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Kicking the Legalese Habit: The SEC's "Plain English Disclosure" Proposal

I. INTRODUCTION

"Plain English is like pornography," stated Nancy Smith, a senior official at the Securities and Exchange Commission ("SEC"). "It's hard to define, but you know it when you see it."¹ At first blush, this is not encouraging to hear from the official who spearheaded the new plain English proposal to clarify SEC-required prospectuses.² However, Smith simply meant that since many different writing styles can communicate effectively, an exact formula for success in plain English is difficult to define.³ Instead, identifying poorly written documents may be an easier task. In its plain English proposal, the SEC seeks to eliminate the many features that make writing difficult to understand.⁴

Corporate prospectuses are the main target of the SEC's plain English initiative.⁵ Although disclosure documents are the "primary ways that the corporate community communicates with investors,"⁶ many corporate attorneys fail to provide investors with meaningful information. Instead, the attorneys draft prospectuses solely to protect the corporation from legal liability.⁷ Thus, over time the prospectuses

1. David S. Felman, *The SEC's Plain English Initiative*, SB69 A.L.I. ABA 331, 343 n.6 (1997) (quoting J. Peder Zane, *Mutual Funds: For Investors, an Initial Public Offering of English*, N.Y. TIMES, Aug. 25, 1996, § 3, at 7). Smith is the director of the Office of Investor Education and Assistance at the SEC, the group that leads the plain English movement for SEC filings. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, A PLAIN ENGLISH HANDBOOK: HOW TO CREATE CLEAR SEC DISCLOSURE DOCUMENTS.

2. See Plain English Disclosure, 62 Fed. Reg. 3152, 3152 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997). The SEC proposed similar revisions for regulations governing small business issuers. See 17 C.F.R. § 228.10 (1997).

3. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1 (draft at 9, on file with the author).

4. See Plain English Disclosure, 62 Fed. Reg. at 3152.

5. See *id.* (discussing the SEC Task Force on Disclosure Simplification's finding that boilerplate language and repetitive disclosure problems are magnified by the complex nature of the securities market).

6. See Isaac C. Hunt, Jr., *Plain English—Changing the Corporate Culture*, 51 U. MIAMI L. REV. 713, 713-714 (1997). Hunt has served as Commissioner of the SEC since February 29, 1996 until the date of publication. See *id.* at 713.

7. See *id.* at 714. Practitioners must be aware not only of the SEC rules, but also of the rules of the Justice Department, the Federal Trade Commission, the states, and of

have become full of legalese and jargon,⁸ ironically inhibiting real disclosure because investors cannot understand the language.⁹ Investors have no remedy for this lack of meaningful disclosure because as long as key information is contained somewhere within the company's prospectus the SEC rules shield the company from liability, regardless of the particular form.¹⁰ Thus, the estimated sixty-three million Americans who invest in more than 6,400 stocks, having assets over \$3.73 trillion in mutual funds alone, are investing without adequate disclosure.¹¹

The SEC proposed Rule 421(d) is the first step to solving this prospectus comprehension problem.¹² In short, the SEC will require that the front and back covers, summary, and risk factor sections of prospectuses be written in plain English.¹³ This requirement, of course, begs the question: What exactly is plain English? As Nancy Smith's analogy at the beginning of this Article suggests, the answer is hard to articulate.

This Comment first charts the histories of the plain English movement¹⁴ and of the disclosure requirements of the SEC.¹⁵ Further, this Comment describes the details of the SEC's plain English proposal.¹⁶ Next, it proposes how the SEC should implement and

course, the Internal Revenue Service. *See id.*

8. *See id.* at 714-15.

9. *See Plain English Disclosure*, 62 Fed. Reg. at 3153 (citing H.R. REP. NO. 73-85, at 8 (1933)).

10. *See* 17 C.F.R. § 230.421 (1997) (stating that "[t]he information required in a prospectus need not follow the order of items of other requirements in the form"). However, although the SEC does not require adherence to one particular form, it does stipulate clear and concise writing presented in reasonable short paragraphs, with the exception of financial or tabular data. *See id.* Essentially, this rule proposes the "understandable" presentation of information "without the necessity of referring to the particular form or to the general rules and regulations." *Id.*

11. *See* Doug Rogers, *Worried About Your Funds? Sit and Listen*, INVESTOR'S BUS. DAILY, Apr. 29, 1997, at B3, available in LEXIS, Bankng Library, Invdy File. This proposal may especially affect the investment decisions of amateur investors who ordinarily do not read prospectuses because they are too complicated to be of any practical use to anyone other than a securities lawyer or expert investor. *See Plain English Disclosure*, 62 Fed Reg. at 3153 n.21 (citing RICHARD C. WYDICK, PLAIN ENGLISH FOR LAWYERS 3 (1994)).

12. *See Plain English Disclosure*, 62 Fed. Reg. 3152 (referring to Supplementary Information).

13. *See id.* The proposed rule provides in pertinent part: "[O]ur rule proposals would: [r]equire companies to use plain English principles in writing the front and back cover pages, summary and risk factor sections of the prospectuses." *Id.*

14. *See infra* Part II.A.

15. *See infra* Part II.B.

16. *See infra* Part III.

enforce this rule efficiently.¹⁷ Finally, this Comment concludes that this plain English proposal, if properly implemented and overseen, will greatly aid investors in their financial decisions and will create a more informed capital market with more accurate pricing.¹⁸

II. BACKGROUND

Plain English is not a new idea in the legal realm. Its history dates back many decades to when Rudolph Flesch first set forth standards for clear, concise, and easily understandable writing.¹⁹ Flesch, along with more modern authors, began applying these plain English rules to legal documents.²⁰ Paralleling the growth of plain English was a movement to increase disclosure to consumers and investors.²¹ Plain English became the vehicle to bridge the gap between disclosure and understandability.²²

A. *History of the Plain English Movement in Legal Writing*

Writers such as Rudolf Flesch, David Mellinkoff, William Strunk, Jr., and E.B. White first summarized and published mechanical and stylistic rules for improved writing, providing a framework for clear and concise writing.

1. Origins of the Plain English Movement

In 1946, Dr. Rudolf Flesch wrote a book setting forth the basic, but crucial idea that writing must be clear and readable in order for people to fully understand what is written.²³ In person-to-person conversations, listeners can immediately seek clarification by asking questions of the speaker.²⁴ In contrast, speeches or articles written for large audiences do not provide “listeners” with the opportunity to interact or to ask questions.²⁵ Therefore, these communicators must convey ideas only within the four corners of their writings or

17. *See infra* Parts IV-V.

18. *See infra* Part V.

19. *See infra* notes 23-47 and accompanying text.

20. *See infra* notes 23-67 and accompanying text.

21. *See infra* notes 68-90 and accompanying text.

22. *See infra* notes 91-123 and accompanying text.

23. *See* RUDOLF FLESCH, *THE ART OF PLAIN TALK 1* (1946) (written from the point of view of the author's five professions: researcher, librarian, teacher, editor, and writer). Originally written as a doctoral thesis, Flesch's writing was widely used by many organizations and governmental agencies. He rewrote his dissertation to adhere more closely to his own readability formula. *See id.* at xii.

24. *See id.* at 1.

25. *See id.* at 2.

speeches.²⁶

In these situations, the communicators must utilize a measuring stick in order to critique their own work before presenting it to the audience.²⁷ In an effort to help writers and speakers judge themselves, Flesch created a statistical formula for measuring readability.²⁸ His formula stressed fewer words per sentence and fewer syllables per word, in order to make writing more understandable.²⁹ Admittedly, Flesch's formula, or any other mathematical formula that tests readability, is only a quick and rough estimate.³⁰ However, Flesch's formula laid the groundwork for the idea that intelligent writing should be understood by everyone, and not just by geniuses.³¹ Flesch's useful device, and the similar ones that followed it, provide writers with a common yardstick to improve their writing by discouraging complex words and lengthy run-on sentences.³²

26. *See id.*

27. *See id.*

28. *See id.* at xii.

29. *See* RUDOLF FLESCH, *THE ART OF READABLE WRITING* 147-156 (1949). Flesch's test is scored from 0 to 100 (100 being the most readable) and is calculated as follows: (1) pick a random sample, such as every third paragraph or every other page, unless the reader wants to test the entire document; (2) count the number of words, using only the first 100 (but stopping at the end of a sentence, so there can be a little above or below 100 words); (3) figure the average sentence length; (4) count the syllables (dividing the number of syllables by the number of samples); (5) count the personal words such as first, second, and third person pronouns, unless they are gender neutral, such as "it," "its," "itself," or "they," and they refer to things rather than people, and divide the personal words by the number of samples; (6) count the personal sentences containing quotations, questions, commands, requests, or exclamations and divide the number of personal sentences by the number of sentences in your sample; (7) find your "reading ease" score by using the average sentence length (Step 3) and the number of syllables per 100 word samples on Flesch's chart on the inside cover of *THE ART OF READABLE WRITING*, *supra*, or multiply the average sentence length by 1.015 and multiply the number of syllables per 100 words by 0.846, add these two figures, subtract 206.835, and the score will fall between 0 and 100; and, (8) find your "human interest" score, looking again at the chart on the inside cover, or multiply the number of personal words per 100 words by 3.635, and multiply the number of personal sentences per 100 sentences by 0.314, and add them. *See id.* at 213-16.

30. *See id.* at xi-xii. Flesch's formula serves one important step to improve writing: it provides writers with a measuring tool by which to check their progress. *See* RUDOLF FLESCH, *HOW TO WRITE PLAIN ENGLISH: A BOOK FOR LAWYERS AND CONSUMERS* 20 (1979).

31. *See id.* at 2. Although Flesch's test is useful, it is not infallible. For example, even though the opening sentence of the Declaration of Independence is considered one of the greatest political statements ever written, it received a very low Flesch Test score of 8.4 out of 100 (100 being the most readable). *See* Albert J. Millus, *Plain Language Laws: Are They Working?*, 16 UCC L.J. 147, 157 (1983).

32. *See* WILLIAM STRUNK JR. & E.B. WHITE, *THE ELEMENTS OF STYLE* 23 (3d ed. 1979). As testament to its usefulness, since Flesch first created his test, over 75 other objective tests of readability have been created. *See* Carl Felsenfeld, *The Plain English Movement in the United States*, 6 CANADIAN BUS. L.J. 408, 418 (1981-82).

Along with his quantitative readability test, Flesch also provided qualitative communication advice.³³ Flesch emphasized the importance of the speaker always knowing his target audience.³⁴ For example, writing a comic book for children requires simpler words and sentences than writing a memorandum for business professionals.³⁵

Later, Flesch supplemented his readability formula by adding a human interest score.³⁶ This new standard recognized that people tend to enjoy reading articles that deal with a specific person and not just “people” in general, or other vague concepts.³⁷ These “personal words,” such as “you” or “she,” draw readers in with their focus on actual characters, rather than just abstract ideas.³⁸

2. Using Punctuation and Technical Details to Make Writing Clearer

Throughout his books, Flesch promoted the use of many literary devices, such as active voice,³⁹ punctuation,⁴⁰ and word choice,⁴¹ which are easily forgotten in many kinds of “technical” writing.⁴² Flesch was not alone in his quest to promote clearer writing. In the 1950s, E.B. White published the writing tips of his Cornell English professor, William Strunk, Jr.⁴³ This writing guide, nicknamed “the

33. See FLESCH, *supra* note 23, at xii.

34. See *id.* at 1.

35. See Gertrude Block, *Plain Language Laws: Promise v. Performance*, 62 MICH. B.J. 950, 954 (1983). At the very least, the writer must remember that his comic book audience is young children, and that his memo audience is sophisticated business people. See *id.*

36. See FLESCH, *supra* note 29, at 216.

37. See *id.* at 63-68. The human interest score deals with “personal words,” such as first, second, and third person pronouns, words with either masculine or feminine gender, and group words such as “folks.” See *id.* at 214-15.

38. See *id.* at 68.

39. See FLESCH, *supra* note 23, at 66-73. Active voice means using strong action verbs, “live words” as Flesch calls them, with people or objects actually doing the action. An example of active voice is “Man bites dog,” instead of “The dog was bitten.” See *id.* at 66.

40. See *id.* at 92-100. Flesch stressed that punctuation is “the most important single device for making things easier to read.” *Id.* at 92. Punctuation makes writings seem more like oral speeches by substituting punctuation marks for pauses and voice intonations. See *id.* at 92-93.

41. See *id.* at 40-47, 66-91. “Prefer the familiar word to the far-fetched. Prefer the concrete word to the abstract. Prefer the single word to the circumlocution. Prefer the short word to the long.” *Id.* at 40.

42. See *id.* at xii.

43. See STRUNK & WHITE, *supra* note 32, at xi. Professor Strunk first privately published his writing guide in 1919. See *id.* Not until after his death in 1957 did his former student, E.B. White, modify the guide and publish it on a large scale. See *id.* at xi.

little book,” comprehensively covers the smallest details of proper writing.⁴⁴ This book serves as a useful handbook, detailing rules on correct punctuation and subject-verb agreement, suggesting the omission of needless words, and summarizing other general writing techniques.⁴⁵ Although these tips were not entirely original when either Flesch or Strunk introduced them in their writings,⁴⁶ the authors increased the availability of these tips by writing them down and publishing them to a larger audience.⁴⁷

3. Plain English Principles Applied to Legal Writing

Legal writing often falls prey to the very problems that plain English proponents seek to eliminate. In 1963, David Mellinkoff published a book that labeled “legalese” as wordy, unclear, pompous, and dull.⁴⁸ He also published a legal writing guide that set forth detailed methods to clarify legal writing.⁴⁹ Mellinkoff’s academic crusade against legalese helped form the foundation for the plain English movement in the law.⁵⁰ With his seven major rules of writing, Mellinkoff explains how legal writing should be judged by the same standard as ordinary,

44. *See id.* at 1-31. The term “little book” is appropriate because the guide is less than ninety pages long. *See id.* at xi. The little book covers both “Elementary Rules of Usage” and “Elementary Principles of Composition.” *See id.* at 1-34. The usage rules involve possessive nouns, comma usage, parenthetical expressions, independent clauses, dash usage, subject-verb agreement, and pronoun agreement. *See id.* at 1-14. The composition principles involve using active voice, omitting needless words, keeping related words together, and using the same tense throughout a paper. *See id.* at 15-33.

45. *See id.* at 1-65.

46. *See FLESCH, supra* note 23, at 40-100.

47. *See id.* at xii.

48. *See* DAVID MELLINKOFF, *THE LANGUAGE OF THE LAW* 24 (1963). Other such terms that Mellinkoff used for poor legal writing are “lawspeak” and “lawyerism.” *See id.*

49. *See* DAVID MELLINKOFF, *LEGAL WRITING: SENSE & NONSENSE* 15-25 (1982) (instructing that the most important question to ask when including legal jargon in writing is: “Does it have to be like this?”). Mellinkoff is not the first to address the problems of legal writing. In 1979, after spending decades helping attorneys improve their writing, Rudolf Flesch published a book that specifically applied his writing techniques to the legal field. *See FLESCH, supra* note 30, at 2. Other authors have also addressed the problem of lack of clarity in legal writing. *See e.g.*, CLAIRE KEHRWALD COOK, *LINE BY LINE* (1985); TOM GOLDSTEIN & JETHRO K. LIEBERMAN, *THE LAWYERS’S GUIDE TO WRITING WELL* (1989); KAREN ELIZABETH GORDON, *THE TRANSITIVE VAMPIRE: A HANDBOOK OF GRAMMAR FOR THE INNOCENT, THE EAGER, AND THE DOOMED* (1984); WILLIAM ZINSSER, *ON WRITING WELL* (4th ed., 1988).

50. *See* George H. Hathaway, *The 1997 Clarity Awards*, 76 MICH. B.J. 448, 449 (1997). Mellinkoff asserted that almost all of legal writing could be written using plain English and that jargon should be used only when it is absolutely necessary. *See id.* at 449 (quoting DAVID MELLINKOFF, *MELLINKOFF’S DICTIONARY OF AMERICAN LEGAL USAGE* (1992); MELLINKOFF, *supra* note 48; MELLINKOFF, *supra* note 49).

everyday writing.⁵¹ He describes how the language of the law is more peculiar than precise, and warns against confusing the two ideas.⁵²

According to Mellinkoff, peculiar or hard to understand legal phrases, such as Latin terms, rarely provide automatic precision.⁵³ Most of the old English and Latin words that now seem standard in written legal documents, were ordinary English words 400 years ago, "with no claim to precision then or now."⁵⁴ Some practitioners, however, continue to use this ancient language because they feel that the legal precedent of boilerplate is well-settled, and will protect them from the possibility of ambiguity in their documents.⁵⁵

Mellinkoff argues that searching through precedent for the meaning of legal phrases often takes more time than searching for the case itself.⁵⁶ Every time an appellate judge renders an opinion, the legal precedent defining a particular word is subject to change.⁵⁷ The massive publication *Words and Phrases*⁵⁸ (90 volumes in Spring, 1997) illustrates the difficulty of finding precision by precedent.⁵⁹ To fully understand the entire precedent involved with a peculiar phrase, the writer must search an entry that could include over two thousand cited uses of the particular phrase.⁶⁰ Mellinkoff believes that writers who seek precision through the legal precedent of peculiar words often

51. See MELLINKOFF, *supra* note 49, at 44. "Rule 1: The language of the law is more peculiar than precise. Don't confuse peculiarity with precision." *Id.* at 1. "Rule 2: Don't ignore even the limited possibilities of precision. The price of sloppy writing is misunderstanding and creative misinterpretation." *Id.* at 15. "Rule 3: Follow the rules of English composition." *Id.* at 44. "Rule 4: Usually you have a choice of how to say it. Choose clarity." *Id.* at 61. "Rule 5: Write simply. Do not puff, mangle, or hide." *Id.* at 100. "Rule 6: Before you write, plan." *Id.* at 114. "Rule 7: Cut it in half!" *Id.* at 126.

52. See *id.* at 1. Mellinkoff warns, "[p]recision is sometimes peculiarly expressed, but don't be taken in by the peculiar expression of nonsense." *Id.*

53. See *id.* at 2.

54. *Id.* at 3. Mellinkoff provided a long list of these often-used, yet imprecise, old English legal words that should be dropped from all legal documents to improve clarity. Among others, these words include: aforesaid, behoof, foregoing, forthwith, henceforth, hereafter, hereby, herein, herewith, hitherto, moreover, said (as an adjective), same (as a noun), thence, thenceforth, thereafter, thereunder, to wit, whence, whereas, whereby, whereupon, and witnesseth. See *id.* at 187.

55. See *id.* at 9. Practitioners reason that since lawyers have used this language for so long, the courts must approve of it. See *id.* at 2.

56. See *id.*

57. See *id.* at 8. For example, one set of precedent says that "cause of action" refers to facts, while another set of precedent says that "cause of action" refers to rights. See *id.* According to one precedent, "cancellation" means termination, while another precedent says that it does not mean termination. See *id.* Also, under different precedents "proximate cause" may mean a direct cause, an indirect cause, or both. See *id.*

58. See WORDS AND PHRASES (3d ed. 1997).

59. See MELLINKOFF, *supra* note 49, at 8.

60. See MELLINKOFF, *supra* note 48, at 376.

fail because the precedent simply points in too many different directions.⁶¹ After squarely rejecting peculiar legal phrases, Mellinkoff describes how to use the rules of English composition to write more effectively.⁶² "If it's bad writing by the standards of ordinary English, it is bad legal writing."⁶³ Mellinkoff stresses going back to the basics of correct grammar as a starting point for achieving clearer legal writing.⁶⁴ To be understood by the reader, the writer must punctuate accurately, avoid run-on sentences, choose words carefully,⁶⁵ and use ordinary, instead of legal words whenever possible.⁶⁶ Finally, Mellinkoff implores writers to plan out their ideas before they start writing and to "[c]ut it in half! Repeat the operation . . . Rewrite. Rewrite. Rewrite."⁶⁷

B. *History of Informed Investing*

Disclosure documents are statements revealing facts that were once unknown concerning a business.⁶⁸ For example, today, when issuing stock, companies must first reveal to the public all pertinent information about the company's business, management, and financial conditions that might affect people's investment decisions.⁶⁹ Before the stock market crash of 1929 and up until 1933, however, the government did not play any role at all in requiring companies to file any disclosure statements.⁷⁰ In 1933, the government took its first step towards providing investors with full information by creating the

61. See MELLINKOFF, *supra* note 49, at 8.

62. See *id.* at 44-60.

63. *Id.* at 44. The language of the law grew up using mostly Latin and French legal terms. For centuries there was little guidance to the use of modern English grammar in the law. The lawyers never questioned the use of archaic terms, so they got along without using correct English—and many have been getting along without it ever since. Lawyers today must relearn the basics of grammar used in lower schools to increase clarity in their writing. See *id.* at 46.

64. See *id.* at 46. Mellinkoff suggests this quick two-part test before using a legal word: "(a) Does it have to be this word? (b) Is this better than ordinary English?" *Id.* at 63.

65. See *id.* at 51-60.

66. See *id.* at 62-65.

67. *Id.* at 114-26. Mellinkoff lists several reasons for wordy legal writing including: (1) the attorney's fear of leaving something out; and, (2) inevitable time pressures. See *id.* at 127. To improve their clarity, lawyers must overcome the fear of omission and take the extra time to omit extraneous words. See *id.* at 130.

68. See BLACK'S LAW DICTIONARY 464 (6th ed. 1990).

69. See Plain English Disclosure, 62 Fed. Reg. 3152, 3153 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

70. See J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER 196-97 (1958).

federal securities laws.⁷¹ The 1933 Securities Exchange Act requires publicly traded companies to fully disclose material information that could affect investors' decision-making on initial securities offerings.⁷² Requiring only general disclosure, the 1933 Securities Exchange Act's main purpose was to eliminate the serious abuses prevalent in the largely unregulated stock market of the 1920s.⁷³ One of the main goals was to provide investors with protection against fraud.⁷⁴

The Securities Exchange Act requires publicly traded companies to disclose all their material information in the form of a prospectus.⁷⁵ Generally, prospectuses are magazine-style booklets that provide the potential securities buyer with information regarding the intricacies of the company in which they are invited to invest.⁷⁶ The prospectus must include details, such as the general character of the business actually transacted by the issuer, and the purpose the proceeds of the security sale will serve.⁷⁷ The prospectus must also provide other details, such as the amount currently outstanding in each class of stock, and the full particulars of the stock to be issued.⁷⁸ The writer must explain how the new sale of stock or other security will affect the overall financial health of the company through the use of financial ratios.⁷⁹ The SEC also requires numerous disclaimers that state the

71. See 15 U.S.C.A. §§ 77a-77aa (West 1997) (listing disclosure requirements for the corporation making a public offering of securities).

72. See *Adato v. Kagan*, 599 F.2d 1111, 1115-26 (2d Cir. 1979); Millus, *supra* note 31, at 147.

73. See *United Housing Found. v. Forman*, 421 U.S. 837, 849 (1975). The court noted that a focus of both 1933 and 1934 Acts was "[t]he need for regulation to prevent fraud and to protect the interest of investors." *Id.*

74. See *Associated Sec. Corp. v. SEC*, 293 F.2d 738, 740 (10th Cir. 1961).

75. See 17 C.F.R. §§ 229.501-229.512 (1997).

76. See Plain English Disclosure, 62 Fed. Reg. 3152, 3153 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

77. See 15 U.S.C. § 77aa(8), (13) (1994) (setting forth the schedule of information required to be included in the registration statement).

78. See *id.* § 77aa(9). Other details required in the prospectus are: the salaries of the issuer's officers, the amount of commission paid to the underwriter, the expenses incurred because of the stock issue, the net proceeds of any of the issuer's other sales of securities in the previous two years, the names and addresses of any attorneys who read and approved the offering, and the balance sheets and income statements that are less than ninety days old. See *id.* § 77aa(14), (18), (19), (23), (25).

79. See 17 C.F.R. § 229.503(d). This is not an exhaustive list. Issuers may also have to disclose financial ratios that reveal the extent to which existing shareholders' shares will be diluted when directors or officers are purchasing securities. The issuers must show the net tangible book value of the securities before and after the distribution. Also, the issuer must show the amount of book value increase accredited to the cash payments made by the purchasers of the shares being offered. See *id.* § 229.506.

risky and unguaranteed nature of investment securities.⁸⁰

A few sections of the prospectus have more specific requirements. The front and back covers must contain background information, such as the company's name, and the amount of securities being offered.⁸¹ The inside front cover must contain statements about the availability of the prospectus and other documents filed with the SEC.⁸² And finally, companies with complicated offerings may be required to summarize the details of the entire prospectus.⁸³

If not specifically required to appear in any of these special sections, the remaining information may be placed in any "reasonable order" understandable to investors within the body of the prospectus.⁸⁴ Investors, through these long and complicated reports, are supposed to learn about the companies and their securities in order to make an informed decision as to whether or not to invest.⁸⁵

The SEC not only requires disclosure when a security is initially issued, but it also requires disclosure at any time the security is traded.⁸⁶ In 1934, Congress passed the 1934 Securities Act⁸⁷ to enforce full disclosure for securities traded on the secondary market.⁸⁸ The 1933 and 1934 Securities Acts were the first steps towards widespread dissemination of information to investors dealing in the securities market.⁸⁹ In later years, the Government began to require

80. See 17 C.F.R. § 229.501-02 (1997). For example, a disclaimer is required on the prospectus cover: "These securities have not been approved or disapproved by the Securities and Exchange Commission nor has the Commission passed upon the accuracy or adequacy of this prospectus. . . Any representation to the contrary is a criminal offense[.]" *Id.* § 229.501. An example of a discretionary disclaimer is as follows: "Certain persons participating in this offering may engage in transactions that stabilize, maintain, or otherwise affect the price of (identify securities), including (list types of transactions). For a description of these activities, see 'Plan of Distribution.'" *Id.* § 229.502.

81. See Plain English Disclosure, 62 Fed. Reg. at 3160.

82. See *id.* at 3161. This information alerts investors that issuers have a continual duty to update prospectus information. See *id.* In addition, any document filed with the SEC can be inspected by the general public. See *id.* at 3162.

83. See *id.* at 3163.

84. 17 C.F.R. § 230.421.

85. See *Adato v. Kagan*, 599 F.2d 1111, 1115-16 (2d Cir. 1979).

86. See *infra* notes 87-88.

87. 15 U.S.C.A. §§ 78a-78mm (West 1997). Among the reasons for the 1934 Act, the code provides: "Transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets . . . make it necessary to provide for regulation and control of such transactions." *Id.* § 78b.

88. See *Reader v. Hirsch & Co.*, 197 F. Supp. 111, 114 (S.D.N.Y. 1961). Securities traded on the secondary market include any security traded after the initial public offering. See 15 U.S.C. § 78b.

89. See *Columbia Gen. Inv. Corp. v. SEC*, 265 F.2d 559, 563 (5th Cir. 1959)

disclosure in areas outside of securities regulation, especially in the consumer arena.⁹⁰

C. *Bridging the Gap Between Plain English and Disclosure*

The early securities statutes merely ensured that information was disclosed; they did not ensure that the information disclosed was understandable. As a result, companies “overloaded” readers with excessive information to ensure that all material facts were disclosed, at the cost of burying the relevant information under a mountain of useless information.⁹¹ Due to the enormous length and over-inclusive disclosures, most readers simply stopped reading the prospectuses.⁹² As long as companies provided full disclosure, no matter how vague or obscure it was to the investor, the company was in compliance with the 1933 and 1934 Securities Acts requirements.⁹³ Thus, no true disclosure existed for the investors because they could not understand what was written, or more typically, they chose not to read the prospectus at all.⁹⁴

1. Plain English in Consumer Disclosure.

Thus, it became clear that simply requiring disclosure did not ensure understandability.⁹⁵ The idea of using Plain English to make

(discussing the Acts' goals of preventing and punishing fraud in the issuance of securities). The Securities Act of 1934 differs from the Securities Act of 1933 because the Securities Act of 1933 is “concerned primarily with the initial distribution of securities, rather than subsequent trading.” *See Reader*, 197 F. Supp. at 113.

90. *See infra* notes 101-06 and accompanying text. In the 1950s, the Retail Installment Sales Acts were designed to provide disclosure of terms to people buying merchandise with multiple payments over a prolonged period. *See, e.g.*, ALASKA STAT. § 45.10.010 (Michie 1996); CAL. CIV. CODE § 1803.2 (West 1985 & West Supp. 1998); FLA. STAT. ANN. § 520.30 (West 1997 & West Supp. 1998); N.J. STAT. ANN. 17 N.J.S.A. § 16C-1-C61 (West 1984 & West Supp. 1998). *See generally* Felsenfeld, *supra* note 32, at 411 (discussing statutory consumer protection). Later, the Truth in Lending Act of 1969 mandated uniform disclosure for all consumer credit transactions. *See* Truth in Lending Act, 15 U.S.C. § 1601(a) (1994) (requiring “meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit offers from different companies”).

91. *See* Felsenfeld, *supra* note 32, at 411-412.

92. *See* LOUIS LOSS, SECURITIES REGULATION 158-66 (1st ed. 1951) (concluding that because the average investor could not understand most prospectuses, they simply stopped reading them).

93. *See* Michael S. Friman, *Plain English Statutes: Long Overdue or Underdone?*, 7 LOY. CONSUMER L. REP. 103, 105 (1995).

94. *See* Plain English Disclosure, 62 Fed. Reg. 3152, 3153 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

95. *See id.*

disclosure more meaningful did not start at the SEC, but instead spread gradually from voluntary corporate efforts to state and federal laws.

a. Voluntary Inclusion of Plain English.

The "real" plain English disclosure movement began in the private sector, where some companies adopted plain language practices on their own, without any mandated regulation.⁹⁶ Significantly, these companies focused on effective communication, rather than just raw disclosure.⁹⁷ The most profound plain English endeavor prior to federal regulation was introduced in 1975, when Citibank of New York began requiring the use of plain English in all of its consumer promissory notes.⁹⁸ The general public viewed this new understandable type of disclosure document very favorably and consumer activists claimed that it was a major breakthrough in consumer communication.⁹⁹ Inevitably, other lenders noticed Citibank's successful innovation and converted their consumer notes into plain English as well.¹⁰⁰

b. Government Mandates to use Plain English in Consumer Disclosure

Eventually, state and federal governments began requiring plain English in consumer related activities and transactions. The federal government first joined the movement in the 1970s by passing numerous laws mandating plain English in consumer transactions, such as retirement plans,¹⁰¹ written warranties for consumer

96. See Felsenfeld, *supra* note 32, at 409. This stage of the movement was more "real" because it provided a mechanism for effective communication rather than providing only for disclosure of information. See *id.*

97. See *id.* There has been a "burgeoning voluntary effort by businesses, particularly the larger ones, to rephrase their contracts in clearer language." *Id.*

98. See Carl Felsenfeld, *The Future of Plain English*, 62 MICH. B.J. 942, 942 (1983). Citibank made the switch to plain English in order to draw more bank customers. See *id.*

99. See *id.*

100. See *id.* For example, one major change in the promissory note was the use of personal pronouns and active verbs instead of the traditional use of third person pronouns and passive voice. See Stephen M. Ross, *On Legalities and Linguistics: Plain Language Legislation*, 30 BUFF. L. REV. 317, 338 (1981).

101. See Employee Retirement Income Security Act of 1974, 29 U.S.C.A. §§ 1001-1461 (West 1985 & West Supp. 1997) (amended). This Act requires that elements of employee benefits plans must be "written in a manner calculated to be understood by the average plan participant." *Id.* § 1022(a) (West 1985), amended by Taxpayer Relief Act of 1997, Pub. L. 105-34, § 1503(b), 111 Stat. 1061, and Departments of Veterans Affairs and Housing and Urban Development and Independent Agencies Appropriations Act of 1997, Pub. L. 104-204, § 603 (b)(3)(C), 110 Stat. 2938, and Health Insurance Portability and Accountability Act of 1996, Pub. L. 104-191, § 101(c)(2), 110 Stat.

products,¹⁰² and consumer account terms.¹⁰³ Then in 1978, President Carter made the most sweeping plain English regulation when he declared that all federal regulations "shall be as simple and clear as possible."¹⁰⁴

Observers criticized these plain English efforts because the federal government failed to define what terms, such as "readily understandable" and "as clear as possible," meant.¹⁰⁵ They argued that writers trying to follow these plain English regulations would inevitably fail because of the lack of clear standards.¹⁰⁶

Recognizing the vagueness in the federal laws, state legislatures drafted statutes that defined more specifically the plain English requirements. For example, states mandated that plain English be used not only in insurance contracts, but all consumer contracts in order to combat deception in negotiations.¹⁰⁷ These early state attempts were more specific than the federal attempts because they designated a target audience for their laws: the "average consumer."¹⁰⁸

States began passing plain English laws, using either flexible subjective tests or strictly ruled objective tests.¹⁰⁹ A flexible subjective test values the understanding of the parties over specific sentence or

1951.

102. See Magnuson-Moss Warranty Act—Federal Trade Commission Improvement Act of 1975, 15 U.S.C. §§ 2301-12 (1994). This "lemon" law requires "simple and readily understand[able]" warranties to be displayed on all consumer products. *Id.* § 2302(a).

103. See Electronic Fund Transfer Act of 1978, 15 U.S.C. §§ 1693-1693r (1994). This Act requires account terms to be written in "readily understandable language." *Id.* § 1693b(b).

104. Exec. Order No. 12,044, 3 C.F.R. 152 (1978), *revoked by* Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (1981). Rudolf Flesch hailed President Carter's plain English effort as a "historic movement" similar to that of the Catholic Church when it started to allow masses in languages other than Latin. Unfortunately, as time passed, the federal bureaucrats returned to their poor writing habits because they lacked incentive to improve. See FLESCH, *supra* note 30, at 1-2. After the next election when President Carter was defeated, President Reagan quickly repealed Carter's plain English endeavor without stating any reasons for doing so. See Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (1981).

105. See Block, *supra* note 35, at 952.

106. See Millus, *supra* note 31, at 148.

107. See Harold A. Lloyd, *Plain Language Statutes: Plain Good Sense or Plain Nonsense?*, 78 LAW LIBR. J. 683, 687 (1986) (citing Texas' Deceptive Trade Practices—Consumer Protection Act, TEX. BUS. & COM. CODE ANN. §§ 17.01-17.854 (West 1998)).

108. See, e.g., ARK. CODE ANN. § 23-80-201 to -208 (Michie 1994); CONN GEN. STAT. § 38a-300 (1992); DEL. CODE ANN. tit. 18, §§ 2740-2741 (Michie 1991); FLA. STAT. ANN. § 627.4145 (West 1996).

109. See CARL FELSENFELD & ALAN SIEGEL, *WRITING CONTRACTS IN PLAIN ENGLISH* 221-29 (1981). Most plain English laws introduced so far utilized either strictly subjective or objective tests of readability. See *id.*

word length.¹¹⁰ For example, the State of New York intended to create a subjective test of readability by requiring that all written residential leases and consumer contracts for values of less than \$50,000, and used for personal purposes, be written "in a clear and coherent manner using words with common and every day meanings."¹¹¹

In contrast, an objective test sets forth specific mechanical guidelines that limit the average number of syllables per word, and the average number of words per sentence, among other details.¹¹² For example, Pennsylvania passed a plain English law with goals similar to New York's, but adopted a strict set of rules using an objective standard, such as Flesch's readability test.¹¹³ Today, in the 1990s, the plain English movement expands throughout the consumer arena,¹¹⁴ as

110. See David C. Elliot, *A Model Plain-Language Act*, 3 SCRIBES J. LEGAL WRITING, 51-59 (1992). A subjective test focuses on the end results, requiring clear communication, rather than mechanical limitations on the number of words per sentence. See *id.* Elliot recommends the enforcement of strict penalties for drafters who do not comply with plain English principles, such as: (1) imposing fines for using archaic language; (2) creating statutory claims for non-compliance; and (3) empowering courts to prohibit publication, use, or sale of a document that violates plain English principles. See *id.* at 52.

111. Friman, *supra* note 93, at 105-06 (quoting Givens, Supplementary Practice Commentaries, N.Y. GEN. OBLIG. LAW § 5-702 (McKinney Supp. 1990)). With its definition of plain English and by valuing the parties' understanding and specific writing requirements, New York clearly intended a subjective test of readability. See Lloyd, *supra* note 107, at 687-88.

112. See FELSENFELD & SIEGEL, *supra* note 109, at 224.

113. See Roseann B. Termini, *A Compliance Guide to Pennsylvania's "Plain English" Consumer Contract Law*, 66 PA. B. ASS'N Q. 74, 75 (1995). Pennsylvania's test restricted many writing devices, such as sentence length, use of negatives, use of conditions, cross references, Latin words, and verb usage. See *id.*

Objective readability test critics, such as Mellinkoff, believe that such tests result only in mechanical conformity without regard to clarity. See MELLINKOFF, *supra* note 49, at 214. Other states that use Flesch's objective test in their insurance contracts laws are Maine, Minnesota, North Carolina, and Ohio. See ME. REV. STAT. ANN. tit. 24A, § 2441 (West 1990); MINN. STAT. 72C.09 (West 1986); N.C. GEN. STAT. § 58-38-25C (Michie 1994); OHIO REV. CODE ANN. §§ 3902.04 (Anderson 1989).

114. For example, a legal scholar recently proposed requiring plain English in all Uniform Commercial Code ("UCC") governed contracts. See Steven O. Weise, "Plain English" Will Set the UCC Free, 28 LOY. L.A. L. REV. 371, 371 (1994). Studies have shown that preparing UCC contracts using plain English principles decreases the number of good faith disputes over the meaning of the words in agreements. See *id.* at 376.

In addition, courts are beginning to advance the plain English movement as illustrated by the Texas Supreme Court's upholding of the use of plain English in disclosure documents in order to protect borrowers from ambiguous language in promissory notes. See *Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890, 896 (Tex. 1991) (Mauzy, J., concurring) (stating that plaintiff did not waive the implied warranties created to protect consumers merely because of the presence of an unintelligible merger clause in the

well as into other areas of the law.¹¹⁵

2. The SEC's Initial Pilot Program

The plain English movement has moved beyond the area of low level consumer contracts and into federal investor laws.¹¹⁶ In 1993, the SEC began its initiative to compel publicly held companies to draft plain English documents for several types of their securities.¹¹⁷ The first projects included a mutual fund prospectus and a joint proxy statement.¹¹⁸

As an incentive, companies that participated in the pilot program received expedited reviews of their disclosure documents by the SEC.¹¹⁹ By taking part in the plain English program, the SEC

contract).

115. The movement expanded beyond consumer contracts when avid plain English author and teacher, Bryan Garner, produced a plain language redraft of the APPELLATE RULES OF FEDERAL PROCEDURE and wrote the *Guidelines for Drafting and Editing Court Rules*. See Hathaway, *supra*, note 50, at 450. Counted as one of his proudest accomplishments, Garner completely redrafted the federal rules with the help of plain English scholars, Judge Robert E. Keeton and Professor Charles Alan Wright. See *id.* Plain English advocates, like these men, continue to redraft legal documents into understandable plain English to this day, and are smoothing the path for its broader acceptance in the academic arena. See *id.* Since 1992, the State Bar Association of Michigan has been recognizing excellent examples of plain English writing, such as Garner's rewrite of the appellate procedure rules, by giving out annual plain English awards. See *id.* at 448.

The movement is also expanding into estate planning, an area that has traditionally used more legalese than SEC filings. See Donna Gill, *Group Approach Makes Estate Planning Forms User-friendly*, CHICAGO LAW., Nov. 1997, at 8. A five-attorney continuing legal education committee in Illinois is experiencing great success with its guide on language simplification in the usually jargon-filled world of estate planning. See *id.* This group did not simply revise these forms—they started from scratch, rewriting the entire set of estate planning forms by using easily understood plain language. See *id.* In the process, the writers eliminated every Latin phrase in their estate planning forms except "per stirpes." See *id.*

116. See George Hathaway & Kathleen Gibson, *The Word from the Securities and Exchange Commission: Put It in Plain English*, 75 MICH. B.J. 1314, 1314 (1996) (explaining that eight mutual funds now use clear language in prospectuses).

117. See *id.* The SEC's push for plain English documents started following Arthur Levitt Jr.'s 1993 appointment as Chairman of the SEC. After becoming chairman, Levitt stated that plain English in SEC documents was one of his top priorities. See *id.*

118. See *id.* A proxy statement is a form that asks a shareholder, who may not be present at the annual shareholders' meeting, to authorize another person to vote in his place. This statement must describe what issues will be dealt with at the meeting so that the shareholder can understand for what the other person should vote. See BLACK'S LAW DICTIONARY 1226 (6th ed. 1990).

119. See Brett D. Fromson, *At Last, a Proxy in Plain English*, WASH. POST, Sept. 22, 1996, at H4. This expedited review proved to be ample incentive because no sale of any security or its prospectus may be released until SEC examiners approve it for accuracy. See Plain English Disclosure, 62 Fed. Reg. 3152, 3164 (1997) (to be codified at 17

guaranteed these companies quicker reviews, allowing them to both practice their plain English skills, and to release securities into the marketplace faster.¹²⁰

The plain English joint proxy statement and mutual fund prospectuses were successful on a large scale. Two major telecommunications industry leaders, Bell Atlantic and NYNEX, chose to participate in the pilot program when their companies merged.¹²¹ Their successful translations into plain English proved that even large corporations could change their writing habits.¹²² The lawyers involved with that large-scale merger reported that writing in plain English did not increase their costs.¹²³ This successful merger finally provided plain English scholars with direct evidence of success for plain English in SEC disclosure statements.

III. DISCUSSION

On January 21, 1997, after the pilot program's initial success, the SEC proposed Rule 421(d)—the Plain English Disclosure Rule.¹²⁴ In short, the proposal: (1) requires companies to use plain English principles in writing the front and back cover pages, summary, and risk factor sections of prospectuses; (2) revises current requirements for highly technical information in the front of prospectuses; and (3) provides companies with more specific guidance on the clarity required in the entire documents.¹²⁵ The proposal specifically describes the required changes needed in prospectuses, and suggests some general plain English techniques to follow in redrafting the prospectuses.¹²⁶ All publicly held companies must fully comply with this rule by December 31, 1998.¹²⁷

C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997) (discussing the general procedures of the plain English pilot program).

120. See Fromson, *supra* note 119, at H4. Ordinarily, SEC examiners can stall a security offering into the market if it is either inaccurate or poorly written. See *id.* This stall could result in the company losing money because it is unable to take advantage of sudden beneficial market conditions, such as lower interest rates. See *id.*

121. See *id.*

122. See *id.*

123. See *id.*

124. See Plain English Disclosure, 62 Fed. Reg. 3152, 3154 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997) (describing the factors that led to the need for reform and the current SEC plain English initiatives).

125. See *id.* at 3152.

126. See *id.* at 3155-64.

127. See Paul Beckett, *Can SEC Walk Its "Plain" Talk?: Agency Takes Role of Documents Editor*, THE HOUSTON CHRON., Mar. 22, 1997, at 5, available in LEXIS, News Library, Hchrn File. Any plain English rule that is finally adopted would be phased in

A. *Specific Changes Required in Prospectuses*

The SEC's proposal focuses only on the front and back covers, summary sections, and risk factor sections of the prospectuses.¹²⁸ All other areas of the prospectus will remain unchanged for now.

1. Cover Page

A prospectus cover page, like the first page of any document, introduces the reader to what is inside and invites the reader to continue reading. Unfortunately, according to the SEC, typical prospectus cover pages currently have a dense format that discourages investors from reading important business disclosures within the body of the document.¹²⁹

Under the SEC's proposal, the highly formatted design of the front of the registration statement and the outside front cover page of the prospectus must be eliminated and replaced with legal warnings in plain English.¹³⁰ Unlike current prospectuses, the new format should invite the investor to read the information through the use of pictures, graphs, charts, and any other non-misleading devices that might describe the company's condition.¹³¹ The SEC proposal also requires that prospectus drafters eliminate presently required cross-references to other sections of the prospectus's body.¹³²

The SEC also encourages writers to replace the previously-used distribution table with bullet lists.¹³³ In addition, the drafter will be

slowly to make sure that the SEC does not exceedingly interfere with companies' access to the capital markets. Registration statements pending on the effective date of the rule would not need to be revised to meet the plain English requirements. However, any updating amendments filed after the proposal's effective date will have to comply with plain English rules. Furthermore, any shelf registration statement (shares which have been authorized but have yet to be issued) will have to comply if issued after the proposal's effective date. Finally, all filings would be required to comply with the rule no later than December 31, 1998. See Plain English Disclosure, 62 Fed. Reg. at 3154.

128. See *infra* notes 129-62 and accompanying text.

129. See Plain English Disclosure, 62 Fed. Reg. at 3158. The SEC encourages companies to make their disclosure documents visually inviting. See *id.*

130. See *id.* Currently, the information on the cover page must be placed in a specific order. Under the proposal, the cover page information may be placed in any order that is inviting to the reader. See *id.* at 3160.

131. See *id.* at 3160. Such visual aids help the investor understand the nature of the business, its products, and its financial health. See *id.*

132. See *id.* The excessive cross-referencing clutters the cover page to the point that it loses its purpose as a quick summary. See *id.* In addition, the SEC expects that the plain English requirement in the risk factors section will improve disclosure to investors, making cross-referencing unnecessary. See *id.*

133. See *id.* The distribution table is a boxed area on the cover that gives the details of the offering's proposed price, the underwriter's commission, and the proceeds of the

required to remove less important items from the front cover, such as the underwriter's expenses in preparing the prospectus, the over-allotment option, finders fees, and non-cash commissions, and place such information in the body of the prospectus.¹³⁴ With these changes, the cover page will display only the essential facts, inviting the reader to continue exploring the prospectus for further details.¹³⁵

The SEC will also require changes to the disclaimers.¹³⁶ The SEC found that the use of bold lettering in the disclaimer tended to make the disclaimers look like unimportant boilerplate language that readers might ignore.¹³⁷ The proposal requires that the cover page disclaimer be written in plain English, preferably without bolding or capitalization.¹³⁸ Finally, any "red herring"¹³⁹ prospectuses that are essentially previews of a corporation's possible offerings, need clearly written plain English disclaimers on their covers, explaining that the document is subject to change.¹⁴⁰ Under the old requirements, the "red herring" disclaimer was drafted in legalese and was also printed in

offering. *See id.*

134. *See id.*

135. *See id.*

136. *See id.* A disclaimer is the repudiation or renunciation of a legal right or claim, such as an investor's claim against the issuer for mistakes made in the prospectus. *See BLACK'S LAW DICTIONARY* 464 (6th ed. 1990). The cover page disclaimer states that the SEC has not checked the prospectus for truthfulness. *See Plain English Disclosure*, 62 Fed. Reg. at 3161.

137. *See Plain English Disclosure*, 62 Fed. Reg. at 3161.

138. *See id.* (noting, however, that the SEC does not propose any specific print size or font type so long as the information is easily readable in plain English).

139. *See id.* "Red herrings" are incomplete prospectuses subject to complete amendment at any time before the registration statement is approved by the SEC, and are not considered offers to sell the securities. *See id.*

140. *See id.* One example of the current red herring disclaimer reads as follows:

Information contained herein is subject to completion or amendment. A registration statement relating to these securities has been filed with the SEC. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This prospectus shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any State in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of any State.

.....

Using plain English, the disclaimer may read as follows: The information in this prospectus is not complete and may be amended. We may not sell these securities until the registration statement filed with the SEC is effective. This prospectus is not an offer to sell nor is it seeking an offer to buy these securities in any state where the offer or sale is not permitted.

Id.

boldface identical to the disclaimer.¹⁴¹

2. Inside Front and Outside Back Cover Pages

Traditionally, the SEC required information of a highly technical nature to appear on either the inside front, or outside back cover pages of the prospectus.¹⁴² Under the new plain English rules, however, the writer should organize the prospectus in a manner that gives meaning to its subsections.¹⁴³ Under the proposal, the writer should move relevant information to sections that will make more sense to the reader.¹⁴⁴ First, the SEC will require that the table of contents be moved from the back page to the inside front cover or immediately behind the cover page, a page the investor will probably read before looking through the body of the prospectus.¹⁴⁵ Under the old method, random details involving a wide variety of issues were placed on the inside front or back covers.¹⁴⁶ Now, activities involving underwriting details should be placed in the underwriter's section.¹⁴⁷ In addition, details of the company's financial condition should be placed in the business description section.¹⁴⁸ By moving these factors to the body of the prospectus, the highly technical information will no longer overshadow the essential business and financial information that is

141. *See id.* Under the new proposal, the font type and font size is left to the writer's discretion. *See id.*

142. *See* 17 C.F.R. §§ 228.502, 229.502 (1997). The information required includes: (1) statements that the governing law is the 1933 Securities Exchange Act; (2) procedures for how all SEC filings may be inspected; (3) names of all the national exchanges on which the security is traded; and (4) the availability of annual reports. *See id.* § 228.502.

143. *See id.* The old method should not be followed simply because it has always been done that way. *See id.*

144. *See* Plain English Disclosure, 62 Fed. Reg. at 3159. Additionally, highly technical legal terminology should be eliminated because it has no meaning to the reader under any subsection. *See id.*

145. *See id.* at 3163. The SEC highly doubts that investors naturally turn to the back of the prospectus to locate a table of contents that could guide them to other sections of the document. *See id.*

146. *See id.* at 3160 (discussing the current cross-referencing on front and back covers).

147. *See id.* at 3163. Currently, all the details regarding the underwriters' commissions, fees, and expenses are on the prospectus cover. *See id.* Under the proposal, these details will be moved to a separate underwriter's section in the body of the prospectus. *See id.*

148. *See id.* at 3161. Other details which should be moved from the inside front and back covers to the business description section are: (1) the availability of annual reports to shareholders; and (2) the enforceability of civil liabilities claims of federal securities against foreign persons. *See id.*

supposed to be highlighted on the covers.¹⁴⁹

3. Summary

Currently, the SEC only requires prospectuses to contain a summary and risk factor section if “the length or complexity of the prospectus makes a summary appropriate.”¹⁵⁰ If a summary section is required, the writer must also include a risk factor section that lists any variables that could significantly affect the stock’s value.¹⁵¹

The SEC argues that many of these so-called “summaries,” reaching lengths of ten to twenty-five pages, are written in incoherent legalese and do not actually summarize the prospectus in any meaningful way.¹⁵² In addition, the SEC warns that risk factor sections contain very general or boilerplate risks¹⁵³ that are often highly unlikely, or are usually in all securities by their nature and, as such, do not add any real meaning to the disclosure.¹⁵⁴

Along with being written in plain English, the new disclosure rule requires that the summary be brief.¹⁵⁵ For fear of limiting the writer’s ability to draft a meaningful summary, the SEC set no specific page limit;¹⁵⁶ however, if excessive summaries continue to be filed, the SEC may eventually impose a five-page limit.¹⁵⁷

149. *See id.* at 3163. Overall, the information provided to investors will be the same because the disclosure will be elsewhere within the prospectus. *See id.*

150. *Id.* at 3163. The prevailing test allows for summary and risk factor sections “to be as long as necessary” to draft a meaningful summary appropriate to the type of offering. *Id.*

151. *See id.* Under both the current and proposed rules, any necessary risk factor section must follow immediately after the summary section, if one is provided, or the cover page of the prospectus. *See id.*

152. *See id.*

153. *See id.* In the proposal, the SEC suggests the following example:

[I]f your company is making an initial public offering of common stock and the securities will be listed and traded on a national securities exchange, it is not helpful to investors to provide a statement that management can give no assurance that an active market will develop in the company’s securities. If, given these facts, you believe that a market will develop for the securities, then the risk factor is misleading. On the other hand, if, given these facts, you believe that a market reasonably may not develop, additional information would be necessary as to why a trading market may not develop.

Id.

154. *See id.*

155. *See id.*

156. *See id.* The SEC is wary of initially setting a page limit because of the wide range of security complexities that exist. *See id.*

157. *See id.* Under a strict page limit proposal, many prospectus writers may have to stop summarizing their company’s business operation section (which is not required but helpful) in order to save space. *See id.*

As for the risk factors, the SEC originally proposed limiting the number of risks allowed and requiring the writer to list the risks in order of importance.¹⁵⁸ However, this suggestion concerned companies who believed that placing a limit on risk factors could force them to omit risks solely because they had already reached their quota.¹⁵⁹ As a result, the SEC has reconsidered and could possibly abolish the requirement limiting or prioritizing the risks in the prospectuses.¹⁶⁰ Even after these modifications, the SEC rule will still prohibit the listing of boilerplate risks, and will require plain English for the material risks that are listed.¹⁶¹ Even without a set page limit, if the writer follows the other plain English principles, the risk factor section will necessarily be shorter.¹⁶²

4. The SEC Review Process

The Division of Corporation Finance of the SEC is working with publicly held companies, such as NYNEX and Bell Atlantic, on drafting disclosure documents using plain English.¹⁶³ All comments written by the reviewers on disclosure statements have been and will continue to use plain English.¹⁶⁴ During this learning process for both the SEC and the companies, the SEC staff released five interpretive letters, explaining its position on such issues as legend requirements,¹⁶⁵ distribution tables showing the price, underwriters' commissions and proceeds of the offering,¹⁶⁶ and the Exchange Act disclosure statement availability.¹⁶⁷ Because the SEC's position on these matters is now well settled, other companies may rely on these letters and need not submit their own specific written requests in similar situations.¹⁶⁸

158. *See id.* The companies worry that limiting the risk factor section would force the writer to leave out additional material risks and that prioritizing the risks would open up the company to further liability, even though all risks were disclosed. *See id.*

159. *See also* Steven Goldstein, *SEC to Ease Restrictions on Plain English Proposal*, CORP. FINANCING WK., Sept. 29, 1997, at 8 (expressing concerns about the proposal to itemize and restrict the potential risks in a prospectus).

160. *See id.*

161. *See* Plain English Disclosure, 62 Fed. Reg. at 3163.

162. *See id.*

163. *See id.* at 3164 (explaining the SEC's plain English pilot program).

164. *See id.*

165. *See id.* at 3164 (preferring the legend to be written in non-bold face print using plain English principles).

166. *See id.* (replacing the distribution table with a bullet-point list of the offering's price, underwriter's commission, and proceeds of the offering).

167. *See id.*

168. *See id.*

5. Consequences of Failing to Use Plain English

Under the new proposal, a company must write a prospectus in plain English in order for the SEC to approve it. If the prospectus is not written in plain English, the SEC will deny the company's request for an acceleration of registration statements,¹⁶⁹ and require the company to rewrite it.¹⁷⁰ A denial of the company's request for an accelerated offering, could cause the company to lose the ability to issue stock quickly and to take advantage of sudden desirable market conditions.¹⁷¹ The two major factors that the SEC will look to in assessing whether or not the prospectus meets the plain English requirement are the clarity of disclosure and the company's good faith effort to comply.¹⁷² If the prospectus lacks clarity, but the writer displays a good faith effort to make the prospectus reasonably concise and readable, the SEC staff will work with the writer through the review and comment process to help meet the company's financing schedule.¹⁷³ If the prospectus displays neither element, the SEC will simply not approve it.¹⁷⁴

B. How to Use Plain English Techniques to Make the Changes

Fortunately, the SEC provides plain English guidance to the prospectus writers.¹⁷⁵ One week before the SEC issued its Plain English disclosure rule, it published a plain English handbook showing writers how to develop clear SEC disclosure documents

169. See 17 C.F.R. § 230.461 (1997). Essentially, any company who wants to set the date for the registration of their security may do so thus allowing the issuer to control the issuance of their security according to their own schedule. See *id.* The request for acceleration is considered a confirmation that the registration statement complies with the Exchange Act. See *id.* The SEC examiner will refuse to accelerate the effective date for many reasons. See *id.* These reasons include, among others: (1) where there has not been a bona fide effort to make the prospectus reasonably concise and readable; (2) where the prospectus is found to have any material inaccuracies; and (3) where the SEC is currently investigating the issuer of one of the underwriters. See *id.*

170. See also Beckett, *supra* note 127, at 5 (explaining that SEC can refuse to accelerate a registration statement).

171. See *id.*

172. See Plain English Disclosure, 62 Fed. Reg. at 3164. The clarity requirement implies that the SEC follows a subjective test of readability because it requires "clear communication" instead of requiring word and sentence limits. See Carol M. Bast, *Lawyers Should Use Plain Language*, 69 FLA. B.J. 30, 32 (1995).

173. See Plain English Disclosure, 62 Fed. Reg. at 3164.

174. See 17 C.F.R. §§ 202.3, 202.5 (providing a host of other remedial sanctions the SEC may take against the issuer such as criminal prosecution if prospectus errors are willful).

175. See *supra* notes 119-20 and accompanying text.

using the SEC's methods.¹⁷⁶ Handbook instructs the writer to know his audience, to know what material information needs to be disclosed, to use clear writing techniques to communicate the information, and to design and structure the document so it is easy and inviting to read.¹⁷⁷ The details of the SEC's proposed rules are discussed below.

1. Know the Audience

Since the purpose of plain English is to communicate important information to current and potential investors, the SEC recommends that the writer first identify the group of people to whom he is writing.¹⁷⁸ To accomplish this goal, the SEC urges companies to gauge the financial sophistication of their investors.¹⁷⁹ Companies with greater resources often use marketing research tools, such as investor polls, to learn about the demographics of their specific investors in detail.¹⁸⁰ Smaller companies simply rely on their investor relations staff or the underwriters to describe who is most likely to buy their securities.¹⁸¹

When writing the prospectus, the SEC suggests that companies should use their investor research to focus on some key demographic factors such as age, income, education level, job experience, financial background, and investment knowledge.¹⁸² After determining the audience's identity, the SEC recommends that writers keep in mind that when dealing with a broad variety of people, the least sophisticated investors need the greatest amount of disclosure.¹⁸³

176. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 1. The SEC will provide anyone with a free copy of this handbook by calling 1-800-SEC-0330 or through its web site at <http://www.sec.gov>.

177. See Plain English Disclosure, 62 Fed. Reg. at 3155.

178. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 12. The SEC stresses that knowing the target audience is the most important step in ensuring that the prospectus is understandable. See *id.*

179. See *id.* This task should not prove difficult because most companies already know how to gauge their investors. See *id.*

180. See *id.*

181. See *id.* The underwriters can acquire the information on the probable backgrounds of a particular company's investors based on the underwriter's experience with similar companies who collected information from their investors. See *id.*

182. See *id.* While drafting the prospectus, the writer must always keep this investor profile in mind. See *id.*

183. See *id.* at 13. Some professionals may be inherently aware of many risks that the amateurs are not. See *id.* Under the proposal, companies must draft the documents so that the less sophisticated investors can understand them because they represent the vast majority of investors. See *id.* To emphasize its point, the SEC recommends that the prospectus writer literally keep a picture of one of the typical investors visible as a gentle reminder of the audience to whom he is writing. See *id.*

Some issuers are serving a diverse audience of investors by presenting information in a format that enables investors to easily find the basic information, while also providing additional detailed information for anyone who is interested.¹⁸⁴ This format follows the proposal's prospectus layout by enabling amateur investors to learn about the security from the summary sections, while leaving the complicated body in tact for the professional.¹⁸⁵ In order for the same document to successfully inform the amateur and the experienced investor, the writer should always keep in mind that he is writing to a varied group that may not all be experts.¹⁸⁶

2. Know What Information Needs to Be Disclosed

Unfortunately, many prospectus writers indiscriminately combine material and immaterial information in long, run-on sentences, dumping large amounts of unnecessary information on the reader.¹⁸⁷ Under plain English principles, the writer must make judgments as to what information is relevant and important enough to be included in a prominent spot in the prospectus, or whether it should be in the prospectus at all.¹⁸⁸ In the end, the writer can only communicate effectively when he understands the substance of the message being conveyed precisely and accurately.¹⁸⁹

Thus, one of the tenets of the SEC's proposal is that the writer should only write about what he personally understands.¹⁹⁰

184. See CATERPILLAR, INC., 1996 THIRD QUARTER FIN. RESULTS (1996) (including a two part document with statistical highlights and condensed financial information in the first part, and a detailed analysis, including complete financial statements for those who want additional information, in the second part).

185. See Plain English Disclosure, 62 Fed. Reg. 3152, 3155 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

186. See *id.* at 3155. Investment wizard, Warren Buffett, gives this piece of advice:

When writing Berkshire Hathaway's annual report, I pretend that I'm talking to my sisters. I have no trouble picturing them: Though highly intelligent, they are not experts in accounting or finance. They will understand plain English but jargon may puzzle them. My goal is simply to give them the information I would wish them to supply me if our positions were reversed. To succeed, I don't need to be Shakespeare; I must, though, have a sincere desire to inform.

OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 5.

187. See Plain English Disclosure, 62 Fed. Reg. at 3155. Many prospectus writers fail to prioritize the information that is relevant and then compound the problem by failing to place it in a logical order. See *id.* All too often, details are disclosed before investors even know why those details matter. See *id.*

188. See *id.* Writers must learn to highlight key information about the offering to ensure that the investors read the most important points. See *id.* at 3155-56.

189. See BRYAN A. GARNER, THE ELEMENTS OF LEGAL STYLE 4 (1991).

190. See Plain English Disclosure, 62 Fed. Reg. at 3155.

Therefore, the SEC stresses that writers should read through their previous prospectuses and remove any information that is redundant, irrelevant to the current issue, or unnecessary boilerplate language.¹⁹¹ In addition, writers should use defined terms sparingly.¹⁹² Although they serve as a shortcut for the writer, defined terms form a roadblock for the reader because the reader must backtrack into the document to recall what the specific term means.¹⁹³ The SEC believes that this backtracking chore discourages investors from thoroughly reading the entire document.¹⁹⁴

Finally, the writer must exclude any information that is only in the prospectus “[b]ecause it’s always been there[.]”¹⁹⁵ Typically, much of the information used in prospectuses is recycled from previously filed documents or from other companies’ prospectuses.¹⁹⁶ If the legal staff has done its research and no one knows why the information is currently required, the information should be omitted.¹⁹⁷

3. Use Clear Writing Techniques

Once the writer knows what to include, he must convey those ideas using plain English writing techniques.¹⁹⁸ Although it is impossible to give a precise formula for effective writing, the SEC suggests utilizing the time-tested writing tips endorsed by many of the plain English authors discussed earlier in this Comment.¹⁹⁹

The SEC’s handbook encourages writers to use active voice with strong verbs so that the reader knows who is doing the acting.²⁰⁰ The

191. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 14. The SEC advises the writer to question the need for the details that appeared in the old documents. *See id.*

192. *See id.* at 16. When writers include defined terms that explain complex ideas and label them with one word or phrase, the reader is forced to learn an entire new vocabulary just to read that one prospectus. *See id.*

193. *See id.*

194. *See id.*

195. *Id.* at 15.

196. *See id.* If at all possible, the SEC suggests that current prospectus writers meet with the authors of the original documents to determine exactly why the information was necessary in the first place. *See id.*

197. *See id.* Also, the writer should omit any information that has been disclosed earlier in the prospectus. *See id.*

198. See Plain English Disclosure, 62 Fed. Reg. 3152, 3155 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

199. *See id.*; see *supra* Part II.A.

200. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 21. An example of passive voice where it is unclear who is doing the acting is: The stock was purchased. An example of active voice which makes it clear who is acting is: The investor bought the stock. *See id.* at 22. The handbook recommends using passive

SEC also encourages writers to use personal pronouns, such as "you" and "I," so readers will know to whom the prospectus is referring.²⁰¹

To clarify the prospectus further, the SEC suggests that the writer should use concrete terms, instead of abstractions.²⁰² Some investors cannot understand concepts such as the Dow Jones Industrial Average²⁰³ or a zero coupon bond.²⁰⁴ Under the proposal, prospectus writers should explain these concepts in plain English so that investors can understand them and take them into account when making investment decisions.²⁰⁵ By explaining abstractions, writers will prevent their audiences from either guessing at the meanings, or from simply putting down their prospectuses altogether because of confusion.²⁰⁶

Under plain English principles, writers should present multiple conditional statements which list all the possible consequences arising out of a specific occurrence to ease the readers' understanding.²⁰⁷ Tabular presentations also avoid reader confusion by organizing complex information in a way that allows the reader to understand it better.²⁰⁸ For example, writers should use tables for "if-then" situations such as "Events of Default."²⁰⁹

Finally, the SEC suggests a sweeping change: the abandonment of all archaic legal writing practices, such as superfluous words,²¹⁰ long

voice only when it is not important for the reader to know who is doing the acting. *See id.* at 24.

201. *See id.* at 26.

202. *See id.* at 27

203. *See id.* The Dow Jones Industrial Average is a figure based on the average price of selected stocks, indicating the relative price of shares on the New York Stock Exchange. *See THE OXFORD DICTIONARY AND THESAURUS* 431 (American ed. 1996).

204. *See* OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1 at 27. A zero-coupon bond is a treasury security that has the interest paid off by the issuer all at one time when the bond reaches maturity, instead of paying a small amount of interest every year. *See BLACK'S LAW DICTIONARY* 125 (abridged 6th ed. 1990).

205. *See* OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1 at 27.

206. *See id.*

207. *See* Plain English Disclosure, 62 Fed. Reg. 3152, 3157 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

208. *See id.*

209. *See id.* These situations usually involve a single consequence that may be triggered by several actions. *See id.* Placing "if-then" statements in table form allows reader to understand complex information more easily than when it is written in a single sentence. *See id.* An "Events of Default" section lists the circumstances in which a security may be taken back from the investor, such as: failure to pay interest on a note when it becomes due, order from a court declaring the company bankrupt, or failure to pay the premium. *See id.*

210. *See* OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 29. The following are examples of phrases that are almost always superfluous or easily

run-on sentences,²¹¹ multiple negatives,²¹² legal jargon,²¹³ and nominalizations.²¹⁴ The SEC believes that these devices serve little purpose other than lengthening documents and hindering a layman's chance to understand what is being disclosed.²¹⁵

C. *The Conflict: The SEC's Proposal versus Practicing Attorneys*

Many practicing attorneys fear the worst. In April 1997, over 1,600 attorneys attended the largest ever spring meeting of the American Bar Association Business Law Section where they strongly criticized the SEC's plain English proposal.²¹⁶ While the SEC envisions investors of all levels of sophistication understanding disclosure documents with relative ease,²¹⁷ opponents of the SEC proposal argue that plain English will actually spawn imprecise language and ambiguities that will open the floodgates of litigation under Section 11²¹⁸ of the 1933 Securities Act strict liability provision.²¹⁹

Three types of plain English opponents are voicing their concerns. These three groups include: (1) people who do not oppose plain English for prospectuses in general, but believe that the SEC is not

replaced with simpler words: in accordance with, in the event that, subsequent to, prior to, despite the fact that, because of the fact that, and owing to the fact that. *See id.*

211. *See id.* at 32. An example of a run-on sentence found in a typical prospectus is: "The following description encompasses all the material terms and provisions of the Notes offered hereby and supplements, and to the extent inconsistent therewith replaces, the description of the general terms and provisions of the Debt Securities (as defined in the accompanying Prospectus) set forth under the heading "Description of Debt Securities" in the Prospectus, to which description reference is hereby made." *Id.* This sentence could easily be broken down into four separate sentences. *See id.*

212. *See Plain English Disclosure*, 62 Fed. Reg. at 3158. An example using multiple negatives: "No clause can become valid unless approved by both parties." *Id.* The same sentence using plain English is: "A clause becomes valid only if both parties approve it." *See id.*

213. *See id.* at 3157. A typical prospectus sentence using legal jargon: "The new debt will rank *pari passu* with other senior debt of the company." *Id.* The same sentence without the jargon: "The new debt will rank equally with the other senior debt of the company." *Id.*

214. *See OFFICE OF INVESTOR EDUC. AND ASSISTANCE*, U.S. SEC, *supra* note 1, at 25. Nominalizations involve taking the action verb and turning it into a noun: We made an application. The writer should write, "we applied." *See id.*

215. *See id.* at 32. "The longer and more complex a sentence, the harder it is for readers to understand any single portion of it." *Id.*

216. *See Inside the SEC*, 11 INSIGHTS 29 (1997).

217. *See Plain English Disclosure*, 62 Fed. Reg. at 3154.

218. *See 15 U.S.C.A. § 77k(a)* (West 1997) (holding every person who signed the registration statement, and every director, soon-to-be director, accountant, engineer, appraiser, or underwriter who worked on the registration statement, strictly liable for any material mistakes or omissions).

219. *See Plain English Disclosure*, 62 Fed. Reg. at 3154-55.

ready to implement it;²²⁰ (2) people who oppose certain features of the new rule,²²¹ and (3) people who believe that plain English is too simplistic to have any utility in SEC disclosure statements.²²²

The first group of opponents believe that the SEC is ill-equipped to handle the task of overseeing such a large scale conversion to plain English.²²³ These attorneys know that the senior SEC staff members who are versed in plain English theory, and who created the proposal, will have little day-to-day direct involvement with reviewing companies' registration statements.²²⁴ Essentially these opponents are asserting that, although the senior SEC officials might adequately handle plain English review, the junior officials who will actually do the work will not be able to handle it.²²⁵ These attorneys urge the SEC to extend the pilot program in order to further train the SEC examiners in the art of plain English.²²⁶

Some plain English opponents want the SEC to change only the specific sections of the proposal that they believe may expose issuers to greater liability.²²⁷ These opponents are primarily concerned that the proposed rules would require the writer to unnecessarily limit and arbitrarily prioritize the risks present in their securities.²²⁸ These

220. See Merrill B. Stone & Geraldine M. Cunningham, *Will 'Plain English' Expose Issuers to Liability Risks?*, NAT'L. L.J., Jul. 14, 1997, at B11 (citing a letter written in dissent of the plain English proposal by The Bond Market Trade Association ("PSA")).

221. See Rogers, *supra* note 11, at B3.

222. See Thomas G. Donlan, *The SEC Stirs Itself to Rule Where It Isn't Needed*, BARRON'S, Jan. 20, 1997, at 62.

223. See Stone & Cunningham, *supra* note 220, at B11.

224. See *id.* (citing letters written in dissent of the proposal by the Plain English Campaign, Inc. ("PEC"), The Bond Market Trade Association ("PSA"), and the Securities Industry Association ("SIA")).

225. See *id.* These opponents stress that the SEC examiners "must be trained adequately in order to handle the highly subjective standards" of understanding plain English principles. JH, *Industry Expresses Concern About SEC's Plain English Prospectus Rule*, SEC. WK., Apr. 7, 1997, at 1. The thought of having a stock offering delayed by a junior SEC official, thus costing the company money, prompts these opponents to shy away from the switch to plain English. See Stone & Cunningham, *supra* note 220, at B11.

226. See Stone & Cunningham, *supra* note 220, at B11 (citing Letter from Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association to SEC (March 31, 1997)).

227. See Stone & Cunningham, *supra* note 220, at B11 (citing Letter from Plain English Campaign (USA) Inc. to SEC (March 18, 1997) ("the PEC letter"); Letter from PSA The Bond Market Trade Association to SEC (March 24, 1996) ("the PSA letter"); Letter from the Capital Markets Committee of the Securities Industry Association to the SEC (April 24, 1997) ("the SIA Letters")).

228. See Rogers, *supra* note 11, at B3. These opponents fear that limiting the risk factors will force the writer to omit more than mere boilerplate or irrelevant risks. See Plain English Disclosure, 62 Fed. Reg. 3152, 3163 (1997) (to be codified at 17 C.F.R.

opponents argue that, for sophisticated offerings, the writer will be forced to exclude material risks simply because the writer has reached a preset limit of risk factors.²²⁹ Furthermore, the proposed requirement of prioritizing the risk factors in order of importance will create a new kind of liability for the issuer.²³⁰ Even if a prospectus adequately includes all material risks in plain English, a plaintiff may be able to bring an action for failure to prioritize the risks correctly.²³¹ These opponents assert that requiring the issuer to rank the risks requires too much speculation to be accurate because risks cannot be predicted reliably to this degree of precision.²³²

The proposed page limit of the summary section is also a concern for those who fear expanded liability.²³³ These critics believe that artificial constraints are not appropriate in today's marketplace, where such wide variations and complexities exist in most securities.²³⁴ To remedy this increased liability, this group proposes a "safe harbor" rule for the summary and risk factor sections of the prospectuses.²³⁵ This "safe harbor" would excuse any errors made while rewriting the prospectuses in plain English for a probationary period long enough for attorneys to become accustomed to the new rules.²³⁶

Essentially, these critics urge the SEC to waive the appropriate Section 11²³⁷ absolute liability arising from errors in translation from

pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

229. See Stone & Cunningham, *supra* note 220, at B11.

230. See David A. Price, *SEC's "Plain English" Rule Raises Liability Issues*, INVESTOR'S BUS. DAILY, May 15, 1997, at A8, available in LEXIS, Bankng Library, Invdly File.

231. See *id.* Under section 11 of the 1933 Securities Exchange Act, issuers, along with anyone else who helped prepare the prospectus, are held absolutely liable for any errors in the prospectus. See 15 U.S.C.A. § 77k(a)(11) (West 1997).

232. See Price, *supra* note 230, at A8.

233. See Stone & Cunningham, *supra* note 220, at B11.

234. See *id.*

235. See *id.* (citing Letter from Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association to SEC (March 31, 1997) (disagreeing with the proposal effectiveness date)).

236. See *id.* (citing Letter from Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association to SEC (March 31, 1997)). This rule would operate similarly to the Safe Harbor Rule for forward-looking statements of business activities. See Stone & Cunningham, *supra* note 220, at B11 (citing Letter from Committee on Federal Regulation of Securities, Section of Business Law of the American Bar Association to SEC (March 31, 1997)); see also 15 U.S.C.A. § 77z-2 (West 1997) (assigning no liability for errors in the prospectus if the statement was clearly marked as "forward-looking" and identified by "meaningful cautionary statements" pointing out key factors which could cause the projected results to differ).

237. See 15 U.S.C.A. § 77k(a) (West 1997) (holding the issuers absolutely liable for any errors or material omissions in a company's registration statement or prospectus).

legalese into plain English, where writers display a good faith attempt to comply with the plain English rule.²³⁸

Third, some attorneys fundamentally oppose the switch to plain English on all levels. They argue that plain English is too imprecise and unsuited for the complex material contained in prospectuses.²³⁹ They fear that investment professionals, who are accustomed to more detailed disclosure, might file shareholders' suits every time their investment goes sour.²⁴⁰ Further, plain English critics believe that the issuing companies will be torn between two sets of rules: one set requiring them to present specific information in detail for professionals; the other set requiring them to simplify the information for amateurs.²⁴¹

IV. ANALYSIS

Overall, the SEC's plain English proposal will improve investor knowledge and will increase readability for the average consumer. However, some minor changes in the SEC's proposal might increase the success of the program.²⁴²

A. Plain English Improves Investor Knowledge

The SEC's plain English proposal both satisfies and extends the old requirements' original goals of detailed, specific disclosure for professional investors.²⁴³ Congress originally sought full disclosure when it enacted the 1933 Securities Exchange Act.²⁴⁴ This goal is furthered through the adoption of plain English, given that plain English seeks to clarify writing,²⁴⁵ while also supplying the same technical information as required under the old method.²⁴⁶ With the adoption of plain English, prospectuses will contain full disclosure sufficient for both lay persons and professional investors, leveling the

238. See Stone & Cunningham, *supra* note 220, at B11.

239. See Donlan, *supra* note 222, at 62.

240. See *id.*

241. See *id.*

242. See *infra* Part V.

243. See *infra* notes 244-54 and accompanying text.

244. See 15 U.S.C.A. § 77a-77zzz (West 1997).

245. See Plain English Disclosure, 62 Fed. Reg. 3152, 3155 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

246. See *id.* Plain English does not represent the "dumbing down" of substantive information. It means writing well so that the information is not needlessly difficult to understand. See Joseph Kimble, *Answering the Critics of Plain Language*, 5 SCRIBES J. OF LEGAL WRITING 51, 54 (1994-95).

playing field for the entire audience of prospectus readers.²⁴⁷

B. Technical Improvements Dramatically Increase Readability

Traditionally, the primary way for investors, either amateur or professional, to learn about their investment choices is to read prospectuses.²⁴⁸ Most investors typically will not read any document that is vague or difficult to understand.²⁴⁹ Therefore, to improve investor knowledge, the prospectuses must be inviting and readable for investors. Common sense dictates that eliminating words that add nothing to a document but legal flavor is the quickest and simplest way to improve readability.²⁵⁰ Also, excessive use of these terms clutter the paper, forcing readers to turn to other parts of the document, thus losing their concentration.²⁵¹ This type of distraction could easily dissuade the amateur investor from reading through the entire prospectus.²⁵² By eliminating these archaic terms, writers can prepare a prospectus that is immediately more understandable and inviting to readers.

In addition to omitting unnecessary terms, writers should also use proper English writing techniques.²⁵³ Through the use of active voice, shorter sentences, subject-verb agreement, and no multiple negatives, writing will drastically improve without sacrificing any substantive business or financial information.²⁵⁴

C. Efficiently Implementing the Plan

In order to efficiently implement the plain English program, the SEC must address the concerns of the attorneys who will be following the rule in practice. The practicing attorneys' cooperation will help both themselves, and the SEC, as shown by the successful responses from several well-attended plain English workshops given by SEC staff members.²⁵⁵ Therefore, for a smoother transition to plain English, the SEC must address the fears of the rule's opponents.

247. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 6.

248. See Plain English Disclosure, 62 Fed. Reg. at 3153.

249. See *id.*

250. See Plain English Disclosure, 62 Fed. Reg. at 3158. One example of a word that adds nothing but legal flavor is the use of "pari passu" instead of "equally." See *id.* In addition, archaic legal terms, such as "hereinafter," add nothing to the meaning or precision of a document. See *id.* at 3155.

251. See *id.* at 3160.

252. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 11.

253. See MELLINKOFF, *supra* note 49, at 44-60.

254. See Plain English Disclosure, 62 Fed. Reg. at 3156.

255. See *Plain English—Give It a Chance*, 11 INSIGHTS 2, 2 (1997).

1. The SEC's Ability to Implement the Plan

Critics who argue that the SEC is not currently equipped with the resources to implement such a large scale program may be overstating the ideals of plain English.²⁵⁶ They believe that more time and expense will be needed to train junior SEC reviewers as to the details of plain English principles.²⁵⁷ These critics misunderstand that the true goal of plain English is understandability, rather than the scrutiny of every minor writing detail.²⁵⁸ In essence, if an educated person of a certain target level, who is not an expert in the securities field, can understand the prospectus, then the plain English translation is successful.²⁵⁹ Thus, even the junior SEC attorneys have the training to determine whether the prospectus is accurate and complete, just as they did under the old regime.

The full implementation of the plain English program should not be postponed until a later date as some critics argue.²⁶⁰ Companies still have until December 31, 1998, to translate the applicable portions of their prospectuses into plain English.²⁶¹ In addition, the SEC's initial proposal only recommends plain English in the body of prospectuses.²⁶² The SEC believes that a gradual adoption of plain English over the next two years may facilitate a full adoption of plain English throughout the entire prospectus at some future date.²⁶³

2. Limits on the Risk Factors or Summary Sections

Critics that fear increased liability from the proposed limiting and prioritizing of risk factors have legitimate concerns. A company's particular risk factors may vary widely, given the particular industry and the current economic conditions.²⁶⁴ The SEC originally intended for this provision to force companies to omit boilerplate risk factors or factors that simply do not apply to that company's situation.²⁶⁵

256. See Stone & Cunningham, *supra* note 220, at B11.

257. See JH, *supra* note 225, at 1.

258. See Plain English Disclosure, 62 Fed. Reg. at 3155.

259. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 42.

260. See Stone & Cunningham, *supra* note 220, at B11. Some critics urge that it is premature to mandate plain English because the SEC examiners are ill-prepared to judge plain English standards correctly. See *id.* These critics, however, do not specify how long they think it will take for the SEC examiners to adequately learn plain English principles. See *id.*

261. See Beckett, *supra* note 127, at 5.

262. See Plain English Disclosure, 62 Fed. Reg. at 3155.

263. See Stone & Cunningham, *supra* note 220, at B11.

264. See *id.*

265. See Plain English Disclosure, 62 Fed. Reg. at 3163.

However, this proposal could cause companies with complex offerings to have material risks that are undisclosed because of the SEC's imposed limit.²⁶⁶

A potential solution to increased Section 11 liability worries is to allow for a safe harbor rule to protect good faith writing efforts from liability from omissions in the risk factor section.²⁶⁷ This safe harbor would excuse any material omissions made by companies that attempt to simplify the risk factors section.²⁶⁸

The concerns about the summary section, unlike the risk factor section, are needless. While limiting risk factors may prove harmful, a limit on the length of the summary section may actually be beneficial. After all, summary information is readily obtainable from the body of the prospectus.²⁶⁹ Thus, an endlessly long summary can needlessly repeat topics covered in the body of the prospectus.²⁷⁰ However, an inflexible page limit could cause some problems. Since complex securities prospectuses require longer summaries than simple securities prospectuses, a strict page limit could result in the complex securities writers omitting material information due to uniform page constraints.²⁷¹ This type of omission could expose companies to additional liability.²⁷² Therefore, a page limit relative to the length of the prospectus might be the best solution.

3. Plain English Belongs in the Legal World

Finally, prior plain English translations, along with the pilot program's success, directly contradict the critics who believe that there is no place for plain English in SEC documents.²⁷³ In the areas of the law adopting plain English, readers displayed greater comprehension of the written materials, without sacrificing precision.²⁷⁴ These success stories started in small scale consumer areas, such as UCC contracts under \$50,000,²⁷⁵ insurance contracts,²⁷⁶ Citibank

266. *See id.*

267. *See id.*

268. *See* Stone & Cunningham, *supra* note 220, at B11.

269. *See* Plain English Disclosure, 62 Fed. Reg. at 3163.

270. *See id.*

271. *See* Stone & Cunningham, *supra* note 220, at B11.

272. *See id.*

273. *See infra* notes 274-80 and accompanying text; *see also supra* Part II.C.

274. *See* Felsenfeld, *supra* note 98, at 942. For example, Citibank's clients reported much greater trust and understanding in their consumer loan documents after they were rewritten in plain English. *See id.*

275. *See, e.g.,* Weise, *supra* note 114, at 376.

276. *See* Felsenfeld, *supra* note 98, at 942.

promissory notes,²⁷⁷ sales contracts,²⁷⁸ and estate planning.²⁷⁹ Given the overwhelming small-scale success of plain English, a large-scale conversion to plain English across the major capital markets will likely result in similar success.²⁸⁰ If traditionally complex documents, such as those used in estate planning, can be converted into plain English, then SEC disclosure documents should make the transition just as smoothly.

V. PROPOSAL

Because the stock market is no longer comprised solely of institutional investors, lawyers, accountants, and investment bankers, a growing number of amateur investors need clearly understandable descriptions of their investment options in order to make informed decisions.²⁸¹ The SEC's Plain English proposal will allow investors to become more informed about their investment choices. However, simply defining plain English as writing that can be easily understood by a layperson, without providing any guidance, would leave the door open to unlimited individual interpretations.²⁸²

Therefore, the SEC should set forth strict guidelines for attorneys to follow using the proven techniques of such writing experts as Rudolf Flesch, David Mellinkoff, William Strunk & E.B. White, and Brian Garner. The SEC included many of these writers' tips in its plain English Handbook.²⁸³ Even if strictly followed, the techniques backed by these experts allow for a great deal of creativity. Their writing tips do not force the writer to write in one standard style, rather, they provide the drafter with the tools to achieve better writing.

The SEC should require both subjective and objective readability tests, directing writers to stress the importance of the audience understanding the document's substance,²⁸⁴ while also requiring the writer to follow the mechanical rules of better writing.²⁸⁵ A subjective readability test should have two components. First, writers should use

277. See Felsenfeld, *supra* note 32, at 409.

278. See *supra* note 114.

279. See *supra* note 115.

280. See Plain English Disclosure, 62 Fed. Reg. 3152, 3154 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

281. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, at 4.

282. See *supra* text accompanying notes 105-06.

283. See OFFICE OF INVESTOR EDUC. AND ASSISTANCE, U.S. SEC, *supra* note 1, 9-55 (stating that the SEC handbook is not copyrighted and encouraging people to copy and distribute it widely).

284. See *id.* at 9-10.

285. See FLESCH, *supra* note 29, at 213-16.

Mellinkoff's *Legal Writing: Sense & Nonsense*²⁸⁶ to learn the specifics of the six minimum plain English principles proposed by the SEC: active voice, shorter sentences, everyday language, tabular presentation of complex material, no legal jargon, and no multiple negatives.²⁸⁷

The second part of the subjective test should measure readability.²⁸⁸ A panel of non-attorney, college-educated, amateur investors should read the prospectus, and then tell the examiners what they thought it meant. Under this give-and-take discussion, the examiners could determine whether the prospectus was understood by investors needing the most assistance in understanding the relative risks involved with buying the security.

An objective readability test should also be given. The prospectus should be evaluated by Flesch's chart, which proposes, on average, sentences under fifteen words, and words under 1.7 syllables.²⁸⁹ Violating this standard would not automatically disqualify a document from meeting plain English principles; however, Flesch's test could be used as a common yardstick to help writers improve their preliminary drafts.²⁹⁰

Relevant to both the subjective and objective tests, Strunk & White's *The Elements of Style* covers many of these same literary devices, while also discussing the correct usage of punctuation and grammar.²⁹¹ Because it is largely ignored in the plain English proposal, the SEC should compel prospectus writers to follow the punctuation and grammar guidelines suggested by Strunk and White.²⁹²

The SEC should not, however, require prospectus writers to limit the number of risks or to rank the risk factors in order of importance. Since any boilerplate or irrelevant factors must be omitted under the general plain English principles, all the remaining factors must have material importance, and should be included in the risk factor

286. DAVID MELLINKOFF, *LEGAL WRITING: SENSE & NONSENSE* (1982).

287. *See id.* Mellinkoff describes, in detail, how to comply with each of these rules. *See id.*

288. *See supra* notes 23-32 and accompanying text.

289. *See FLESCHE, supra* note 30, at 25.

290. *See id.* at 20-21. This objective test leaves no room for interpretation, so writers may use this test while drafting their documents to periodically check their own progress, without needing SEC help. *See id.* at 20-25.

291. *See generally* STRUNK & WHITE, *supra* note 32 (providing rules and principles regarding both form and style).

292. *See id.* at 1-39. A sampling of these detailed rules includes comma and pronoun usage, subject and verb agreement, word choice, and verb tenses. *See id.*

section.²⁹³ Furthermore, the differences in the importance of risks may only be fine distinctions for ranking purposes.²⁹⁴ These fine distinctions could give rise to a separate shareholder suit for improper ordering of the risk factors.²⁹⁵ Accordingly, investors should use their own judgment when evaluating a company by the probability of relevant risks being realized.²⁹⁶

By eliminating its proposed limits, the SEC would have no need for a safe harbor rule allowing companies to avoid liability for risk factor errors, in the case of good faith efforts to comply.²⁹⁷ Without the imposed limits, companies would have no excuse for omitting any material risk factors. By their nature, the risks involved with purchasing a security should not be downplayed or abbreviated because most investors base their decisions on a security's riskiness.²⁹⁸

Limiting the length of the summary sections will force the summaries to become more concise.²⁹⁹ However, setting a single page limit for all prospectuses is inherently unfair, given that writers for complex companies will require more pages to summarize their prospectuses than writers for more basic companies would require.³⁰⁰ Therefore, while a strict page limit on the summary should not be required, a percentage-based limit, as compared to the full prospectus length, would keep summary sections manageable.³⁰¹

Finally, the SEC should stick with its original plan for full implementation for all companies by the end of 1998.³⁰² By next year, all companies would have to simultaneously translate their SEC documents into plain English, offering no company any clear time advantage.³⁰³ By 1999, plain English principles will allow publicly held companies to enter the twenty-first century with well-informed

293. See *supra* notes 151-62 and accompanying text.

294. See Price, *supra* note 230, at A8. Issuers are aware of the risks involved with their securities, but it is highly improbable to reliably predict the odds of each risk. See *id.*

295. See *id.*

296. See *id.*

297. See *supra* notes 267-68 and accompanying text.

298. See Stone & Cunningham, *supra* note 220, at B11.

299. See Plain English Disclosure, 62 Fed. Reg. 3152, 3163 (1997) (to be codified at 17 C.F.R. pts. 228, 229, 230, 239) (proposed Jan. 21, 1997).

300. See *supra* notes 271-72 and accompanying text.

301. See *supra* notes 271-72 and accompanying text.

302. See Beckett, *supra* note 127, at 5.

303. See *id.* With an inflexible December 31, 1998 deadline in place, all companies covered by this proposal will have to adapt to the new rules within the next nine months. See *id.*

investors trading securities based on their true knowledge of the material risks.

VI. CONCLUSION

The momentum of plain English over the last several decades is carrying its principles into the world of corporate investment. Now companies that have been disclosing information to potential investors solely through legalese and jargon must step back and rediscover what those phrases originally meant. At first, this task may prove difficult. However, companies have until the end of 1998 to translate the covers, summary, and risk factor sections of their prospectuses into plain English. The best interests of the investors, the SEC, and the companies themselves will be served through better understanding of the inner-workings of the corporations.

Ideally, years from now, an amateur investor will be able to read any prospectus and decide whether to invest in that company without the help of an attorney. The process must start now to slowly eliminate the legal jargon from a field traditionally wrought with it. The challenge lies in writing complex SEC materials in understandable English. The task will not be easy, but it can be accomplished. As noted, "Albert Einstein once said that his goal in stating an idea was to make it as simple as possible, but no simpler."³⁰⁴ Writers should aim to achieve that same goal when drafting prospectuses in plain English.

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304. BRYAN A. GARNER, *A DICTIONARY OF MODERN LEGAL USAGE* 661 (2d ed. 1995).