

1 UNITED STATES COURT OF APPEALS

2 FOR THE SECOND CIRCUIT

3  
4 August Term, 2009

5 (Argued: November 13, 2009 Decided: January 25, 2010)

6 Docket Nos. 09-0837-cv, 09-0858-cv

7 (consolidated for disposition)  
8

9 IN RE MORGAN STANLEY INFORMATION FUND SECURITIES LITIGATION,  
10 No. 09-0837-cv,

11 James M. Lindsay, Michael J. McDermott, Stephen B. Dornak,  
12 Dietmar H. Kubb, Lisette Vaessen, and Emil H. Vaessen, on  
13 behalf of themselves and all others similarly situated,

14 *Plaintiffs-Appellants,*

15 - v. -

16 Morgan Stanley, Morgan Stanley & Co., Inc., Morgan Stanley  
17 DW Inc., Morgan Stanley Information Fund, Morgan Stanley  
18 Investment Advisors Inc., Morgan Stanley Investment  
19 Management Inc., and Morgan Stanley Distributors, Inc.,

20 *Defendants-Appellees.*  
21

1 IN RE MORGAN STANLEY TECHNOLOGY FUND SECURITIES LITIGATION,  
2 No. 09-0858-cv,

3 John C. Armstrong, Nina H. Armstrong, and James Barenboim,  
4 on behalf of themselves and all others similarly situated,

5 *Plaintiffs-Appellants,*

6 - v. -

7 Morgan Stanley, Morgan Stanley & Co., Inc., Morgan Stanley  
8 DW Inc., Morgan Stanley Technology Fund, Morgan Stanley  
9 Investment Advisors Inc., Morgan Stanley Investment  
10 Management Inc., and Morgan Stanley Distributors, Inc.,

11 *Defendants-Appellees.\**

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13 Before:

14 McLAUGHLIN and WESLEY, *Circuit Judges*, and KAHN,\*\* *District*  
15 *Judge.*

16 Plaintiffs appeal from a February 2, 2009 order of the  
17 United States District Court for the Southern District of  
18 New York (Jones, J.), which dismissed their claims relating  
19 to two Morgan Stanley mutual funds brought pursuant to  
20 sections 11, 12(a)(2), and 15 of the Securities Act of 1933,  
21 15 U.S.C. §§ 77k, 77l(a)(2), 77o. The district court held  
22 that plaintiffs had not identified any legal basis that  
23 required defendants to disclose in the funds' offering  
24 documents information that related primarily to an  
25 affiliated Morgan Stanley broker-dealer.

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\* The Clerk of the Court is respectfully directed to amend the official captions in both actions to conform to the captions listed above.

\*\* The Honorable Lawrence E. Kahn, United States District Court for the Northern District of New York, sitting by designation.

1 AFFIRMED.  
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3 DANIEL W. KRASNER (Jeffrey S. Nobel and Nancy A.  
4 Kulesa, IZARD Nobel LLP, Hartford,  
5 Connecticut; Robert B. Weintraub, Wolf  
6 Haldenstein Adler Freeman & Herz LLP, New  
7 York, New York, *on the brief*), Wolf  
8 Haldenstein Adler Freeman & Herz LLP, New  
9 York, New York, *for Plaintiffs-Appellants in*  
10 *both actions.*

11 RICHARD A. ROSEN (Walter Rieman, *on the brief*), Paul,  
12 Weiss, Rifkind, Wharton & Garrison LLP, New  
13 York, New York, *for Defendants-Appellees in*  
14 *both actions.*

15 MARK PENNINGTON (David M. Becker, Mark D. Cahn, Jacob  
16 H. Stillman, *on the brief*), *for amicus curiae*  
17 *Securities and Exchange Commission.*

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18  
19 WESLEY, *Circuit Judge:*

20 These cases concern the boundaries of disclosure  
21 obligations in registration statements and prospectuses  
22 filed on Form N-1A pursuant to the Securities Act of 1933  
23 ("Securities Act"), 15 U.S.C. § 77a *et seq.* In separate but  
24 substantially similar putative class actions, two groups of  
25 plaintiffs brought claims under sections 11, 12(a)(2), and  
26 15 of the Securities Act. *In re Morgan Stanley Info. Fund*  
27 *Sec. Litig.*, No. 02 Civ. 8579 (S.D.N.Y.) ("Info. Fund  
28 Action"); *In re Morgan Stanley Tech. Fund Sec. Litig.*, No.  
29 02 Civ. 6153 (S.D.N.Y.) ("Tech. Fund Action"). With the

1 exception of the Morgan Stanley mutual fund specified in the  
2 caption of each case, the defendants are identical in both  
3 actions. Both groups of plaintiffs allege that defendants  
4 failed to make certain disclosures relating to the mutual  
5 funds that are required by the federal securities laws.

6 In a consolidated decision, the United States District  
7 Court for the Southern District of New York (Jones, J.)  
8 granted defendants' motions to dismiss plaintiffs' Second  
9 Amended Consolidated Complaints. *In re Morgan Stanley Tech.*  
10 *Fund Sec. Litig.*, 643 F. Supp. 2d 366, 369 (S.D.N.Y. 2009).  
11 The district court held that plaintiffs' failure to identify  
12 unlawful omissions in the mutual funds' registration  
13 statements or prospectuses doomed their claims. *Id.* at 381-  
14 82.

15 In this appeal, plaintiffs argue that the district  
16 court erred by rejecting their omissions-based legal theory.  
17 However, the Securities and Exchange Commission ("SEC" or  
18 "Commission") has appeared before us as an amicus curiae and  
19 opined that neither the Securities Act nor Form N-1A  
20 required defendants to disclose the information that  
21 plaintiffs allege was omitted. The Commission's position is  
22 consistent with both its prior interpretations of Form N-1A

1 and the decision below, it is entitled to judicial  
2 deference, and we find it persuasive. Moreover, a careful  
3 review of plaintiffs' allegations reveals that the true  
4 object of their claims is the alleged malfeasance of the  
5 mutual funds' affiliated broker-dealer entities and not the  
6 public offerings conducted by the funds themselves. We  
7 decline to expand liability under sections 11, 12(a)(2), and  
8 15 to require issuers and offering participants to make  
9 disclosures regarding affiliates that are not otherwise  
10 called for by the securities laws. Therefore, we affirm.

#### 11 **I. BACKGROUND**

12 The focus of these class actions is, at least  
13 nominally, two open-ended Morgan Stanley mutual funds:  
14 defendant Morgan Stanley Information Fund ("Info. Fund") and  
15 defendant Morgan Stanley Technology Fund ("Tech. Fund,"  
16 collectively with the Info. Fund, the "Funds"). Plaintiffs  
17 have not disputed the district court's finding that the  
18 operative pleadings in these two cases are "virtually  
19 identical." *In re Morgan Stanley Tech. Fund Sec. Litig.*,  
20 643 F. Supp. 2d at 369 n.2. We agree with that  
21 characterization. The gravamen of both actions is that  
22 defendants failed to disclose that the Morgan Stanley

1 broker-dealers affiliated with the Funds suffered from  
2 internal conflicts of interest, and, because the Funds'  
3 managers relied on these broker-dealers' stock research, the  
4 broker-dealers' conflicts increased the risk to investors  
5 associated with purchasing shares of the Funds.

6 **A. The Parties**

7 The lead plaintiffs in both actions purchased the  
8 Funds' shares during the class periods set forth in their  
9 pleadings.<sup>1</sup> Each defendant is a commercial entity that  
10 played a role in the Morgan Stanley enterprise, and each  
11 action bears the title of the mutual fund to which it  
12 relates.

13 Shares of the Info. Fund were publicly traded starting  
14 in 1995, and shares of the Tech. Fund were available to  
15 investors beginning in September 2000. In order to sell  
16 their shares to the public, both Funds registered their  
17 securities with the SEC by utilizing Form N-1A to file a  
18 series of registration statements and prospectuses

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<sup>1</sup> The class period in the Info. Fund Action spans from October 25, 1999 through October 25, 2002; the class period in the Tech. Fund Action is defined as September 25, 2000 through July 31, 2002. The difference in these class periods is immaterial to our resolution of this appeal, and we therefore refer to them collectively as a single "Class Period."

1 (collectively, the "Offering Documents").<sup>2</sup> The Info. Fund  
2 made four sets of filings between July 1999 and October  
3 2002; the Tech. Fund made two sets of filings between August  
4 2000 and July 2002.<sup>3</sup>

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<sup>2</sup> The SEC created Form N-1A to facilitate registration by certain types of open-ended management investment companies under the Securities Act and the Investment Companies Act of 1940, 15 U.S.C. § 80a-1 *et seq.* See SEC, Registration Form Used by Open-Ended Management Investment Companies; Guidelines ("Form N-1A Adopting Release"), Securities Act Release No. 33-6479, Investment Company Act Release No. 13,436, 48 Fed. Reg. 37,928, 37,929 (Aug. 22, 1983). The Form creates a three-part registration statement that is also sufficient to satisfy qualifying issuers' prospectus-related obligations under sections 5(b)(2) and 10(a) of the Securities Act, 15 U.S.C. §§ 77e(b)(2), 77j(a). See Form N-1A Adopting Release, 48 Fed. Reg. at 37,929. First, in order to avoid prospectus disclosures that are "too long and complex," the Form calls for a streamlined, "simplified prospectus" and a "Statement of Additional Information," or "SAI," that is to be made available to investors upon request. *Id.* The purpose of the SAI is to offer issuers "the opportunity to provide more detailed discussions of matters required to be in the prospectus, as well as discussions of certain matters that are not required to be in the prospectus, but which may be of interest to at least some investors." *Id.* Finally, the third part of Form N-1A, referred to as "Part C," "pertains to information that is not required to be in the prospectus, but is required by the registration statement." *Id.*

<sup>3</sup> The Info. Fund's four sets of Form N-1A filings were submitted to the SEC on July 27, 1999, May 30, 2000, May 30, 2001, and May 30, 2002. The Tech. Fund's two sets of Form N-1A materials were filed on August 17, 2000 and October 31, 2001. Plaintiffs have not identified material differences between any of these filings that are relevant to their claims.

1           The Offering Documents indicate that the "Investment  
2 Objective" of each Fund was to "seek[] long-term capital  
3 appreciation," which both Funds defined as "selecting  
4 securities with the potential to rise in price rather than  
5 pay out income." Each Fund disclosed a slightly different  
6 strategy for pursuing this objective. The Info. Fund  
7 indicated that it would "normally invest at least 65% of its  
8 total assets in common stocks and investment grade  
9 convertible securities of companies engaged in the  
10 communications and information industry located throughout  
11 the world." The Tech. Fund stated that it would "normally  
12 invest at least 80% of its assets in common stock of  
13 companies of any asset size engaged in technology and  
14 technology-related industries." The Funds also disclosed,  
15 using nearly identical language, that their managers had  
16 been granted "considerable leeway" to select both general  
17 trading strategies and specific investments for the Funds'  
18 portfolios.

19           The non-Fund defendants are the same in both actions.  
20 Defendant Morgan Stanley is a Delaware corporation that  
21 functions as a holding company and parent entity for each of  
22 the non-Fund defendants. Defendant Morgan Stanley



1 Distributors Inc. ("MS Distributors") served as the  
2 principal underwriter for each Fund. Defendant Morgan  
3 Stanley Investment Advisors Inc. ("MS Advisors") was the  
4 Funds' principal investment manager. MS Advisors  
5 subcontracted with defendant Morgan Stanley Investment  
6 Management Inc. ("MS Investment") to perform certain asset-  
7 management functions for the Funds, such as the purchase and  
8 sale of securities for their portfolios.

9 The final two defendants were Morgan Stanley's primary  
10 broker-dealer subsidiaries during the Class Period: Morgan  
11 Stanley & Co., Inc. and Morgan Stanley DW Inc.

12 (collectively, "MS&Co."). Each is a registered broker-  
13 dealer. Both entities offered a variety of financial  
14 services relating to research, institutional and retail  
15 brokerage, corporate finance, and investment banking.  
16 Plaintiffs allege that, during the Class Period, both  
17 entities sold shares of the Funds to the public pursuant to  
18 a contract with MS Distributors.

19 **B. Plaintiffs' Allegations**

20 The thrust of plaintiffs' cases is that the Funds'  
21 Offering Documents unlawfully omitted certain information  
22 relating to the manner in which MS&Co. conducted its

1 operations, and that MS&Co.'s undisclosed conduct increased  
2 the risks associated with purchasing shares of the Funds.  
3 The central allegations are that defendants failed to  
4 disclose: (1) that there were conflicts of interest at  
5 MS&Co. that could potentially taint the objectivity of its  
6 stock research, and (2) that the Funds nevertheless relied  
7 on MS&Co.'s research, as evidenced by the proportion of  
8 securities in the Funds' portfolios from companies that were  
9 either covered by MS&Co.'s research analysts or being  
10 pursued by MS&Co. as potential investment banking clients.

11 With respect to the conflicts of interest at the Funds'  
12 affiliated broker-dealer, plaintiffs assert that MS&Co.  
13 intentionally dismantled the "Information Barrier" between  
14 its investment banking and research functions during the  
15 Class Period, and that defendants unlawfully failed to  
16 disclose that fact in the Offering Documents.<sup>4</sup> Following

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<sup>4</sup> Although plaintiffs use the term "Chinese Wall," we use the term "Information Barrier" and intend it to have the same meaning. See, e.g., SEC, Self-Regulatory Organizations; International Securities Exchange, Inc., Notice of Filing of Proposed Rule Change and Amendments No. 1 and 2 Thereto To Amend the Market Maker Information Barrier Requirements Under ISE Rule 810, Exchange Act Release No. 50,197, 69 Fed. Reg. 51,735, 51,735 (Aug. 13, 2004) (recommending that the phrase "Chinese Wall" be replaced with "Information Barrier" in the rules of the International Securities Exchange). The basic concept arose

1 this change, MS&Co.'s research analysts received  
2 compensation based partially on MS&Co.'s generation of  
3 investment banking revenue. The resulting conflicts of  
4 interest allegedly led these analysts to disseminate biased  
5 research reports that exaggerated the merits of investing in  
6 some of the securities issued by MS&Co.'s potential  
7 investment banking clients. Such reports, plaintiffs  
8 contend, artificially inflated the price of those securities  
9 to the detriment of the Funds (and, presumably, all  
10 investors using MS&Co.'s research).

11 In addition to the conflicts of interest arising out of  
12 MS&Co.'s compensation system, plaintiffs also allege that  
13 "[d]efendants" (without further specification) participated  
14 in "schemes" to "have research analysts issue false reports  
15 in order to obtain investment banking business" and to  
16 "manipulate the price of initial public offerings." With  
17 respect to their allegations of IPO manipulation, plaintiffs

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out of regulatory concerns about the need to "segment the flow of sensitive information" within broker-dealers that provide a diverse package of financial services. See, e.g., SEC, Div. of Market Reg., Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Nonpublic Information, at 2 n.5 (Mar. 1990), available at <http://www.sec.gov/divisions/marketreg/brokerdealerpolicies.pdf>.

1 incorporated into their pleadings the "specific facts" from  
2 "the approximately 303 complaints" filed as part of the  
3 consolidated Multi-District Litigation Panel action  
4 captioned as *In re IPO Securities Litigation*, No. 21 M.C.  
5 92.

6 Plaintiffs also incorporated by reference the SEC's  
7 allegations in an enforcement action against MS&Co. relating  
8 to its lack of an Information Barrier during the Class  
9 Period. In 2002, following the close of the Class Period,  
10 nine brokerage firms agreed to a \$1.4 billion global  
11 settlement with the SEC and other regulators relating to  
12 improper conflicts of interest that arose from the  
13 commingling of research and investment banking functions.  
14 See Press Release, Sec. & Exch. Comm'n, SEC, NY Attorney  
15 General, NASD, NASAA, NYSE and State Regulators Announce  
16 Historic Agreement to Reform Investment Practices; \$1.4  
17 Billion Global Settlement Includes Penalties and Funds for  
18 Investors, Release No. 2002-179 (Dec. 20, 2002), available  
19 <http://www.sec.gov/news/press/2002-179.htm>.<sup>5</sup> As part of the

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<sup>5</sup> We may take judicial notice of the full contents of the SEC's filings relating to this enforcement action because plaintiffs rely upon portions of them in their pleadings and, in any event, these proceedings are a matter of public record. See *Chambers v. Time Warner, Inc.*, 282 F.3d 147,

1 global settlement agreement, the implicated firms were  
2 required to "sever the links between research and investment  
3 banking" in order to "ensure that stock recommendations are  
4 not tainted by efforts to obtain investment banking fees."  
5 *Id.*

6 As part of the global settlement, the SEC commenced a  
7 separate enforcement action against MS&Co., which was filed  
8 in the Southern District of New York on April 28, 2003. See  
9 Press Release, Sec. & Exch. Comm'n, SEC Sues Morgan Stanley  
10 for Research Analyst Conflicts of Interest: Firm to Settle  
11 with SEC, NASD, NYSE, NY Attorney General, and State  
12 Regulators ("*MS&Co. Settlement Release*"), Release No. 18,117  
13 (Apr. 28, 2003), available at [http://www.sec.gov/litigation/  
14 litreleases/lr18117.htm](http://www.sec.gov/litigation/litreleases/lr18117.htm). In that action, the SEC asserted  
15 that, between approximately July 1999 and 2001:

16 Morgan Stanley engaged in acts and practices that  
17 created conflicts of interest for its research  
18 analysts with respect to investment banking  
19 activities and considerations. . . . As a result,  
20 Morgan Stanley research analysts were faced with a  
21 conflict of interest between helping generate  
22 investment banking business for Morgan Stanley and

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152-53 (2d Cir. 2002); *Kramer v. Time Warner Inc.*, 937 F.2d  
767, 774 (2d Cir. 1991). We do not rely on the SEC's  
allegations for their truth, but "rather to establish the  
fact of such litigation and related filings." *Kramer*, 937  
F.2d at 774.

1 their responsibilities to publish objective  
2 research reports that, if unfavorable to actual or  
3 potential banking clients, could prevent Morgan  
4 Stanley from winning that banking business.

5 (Compl. ¶ 2, *SEC v. Morgan Stanley & Co. Inc.*, No. 03 Civ.  
6 2948 (S.D.N.Y. Apr. 28, 2003).) MS&Co. consented to the  
7 entry of a final judgment in that action, which directed it  
8 to separate its investment banking and research functions,  
9 disgorge \$25 million, pay a \$25 million civil penalty, and  
10 spend \$75 million over five years on independent research  
11 consultants for use by retail brokerage customers. (Consent  
12 of Morgan Stanley & Co., *SEC v. Morgan Stanley & Co. Inc.*,  
13 No. 03 Civ. 2948 (S.D.N.Y. Apr. 2003).)

14 Against this backdrop of allegations relating to  
15 MS&Co., plaintiffs assert that the Funds' reliance on  
16 MS&Co.'s research introduced additional investment risks  
17 associated with the purchase of the Funds' shares.  
18 Specifically, plaintiffs contend that the Funds were aware  
19 of the conflicts at MS&Co. because of their status as  
20 proprietary mutual funds under the Morgan Stanley umbrella,  
21 but that the Funds' managers nevertheless utilized MS&Co.'s  
22 research when making investment decisions for the Funds'  
23 portfolios. Plaintiffs argue that the Funds should have  
24 disclosed that these circumstances led to heightened

1 investment risks, and that the Offering Documents contained  
2 "numerous" material omissions relating to the Funds.

3 However, the majority of the omissions that are alleged to  
4 have occurred relate to MS&Co., not to the Funds. Quoting  
5 from the pleadings, these omissions include that:

- 6 • "there was no [Information Barrier] between  
7 MS&Co.'s research department and its investment  
8 banking department";
- 9 • part of the compensation of MS&Co.'s research  
10 analysts was "based upon their  
11 securing/participation in investment banking  
12 business for MS&Co.," and the "objectivity of  
13 [MS&Co.'s] research reports . . . was inherently  
14 and materially tainted by" MS&Co.'s interest in  
15 developing investment banking business;
- 16 • MS&Co. either had, or was seeking to develop,  
17 investment banking relationships with "a material  
18 number of the companies whose securities were part  
19 of the [Funds'] portfolio[s]";
- 20 • "MS&Co. at times issued falsely positive research  
21 reports to enhance MS&Co.'s opportunity to  
22 maintain and obtain investment banking business  
23 from the company covered by the report"; and
- 24 • "defendants had inflated the market price" of  
25 securities in the Funds' portfolios "by  
26 conditioning allocations of shares in [an] IPO  
27 upon the requirement that customers agree to  
28 purchase additional shares of that security in the  
29 aftermarket, and, in some cases, to make those  
30 additional purchases at pre-arranged, ever  
31 escalating prices."

32 With respect to the Funds themselves, plaintiffs'  
33 principal allegation is that these events at MS&Co. made it

1 riskier to invest in the Funds. This is true, plaintiffs  
2 contend, because – notwithstanding their legal duties to the  
3 Funds’ shareholders – the Funds’ managers had an unspecified  
4 “material incentive” to cause the Funds to invest in  
5 “companies for which MS&Co. issued research reports and/or  
6 provided or was seeking to provide investment banking  
7 services.” Plaintiffs further allege that the Funds should  
8 have specified in the Offering Documents that MS&Co. offered  
9 research coverage regarding approximately 76% of the  
10 securities in the Info. Fund’s portfolio and 85% of the  
11 securities in the Tech. Fund’s portfolio, and that MS&Co.  
12 had provided investment banking services for more than 30%  
13 of the companies in which the Funds had invested.

14 Plaintiffs assert that defendants were required to  
15 disclose all of this information in the Funds’ Offering  
16 Documents under Form N-1A and the Securities Act. As to  
17 Form N-1A, plaintiffs rely on Item C of the Form’s “General  
18 Instructions” and Items 2 and 4 of the “Information Required  
19 in a Prospectus” under Part A of the Form.

20 Item C(1)(b) of the General Instructions states:

21 The prospectus disclosure requirements in Form N-  
22 1A are intended to elicit information for an  
23 average or typical investor who may not be  
24 sophisticated in legal or financial matters. The



1 prospectus should help investors to evaluate the  
2 risks of an investment and to decide whether to  
3 invest in a Fund by providing a balanced  
4 disclosure of positive and negative factors.  
5 Disclosure in the prospectus should be designed to  
6 assist an investor in comparing and contrasting  
7 the Fund with other funds.

8 Item C(2)(a) states, in pertinent part:

9 The purpose of the [Form N-1A] prospectus is to  
10 provide essential information about the Fund in a  
11 way that will help investors to make informed  
12 decisions about whether to purchase the Fund's  
13 shares described in the prospectus.

14 Plaintiffs also contend that Part A of Form N-1A, which  
15 relates to the "simplified prospectus" called for by the  
16 Form, required defendants to disclose the allegedly omitted  
17 information. Item 2, titled "Risk/Return Summary:  
18 Investments, Risks, and Performance," calls for, *inter alia*,  
19 a "Narrative Risk Disclosure" regarding "the principal risks  
20 of investing in the Fund, including the risks to which the  
21 Fund's portfolio as a whole is subject and the circumstances  
22 reasonably likely to affect adversely the Fund's net asset  
23 value, yield, and total return." Item 4, titled "Investment  
24 Objectives, Principal Investment Strategies, Related Risks,  
25 and Disclosure of Portfolio Holdings," calls for similar  
26 risk-related disclosures.

27 Finally, in addition to their reliance on Form N-1A,

1 plaintiffs argue that defendants were required by the  
2 Securities Act itself to disclose the allegedly omitted  
3 information in order to avoid rendering misleading the  
4 statements in the Offering Documents. See 15 U.S.C. §§  
5 77k(a), 77l(a)(2); see also 17 C.F.R. § 230.408. The  
6 statements in the Offering Documents on which plaintiffs  
7 rely in making this assertion relate to the Funds'  
8 investment objectives, investment strategies, and risks.

9 Based on these contentions, plaintiffs argue that they  
10 sustained damages from defendants' omissions that are  
11 measurable by a comparison of the Funds' performance during  
12 the Class Period relative to industry benchmarks such as the  
13 S&P 500 and the Nasdaq Composite Index. In the Info. Fund  
14 Action, the named plaintiffs claim that they lost  
15 approximately \$280,000. The named plaintiffs in the Tech.  
16 Fund Action purport to have lost approximately \$241,578. In  
17 total, plaintiffs assert that the losses sustained by their  
18 combined class of proposed claimants exceed one billion  
19 dollars.

### 20 **C. The SEC's Amicus Brief**

21 Prior to the oral argument relating to these appeals,  
22 the Court requested that the SEC submit an amicus curiae

1 brief expressing the Commission's opinion as to whether  
2 any part of Form N-1A [gave] rise to a duty owed  
3 by the defendants to disclose that: (a) the  
4 [Funds'] affiliated broker-dealer[] [MS&Co.] had  
5 ceased to maintain an Information Barrier between  
6 [its] research and investment-banking departments;  
7 and (b) the resulting organizational structure [of  
8 Morgan Stanley] may affect the investment strategy  
9 employed by the [Funds'] managers?

10 The Commission responded on November 12, 2009, and took  
11 the position that Form N-1A did not require disclosures  
12 relating to the dismantling of MS&Co.'s Information Barrier.  
13 First, the SEC reasoned that the "General Instructions" to  
14 Form N-1A, including Item C, are

15 not an independent source of disclosure  
16 obligations. Rather, [the General Instructions]  
17 are intended to provide funds with general  
18 guidance as to the nature of the information they  
19 should provide in responding to specific  
20 disclosure items, and to the sorts of language, in  
21 terms of sophistication or technicality, that they  
22 should use in providing that information.

23 (Brief of the Securities and Exchange Commission, Amicus  
24 Curiae, In Support of Appellees on Issue Addressed ("SEC  
25 Amicus Br.") at 8.)

26 Second, the SEC turned to the risk-focused instructions  
27 cited by plaintiffs in Items 2 and 4 of the Form's Part A.  
28 The Commission characterized the risk to the Funds arising  
29 out of the deterioration of MS&Co.'s Information Barrier as

1 "generic" and asserted that "the fact of affiliation  
2 [between MS&Co. and the Funds] appears to be irrelevant" to  
3 the existence of such a risk. (*Id.* at 8-9.) Rather,  
4 "[t]his risk arises purely from the breach of the  
5 [Information Barrier] and has nothing to do with whether the  
6 broker-dealer is affiliated with the purchaser of the  
7 securities." (*Id.* at 8.) The SEC distinguished that  
8 "generic" risk from

9           allegations that a fund's investment objectives  
10           included enhancing an affiliated entity's  
11           investment banking business, and that the fund's  
12           investment strategy was to achieve that goal by  
13           buying securities that the affiliated entity had  
14           underwritten . . . .

15 (*Id.* at 5-6.) With respect to this latter type of risk, the  
16 agency opined that "an investment objective and strategy of  
17 enhancing an affiliate's business by buying securities that  
18 the affiliate had underwritten would have to be disclosed"  
19 under Form N-1A. (*Id.* at 6.) However, the SEC reasoned  
20 that:

21           [T]he danger that analyst reports (whether from  
22           affiliated or unaffiliated analysts) will be  
23           tainted by undisclosed conflicts of interest or  
24           actual corruption is but one of an indefinitely  
25           large number of factors that could cause a fund  
26           (or any other investor) to purchase overpriced  
27           securities, and it would not be useful to  
28           investors to require an attempt to set all of  
29           those forth in the prospectus.



1 Rule 12(b)(6) because they failed to identify a legal basis  
2 requiring disclosure of the allegedly omitted information.  
3 For the reasons set forth below, we agree with the  
4 conclusion reached below and therefore affirm.

5 **A. Overview of the Applicable Law**

6 Sections 11, 12(a)(2), and 15 of the Securities Act  
7 impose liability on certain participants in a registered  
8 securities offering when the publicly filed documents used  
9 during the offering contain material misstatements or  
10 omissions. Section 11 applies to registration statements,  
11 and section 12(a)(2) applies to prospectuses and oral  
12 communications. 15 U.S.C. §§ 77k(a), 77l(a)(2).

13 Section 15, in turn, creates liability for individuals  
14 or entities that "control[] any person liable" under section  
15 11 or 12. *Id.* § 77o. Thus, the success of a claim under  
16 section 15 relies, in part, on a plaintiff's ability to  
17 demonstrate primary liability under sections 11 and 12.  
18 *See, e.g., SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450,  
19 1472-73 (2d Cir. 1996). Because the district court's  
20 dismissal of plaintiffs' section 15 claims was predicated on  
21 their failure to state claims under sections 11 and 12, the  
22 latter two provisions warrant the bulk of our analysis.

1           Section 11 of the Securities Act prohibits materially  
2 misleading statements or omissions in registration  
3 statements filed with the SEC. See 15 U.S.C. § 77k(a). In  
4 the event of such a misdeed, the statute provides for a  
5 cause of action by the purchaser of the registered security  
6 against the security's issuer, its underwriter, and certain  
7 other statutorily enumerated parties. *Id.* To state a claim  
8 under section 11, the plaintiff must allege that: (1) she  
9 purchased a registered security, either directly from the  
10 issuer or in the aftermarket following the offering; (2) the  
11 defendant participated in the offering in a manner  
12 sufficient to give rise to liability under section 11; and  
13 (3) the registration statement "contained an untrue  
14 statement of a material fact or omitted to state a material  
15 fact required to be stated therein or necessary to make the  
16 statements therein not misleading." *Id.*

17           Section 12(a)(2) provides similar redress where the  
18 securities at issue were sold using prospectuses or oral  
19 communications that contain material misstatements or  
20 omissions. See *id.* § 77l(a)(2). Whereas the reach of  
21 section 11 is expressly limited to specific offering  
22 participants, the list of potential defendants in a section

1 12(a)(2) case is governed by a judicial interpretation of  
2 section 12 known as the "statutory seller" requirement. See  
3 *Pinter v. Dahl*, 486 U.S. 622, 643-47 & n.21 (1988); see also  
4 *Wilson v. Saintine Exploration & Drilling Corp.*, 872 F.2d  
5 1124, 1125-26 (2d Cir. 1989). An individual is a "statutory  
6 seller" – and therefore a potential section 12(a)(2)  
7 defendant – if he: (1) "passed title, or other interest in  
8 the security, to the buyer for value," or (2) "successfully  
9 solicit[ed] the purchase [of a security], motivated at least  
10 in part by a desire to serve his own financial interests or  
11 those of the securities['] owner." *Pinter*, 486 U.S. at 642,  
12 647; see also *Capri v. Murphy*, 856 F.2d 473, 478 (2d Cir.  
13 1988).<sup>6</sup> As a result of this interpretation and the  
14 remaining statutory text, the elements of a *prima facie*  
15 claim under section 12(a)(2) are: (1) the defendant is a

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<sup>6</sup> No defendant has argued on appeal that it is not a proper party to any of plaintiffs' claims. The defendants in plaintiffs' section 11 claims – the Funds, as issuers, and MS Distributor, as an underwriter of the Funds' shares – appear to be permissible parties under the statute. See 15 U.S.C. § 77k(a). The defendants in plaintiffs' section 12(a)(2) claims are the Funds, Morgan Stanley, MS&Co., MS Distributor, MS Advisors, and MS Management. It is unclear from plaintiffs' allegations that each of these defendants satisfies the "statutory seller" requirement, but that issue has not been raised by the parties and we need not address it in light of our broader holding.



1 "statutory seller"; (2) the sale was effectuated "by means  
2 of a prospectus or oral communication"; and (3) the  
3 prospectus or oral communication "include[d] an untrue  
4 statement of a material fact or omit[ted] to state a  
5 material fact necessary in order to make the statements, in  
6 the light of the circumstances under which they were made,  
7 not misleading." 15 U.S.C. § 771(a)(2).

8 Claims under sections 11 and 12(a)(2) are therefore  
9 Securities Act siblings with roughly parallel elements,  
10 notable both for the limitations on their scope as well as  
11 the *in terrorem* nature of the liability they create. See  
12 *Pinter*, 486 U.S. at 646; *Herman & MacLean v. Huddleston*, 459  
13 U.S. 375, 381-82 & n.12 (1983). Issuers are subject to  
14 "virtually absolute" liability under section 11, while the  
15 remaining potential defendants under sections 11 and  
16 12(a)(2) may be held liable for mere negligence.  
17 *Huddleston*, 459 U.S. at 382.<sup>7</sup> Moreover, unlike securities

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<sup>7</sup> More specifically, section 11 provides several due diligence defenses available to non-issuer defendants, see 15 U.S.C. § 77k(b), and section 12(a)(2) contains a "reasonable care" defense, *id.* § 771(a)(2). Defendants may also avoid liability under both provisions for damages based on the depreciation in value of a security that results from events other than misrepresentations or omissions. See *id.* §§ 77k(e), 771(b). Generally speaking, defendants bear the burden of demonstrating the applicability of each of these

1 fraud claims pursuant to section 10(b) of the Securities  
2 Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78a *et*  
3 *seq.*, plaintiffs bringing claims under sections 11 and  
4 12(a)(2) need not allege scienter, reliance, or loss  
5 causation. See *Rombach*, 355 F.3d at 169 n.4. Thus, in  
6 contrast to their "'catchall'" cousin in the Exchange Act –  
7 section 10(b), 15 U.S.C. § 77j(b) – sections 11 and 12(a)(2)  
8 of the Securities Act apply more narrowly but give rise to  
9 liability more readily. *In re Fuwei Films Sec. Litig.*, 634  
10 F. Supp. 2d 419, 433-34 (S.D.N.Y. 2009) (quoting *Ernst &*  
11 *Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976)); see also  
12 *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 752-53  
13 (1975).

14 In many cases – including this one – two issues are  
15 central to claims under sections 11 and 12(a)(2): (1) the  
16 existence of either a misstatement or an unlawful omission;  
17 and (2) materiality. The definition of materiality is the  
18 same for these provisions as it is under section 10(b) of  
19 the Exchange Act: "'[W]hether the defendants'  
20 representations, taken together and in context, would have

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defenses, which are therefore unavailing as a means of  
defeating a motion to dismiss pursuant to Rule 12(b)(6).

1 misled a reasonable investor.'" *Rombach*, 355 F.3d at 172  
2 n.7 (quoting *I. Meyer Pincus & Assocs. v. Oppenheimer & Co.*,  
3 936 F.2d 759, 761 (2d Cir. 1991)); see also *DeMaria v.*  
4 *Andersen*, 318 F.3d 170, 180 (2d Cir. 2003). However,  
5 because the materiality element presents "a mixed question  
6 of law and fact," it will rarely be dispositive in a motion  
7 to dismiss:

8 "[A] complaint may not properly be dismissed . . .  
9 on the ground that the alleged misstatements or  
10 omissions are not material unless they are so  
11 obviously unimportant to a reasonable investor  
12 that reasonable minds could not differ on the  
13 question of their importance."

14 *ECA v. JP Morgan Chase*, 553 F.3d 187, 197 (2d Cir. 2009)  
15 (quoting *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162  
16 (2d Cir. 2000)); see also *United States v. Gaudin*, 515 U.S.  
17 506, 512 (1995); *First Jersey Sec.*, 101 F.3d at 1466-67.

18 The district court did not rely on materiality in its  
19 decision, and the parties' arguments regarding this issue  
20 are unpersuasive at the pleadings stage. Nor have  
21 plaintiffs argued that the Offering Documents contained  
22 actual misrepresentations. Therefore, at the heart of this  
23 appeal lies the question of whether plaintiffs have  
24 identified an unlawful omission in the Funds' Offering  
25 Documents.

1 **B. The Sufficiency of Plaintiffs' Allegations**

2 Collectively, the language of sections 11 and 12(a)(2)  
3 creates three potential bases for liability based on  
4 registration statements and prospectuses filed with the SEC:  
5 (1) a misrepresentation; (2) an omission in contravention of  
6 an affirmative legal disclosure obligation; and (3) an  
7 omission of information that is necessary to prevent  
8 existing disclosures from being misleading. See 15 U.S.C.  
9 §§ 77k(a), 77l(a)(2).<sup>8</sup> This appeal relates only to  
10 omissions. The question is whether, assuming the truth of  
11 plaintiffs' allegations, the Offering Documents omitted  
12 information that defendants were required to disclose. See  
13 *Resnik v. Swartz*, 303 F.3d 147, 154 (2d Cir. 2002) ("For an  
14 omission to be actionable, the securities laws must impose a

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<sup>8</sup> Whereas section 11 contemplates actions based on "[omissions of] material fact *required to be stated*" in registration statements, 15 U.S.C. § 77k(a) (emphasis added), section 12(a)(2) lacks parallel language regarding prospectuses and oral communications, *id.* § 77l(a)(2) (prohibiting only omissions of those facts "necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading"). See *Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1204 (1st Cir. 1996), *abrogated on other grounds by* 15 U.S.C. § 78u(4)(b)(2) (the Private Securities Litigation Reform Act). However, because we conclude that plaintiffs have not identified a legal basis requiring disclosure, we need not resolve the import of this distinction.

1 duty to disclose the omitted information."); see also *In re*  
2 *Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993)  
3 ("[A]n omission is actionable under the securities laws only  
4 when the corporation is subject to a duty to disclose the  
5 omitted facts."). Two types of omissions can give rise to  
6 liability under these provisions.

7 **1. Affirmative Disclosure Obligations**

8 Plaintiffs first argue that the "General Instructions"  
9 of Form N-1A required defendants to disclose the allegedly  
10 omitted information. In support of this contention,  
11 plaintiffs rely on language from Item C of the General  
12 Instructions, which states that "[t]he prospectus disclosure  
13 requirements in Form N-1A are intended to elicit information  
14 for an average or typical investor who may not be  
15 sophisticated in legal or financial matters" and that "[t]he  
16 purpose of the prospectus is to provide essential  
17 information about the Fund." The district court rejected  
18 this contention, and we find no fault in its conclusion.

19 The Form's General Instructions suggest that the Funds  
20 were not precluded from providing additional information  
21 beyond that called for in the more specific instructions  
22 accompanying Parts A, B, and C. In addition to the language

1     relied on by plaintiffs, Item C(3)(b) states that “[a] Fund  
2     may include, except in the Risk/Return Summary [in Items 2  
3     and 3 of Part A], information in the prospectus or the SAI  
4     that is not otherwise required.” Consistent with this  
5     theme, Item C(1)(d) provides that “[t]he requirements for  
6     prospectuses included in Form N-1A will be administered by  
7     the Commission in a way that will allow variances in  
8     disclosure . . . if appropriate for the circumstances  
9     involved while remaining consistent with the objectives of  
10    Form N-1A.” The SEC has also indicated in guidance  
11    accompanying the Form that, “in order to preserve  
12    registrants’ flexibility, registrants . . . are generally  
13    free to include in the prospectus information in addition to  
14    that required by the specific items of the Form.” See Form  
15    N-1A Adopting Release, 48 Fed. Reg. at 37,929. However, it  
16    is one thing to suggest that, based on this language, the  
17    Funds were *not prohibited* from providing additional  
18    information. It is entirely different to argue, as  
19    plaintiffs do, that defendants were *required* to make  
20    additional disclosures by the Form’s General Instructions.  
21    The latter contention lacks support in the language of the  
22    Form.

1           To the extent there is any doubt about this issue, our  
2 conclusion is confirmed by the author of the Form. When  
3 faced with ambiguity in an agency promulgation, courts can –  
4 and often do – seek the interpretive opinion of the agency  
5 and defer to its views. See, e.g., *Press v. Quick & Reilly,*  
6 *Inc.*, 218 F.3d 121, 126-28 (2d Cir. 2000). Such deference  
7 is especially prudent here in light of the SEC’s expertise  
8 in administering the securities laws, its ability to seek  
9 input from the public when crafting regulatory policy, and  
10 its relative political accountability. See *Bruh v. Bessemer*  
11 *Venture Partners III L.P.*, 464 F.3d 202, 207-08 (2d Cir.  
12 2006); *cf. Resnik*, 303 F.3d at 154-55 (quoting *Lewis v.*  
13 *Vogelstein*, 699 A.2d 327, 332-33 (Del. Ch. 1997)).

14           We requested the SEC’s opinion with respect to whether  
15 the General Instructions accompanying Form N-1A required  
16 defendants to make additional disclosures in the Funds’  
17 Offering Documents beyond those specified in the  
18 instructions relating to Parts A, B, and C of the Form. The  
19 SEC responded “no” to our inquiry, reasoning that the  
20 General Instructions “are not an independent source of  
21 disclosure obligations.” (SEC Amicus Br. at 8.) It cannot  
22 be said that this interpretation of Form N-1A is “plainly

1 erroneous or inconsistent with the law.” *Roth ex rel.*  
2 *Beacon Power Corp. v. Perseus L.L.C.*, 522 F.3d 242, 247 (2d  
3 Cir. 2008) (citing *Auer v. Robbins*, 519 U.S. 452, 461-62  
4 (1997)); *Levy ex rel. Immunogen Inc. v. Southbrook Int’l*  
5 *Invs., Ltd.*, 263 F.3d 10, 14 (2d Cir. 2001); *Press*, 218 F.3d  
6 at 128. Therefore, the SEC’s interpretation is entitled to  
7 deference. See *Auer*, 519 U.S. at 461; *DeMaria*, 318 F.3d at  
8 175. And, because we find the SEC’s view persuasive, we  
9 need not pause to determine the precise quantum of deference  
10 to which its opinion is entitled. See *Cnty. Health Ctr. v.*  
11 *Wilson-Coker*, 311 F.3d 132, 137-38 (2d Cir. 2002) (declining  
12 to “decide the exact molecular weight of the deference” due  
13 to an agency position). Accordingly, we hold that the  
14 General Instructions to Form N-1A did not require defendants  
15 to disclose the allegedly omitted information identified in  
16 the pleadings.

17 Plaintiffs next argue that defendants were required to  
18 disclose the omitted information under Items 2 and 4 of Part  
19 A of the Form, which relate to “principal risks” to be  
20 disclosed in a prospectus. Here, plaintiffs present a  
21 moving target of sorts, describing the allegedly omitted  
22 risks only vaguely, if at all, throughout their pleadings



1 and briefing. In their response to the SEC's amicus  
2 submission, however, plaintiffs clarified their position to  
3 some extent:

4 [O]nce the [Information Barrier] between Morgan  
5 Stanley's investment banking and research  
6 operations was dismantled, the conflicts of  
7 interest that infected Morgan Stanley's research  
8 and investment banking departments created a new  
9 material risk in these Funds' portfolios that  
10 would have not have existed had the [Information  
11 Barrier] been maintained. Instead of investing in  
12 securities strictly on their merits, there was an  
13 increased risk that the Funds would  
14 disproportionately invest in and/or retain the  
15 securities of Morgan Stanley's investment banking  
16 clients/potential clients, without regard to  
17 whether they were good investments.

18 (Plaintiffs-Appellants' Brief in Opposition to Amicus Curiae  
19 Securities and Exchange Commission ("Pls.' Supp. Br.") at 7-  
20 8.)

21 At bottom, plaintiffs argue that the dismantling of  
22 MS&Co.'s Information Barrier augmented the risks associated  
23 with investing in the Funds because the Funds' managers  
24 utilized MS&Co.'s research when making investment decisions  
25 for the Funds' portfolios. The district court properly  
26 characterized this position as relying on the risk-related  
27 instructions in Part A of the Form, and it found that there  
28 were insufficient factual allegations to support an  
29 inference that the Funds' managers pursued investment

1 strategies that were designed to facilitate MS&Co.'s  
2 generation of investment banking revenue. See *In re Morgan*  
3 *Stanley Tech. Fund Sec. Litig.*, 643 F. Supp. 2d at 377.  
4 Plaintiffs have not challenged that conclusion, and, absent  
5 a more particularized contention, we decline to revisit this  
6 aspect of the district court's decision. See, e.g., *Norton*  
7 *v. Sam's Club*, 145 F.3d 114, 117-18 (2d Cir. 1998). As  
8 such, this is not a case involving a situation in which "a  
9 fund's investment objectives included enhancing an  
10 affiliated entity's investment banking business," which, in  
11 the SEC's view, would have to be disclosed. (SEC Amicus Br.  
12 at 5.) Instead, the only question to be resolved is whether  
13 Form N-1A obligated defendants to disclose the allegedly  
14 omitted information as a "principal risk" of investing in  
15 the Funds.

16 Form N-1A's definition of "principal risk" is ambiguous  
17 in this regard. Hence, it is prudent to look to the SEC for  
18 interpretive guidance. In its amicus brief, the Commission  
19 characterizes the risk disclosures sought by plaintiffs as  
20 arising from "the danger that analyst reports . . . will be  
21 tainted by undisclosed conflicts of interest or actual  
22 corruption" at MS&Co., and asserts that "the fact of

1 affiliation" between MS&Co. and the other defendants  
2 "appears to be irrelevant." (*Id.* at 8, 10.) Based on these  
3 characterizations, the SEC opines that plaintiffs have only  
4 identified a "generic risk factor[] that [has] nothing to do  
5 with a specific fund," and – consistent with the decision  
6 below – that defendants were not required by Form N-1A to  
7 disclose this type of information. (*Id.* at 10.)

8 Not surprisingly, plaintiffs disagree. They first  
9 argue that this aspect of the SEC's amicus submission is  
10 entitled to "little if any deference" because it constitutes  
11 an "application" of Form N-1A rather than an  
12 "interpretation." (Pls.' Supp. Br. at 2.) We are, of  
13 course, mindful that the institutional considerations that  
14 may lead us to defer to the SEC's views on the  
15 interpretation of its promulgations counsel a different  
16 course when the question presented calls for an assessment  
17 of the sufficiency of a complaint. The task of construing a  
18 litigant's pleading rests firmly with the courts.  
19 Nevertheless, plaintiffs' distinction between an agency  
20 "interpretation" and an "application" is untenable and  
21 without support in our case law. In *Press v. Quick &*  
22 *Reilly, Inc.*, for example, we afforded deference to the

1 SEC's reasonable determination that the defendant broker-  
2 dealers in that case had satisfied their obligation to  
3 disclose third party remuneration under SEC Rule 10b-10.  
4 See 218 F.3d at 128-29. We see no basis discernible from  
5 *Press*, our other similar holdings, or this case that would  
6 allow us to draw a principled line between interpretations  
7 and applications of relevant agency promulgations.  
8 Therefore, we continue to adhere to our prior decisions and  
9 defer to the SEC's opinion so long as it is neither plainly  
10 erroneous nor contrary to law. See, e.g., *Beacon Power*, 522  
11 F.3d at 247-48.

12 In further support of their position that the SEC's  
13 amicus submission is not entitled to judicial deference,  
14 plaintiffs argue that the agency "erroneously concluded that  
15 the facts omitted here . . . were not particular to the  
16 defendant Funds." (Pls.' Supp. Br. at 4.) Instead,  
17 plaintiffs argue that they "claim *only* that those funds  
18 affiliated with full-service investment banking firms, where  
19 the required Information Barrier ha[s] been dismantled and  
20 there are resulting research-investment banking conflicts of  
21 interest, are required to disclose these facts." (*Id.* at 5  
22 (emphasis in original).) However, like the district court

1 and the SEC, we find unconvincing plaintiffs' attempt to  
2 recast the nature of the risk they have identified by  
3 limiting this case to its facts.

4 Consistent with the general guidance that accompanied  
5 the 1998 amendments to the Form, the SEC asserts that Form  
6 N-1A does not require disclosure of general risks that are  
7 present throughout the markets. Rather, the Form's  
8 instructions call for the disclosure of only those risks "to  
9 which the Fund's particular portfolio as a whole is expected  
10 to be subject." The SEC has also indicated, outside of this  
11 litigation, that it designed this requirement "to elicit  
12 risk disclosure *specific to that fund.*" SEC, Final Rule:  
13 Registration Form Used by Open-End Management Investment  
14 Companies, Securities Act Release No. 7512, Exchange Act  
15 Release No. 39,748, Investment Company Act Release No.  
16 23,064, 63 Fed. Reg. 13,916, 13,928 n.111 (Mar. 23, 1998)  
17 (emphasis added). In its amicus submission, the SEC takes  
18 the view that the risks identified by plaintiffs are not  
19 limited to the context presented by their factual  
20 allegations, and that systemic risks relating to the  
21 potential that a company's stock price is inflated by biased  
22 research coverage are present throughout the market. Put

1 differently, all investors, including the Funds' managers,  
2 face the risk that the research they use to make their  
3 decisions may be biased or flawed, and that the prices they  
4 pay for securities may not accurately reflect the  
5 securities' intrinsic value. In order to justify  
6 disregarding the Commission's conclusion, plaintiffs must  
7 persuade us that the omitted risks relating to investing in  
8 the Funds – not just the factual circumstances at Morgan  
9 Stanley or MS&Co. – are unique. Simply put, they have not  
10 done so.

11 Plaintiffs' allegations focus on the conduct of MS&Co.  
12 However, the pleadings do not suggest that there was  
13 anything untoward about the relationship between MS&Co. and  
14 the Funds, and there are no allegations that the internal  
15 problems at MS&Co. directly affected the manner in which the  
16 Funds' managers approached investment decisions.<sup>9</sup> The

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<sup>9</sup> The SEC has already sanctioned MS&Co., and we do not understand its position in this litigation to condone the dismantling of MS&Co.'s Information Barrier. Nor do we perceive any inconsistency between the agency's position here and plaintiffs' perceptions of the SEC's "long-standing view of Information Barriers." (Pls.' Supp. Br. at 17 n.14.) Therefore, *American Federation of State, County & Municipal Employees v. American International Group, Inc.*, 462 F.3d 121 (2d Cir. 2006) is inapposite. Plaintiffs' suggestion to the contrary only serves to further illustrate the extent to which their claims place undue focus on events

1 affiliation between MS&Co. and the Funds was disclosed in  
2 the Offering Documents and is insufficient to bridge this  
3 gap. Without more, we see no basis in Form N-1A for  
4 requiring the Funds to complicate their public filings by  
5 making additional disclosures about the internal workings of  
6 a broker-dealer with only a limited role in the issuance of  
7 the securities that are the focus of this case, *i.e.*, the  
8 Funds' shares. "To demand more would open the door to  
9 unceasing and unreasonable clamorings for all manner of  
10 tutoring . . . , which would afford a bonanza to lawyers . .  
11 . with no corresponding benefit to the actual investor."  
12 *Greenapple v. Detroit Edison Co.*, 618 F.2d 198, 211 (2d Cir.  
13 1980).

14 The flaw in plaintiffs' MS&Co.-focused tunnel vision is  
15 not remedied by their allegations relating to the  
16 proportions of securities in the Funds' portfolios issued by  
17 companies that were either covered by MS&Co.'s research  
18 analysts or utilizing MS&Co.'s investment banking services.  
19 Nothing about these facts changes the nature of the risks  
20 associated with utilizing MS&Co.'s research. See *Kramer v.*  
21 *Time Warner Inc.*, 937 F.2d 767, 776 (2d Cir. 1991) ("It is

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at MS&Co. rather than at the Funds.

1 in the *very nature of securities markets* that even the most  
2 exhaustively researched predictions are fallible.” (emphasis  
3 added)). Additionally, plaintiffs have not alleged that  
4 MS&Co.’s recommendations relating to these companies  
5 diverged from the assessments of analysts outside of Morgan  
6 Stanley, or that the Funds’ managers breached their legal  
7 duties to the Funds’ shareholders by blindly and  
8 uncritically following MS&Co.’s potentially tainted  
9 recommendations. See *In re Morgan Stanley Tech. Fund Sec.*  
10 *Litig.*, 643 F. Supp. 2d at 378 n.6. Consequently, while one  
11 might infer from the pleadings that conflicts of interest  
12 affected MS&Co.’s research analysis of the companies in the  
13 Funds’ portfolios, plaintiffs’ allegations do not support an  
14 inference that the Funds’ managers made investment decisions  
15 under circumstances that gave rise to unique, undisclosed  
16 risks relating to the Funds.

17 In seeking to implicate the Funds merely by virtue of  
18 their affiliation with MS&Co., plaintiffs also overstate the  
19 import of the inference that the Funds’ managers knew that  
20 MS&Co. had dismantled its Information Barrier. Assuming,  
21 *arguendo*, that the pleadings support such an inference,  
22 plaintiffs have not alleged that the Funds’ managers knew



1 that MS&Co.'s analysts had breached their professional  
2 obligations by disseminating biased or false research or  
3 manipulating IPOs. Affiliated or not, the Funds were not  
4 MS&Co.'s keeper, and defendants were not obligated to  
5 suggest – in the Funds' Offering Documents – that MS&Co.'s  
6 employees may have engaged in activities that might later be  
7 determined to run afoul of the securities laws.

8 “[D]isclosure is not a ‘rite of confession or exercise of  
9 common law pleading.’” *I. Meyer Pincus & Assocs.*, 936 F.2d  
10 at 762 (quoting *Data Probe Acquisition Corp. v. Datatab,*  
11 *Inc.*, 722 F.2d 1, 5-6 (2d Cir. 1983)). Defendants’  
12 knowledge of the lack of an Information Barrier at MS&Co.  
13 does not demonstrate that the allegedly omitted risks  
14 relating primarily to MS&Co.'s operations – however  
15 disconcerting they may be in a broader sense – were anything  
16 but run-of-the-mill insofar as Form N-1A is concerned.

17 To be clear, plaintiffs are not required under sections  
18 11 and 12(a)(2) of the Securities Act to allege that  
19 defendants acted with scienter or intentionally omitted  
20 information from the Offering Documents. See *Rombach*, 355  
21 F.3d at 169 n.4. The allegations regarding the extent of  
22 defendants’ knowledge of MS&Co.'s activities are relevant,

1     however, to assessing the nature of the risks that  
2     plaintiffs have identified in their claims. The pleadings  
3     indicate that these risks arose because the Funds' managers  
4     purchased securities "in a market artificially inflated by  
5     [MS&Co.'s] falsely rosy analyst reports . . . [and] market  
6     manipulations." Plaintiffs have not persuaded us that such  
7     risks were unique to investing in the Funds, and they have  
8     not presented any other meritorious basis for attributing  
9     error to the SEC's opinion that defendants were not required  
10    to disclose this information as an investment risk under  
11    Part A of Form N-1A. Therefore, we defer to the persuasive  
12    view of the SEC, and hold that Items 2 and 4 of Form N-1A's  
13    Part A did not create a disclosure obligation that supports  
14    plaintiffs' claims.

15           **2. Duty to Avoid Misleading Statements**

16           Our conclusion that Form N-1A did not directly require  
17    defendants to disclose the allegedly omitted information  
18    does not mark the end of our inquiry. Sections 11 and  
19    12(a)(2) both call for the disclosure of information that is  
20    necessary to avoid rendering misleading the representations  
21    in registration statements and prospectuses. See 15 U.S.C.  
22    §§ 77k(a), 77l(a)(2). SEC Rule 408, which applies to

1 filings on Form N-1A, establishes a similar requirement  
2 relating only to registration statements. See 17 C.F.R. §  
3 230.408.

4 Citing these provisions, plaintiffs argue that the  
5 statements in the Offering Documents "concerning the Fund[s]  
6 and [their] investment strategy and principal risks  
7 triggered a clear duty to disclose all material information  
8 on the same or related subjects." They further contend that  
9 "the boilerplate disclosures" in the Offering Documents  
10 regarding the Funds' "principal investment strategies" and  
11 "principal risks" were rendered misleading by the absence of  
12 the allegedly omitted information.

13 These contentions misconstrue the nature of defendants'  
14 disclosure obligations and must be rejected.<sup>10</sup> When  
15 analyzing offering materials for compliance with the  
16 securities laws, we review the documents holistically and in

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<sup>10</sup> The question that we presented to the SEC as part of our invitation to participate in this appeal as an amicus curiae focused on Form N-1A and did not relate to the issue of whether the alleged omissions rendered the Offering Documents misleading under Rule 408. This is because we see no ambiguity in the relevant language of the Securities Act or Rule 408 with respect to this issue. Thus, although our conclusion is consistent with the views expressed by the Commission, we have not deferred to this aspect of its amicus submission.

1 their entirety. See, e.g., *Olkey v. Hyperion 1999 Term*  
2 *Trust, Inc.*, 98 F.3d 2, 5 (2d Cir. 1996). The literal truth  
3 of an isolated statement is insufficient; the proper inquiry  
4 requires an examination of "defendants' representations,  
5 taken together and in context." *DeMaria*, 318 F.3d at 180  
6 (internal quotation marks omitted). Thus, when an offering  
7 participant makes a disclosure about a particular topic,  
8 whether voluntary or required, the representation must be  
9 "complete and accurate." *Glazer v. Formica Corp.*, 964 F.2d  
10 149, 157 (2d Cir. 1992) (internal quotation marks omitted).

11 Plaintiffs' argument, however, stretches these  
12 principles past their logical breaking point. The Offering  
13 Documents' disclosures did not trigger a generalized duty  
14 requiring defendants to disclose the entire corpus of their  
15 knowledge regarding MS&Co. See *In re Time Warner Inc. Sec.*  
16 *Litig.*, 9 F.3d at 267 ("[A] corporation is not required to  
17 disclose a fact merely because a reasonable investor would  
18 very much like to know that fact."). The SEC designed Form  
19 N-1A in an attempt to balance the costs and benefits of  
20 additional disclosures in the context of a specific class of  
21 issuers. Form N-1A Adopting Release, 48 Fed. Reg. at 37,928  
22 (noting that the Form was intended to "provide guidance to

1 registrants and their counsel who may be concerned about  
2 potential liability for material omissions from the  
3 prospectus"). While defendants were required to make  
4 complete and accurate disclosures regarding the principal  
5 risks of investing in the Funds, these mandatory disclosures  
6 did not obligate defendants to make disclosures relating to  
7 the commonly understood risks associated with securities  
8 research. See *id.* Consequently, we decline to hold that  
9 defendants' disclosure of the information called for by Form  
10 N-1A gave rise to a duty to make disclosures about "related  
11 subjects" not called for by the Form.

12 In light of that conclusion, plaintiffs' remaining  
13 arguments give us little pause. As stated above, plaintiffs  
14 have not alleged that the Funds' managers pursued an  
15 undisclosed objective or investment strategy when making  
16 investment decisions for the Funds. Therefore, the Funds'  
17 disclosures about these topics were not misleading.  
18 Similarly, in light of our holding that plaintiffs have not  
19 identified any undisclosed "principal risks" relating to the  
20 Funds, it cannot be said that the Offering Documents' risk  
21 disclosures were misleading because they omitted the generic  
22 risks relied on by plaintiffs. Accordingly, we hold that

1 the Offering Documents were not rendered misleading as a  
2 consequence of the omissions that are alleged to have  
3 occurred.

### 4 **III. CONCLUSION**

5 For the reasons set forth above, we conclude that  
6 plaintiffs have not identified any unlawful omissions in the  
7 Funds' Offering Documents. Therefore, their claims under  
8 sections 11 and 12(a)(2) of the Securities Act were properly  
9 dismissed. As such, we find no error in the district  
10 court's dismissal of plaintiffs' claims for control-person  
11 liability under section 15. We have considered plaintiffs'  
12 remaining arguments and find them to be without merit.  
13 Accordingly, the district court's February 2, 2009 order is  
14 hereby AFFIRMED.