requirement that the restrictions were reasonably related to the State's interest. The court concluded that the challenged regulations met this test because "the disclosure requirement at issue here, a registration statement that must be in effect prior to a public offering of securities, is reasonably related to the State's interest in promoting the integrity of capital markets by ensuring that investors make decisions based on full and accurate information."

Moreover, even if the court were to accept the argument that the restrictions were an absolute prohibition on speech (and not part of a broader disclosure requirement), the SJC ruled that there was no First Amendment violation. In reaching this conclusion, the SJC focused on the only two tests that would apply: whether the challenged regulations directly advanced the government interest and were not more extensive than necessary. The court found the first test satisfied premised upon expert testimony that "the registration system's ability to promote well-informed markets would be compromised if unregistered securities could be widely advertised using incomplete information selected by the issuer." On the second test, the court rejected Bulldog's argument that regulation of securities should be shifted from the "offer stage" to the "point of sale" stage. Specifically, the court concluded that Bulldog's "proposed alternatives will certainly decrease the quality and will likely decrease the quantity of information in the marketplace, will increase the likelihood of securities scams and of unlawful sales of unregistered securities to unsophisticated investors, and will weaken the market's efficiency overall."

Bulldog I and II provide further support for our view that hedge fund managers should not have interactive websites that are publicly accessible by any visitor. Rather, access only should be provided via password after a determination has been made that the visitor is a financially accredited investor. Moreover, communications with prospective investors made for the purpose of ascertaining their accredited status should not include materials that could be construed as an offer or solicitation, such as information on investment philosophy, investment vehicles, managerial expertise and fund performance. In the absence of such due diligence, even out-of-state hedge fund managers may be the target of administrative enforcement action in Massachusetts.