

# Gag Rule for Hedge Funds Challenged in Supreme Court on First Amendment Grounds in *Bulldog Investors v. Galvin*

by HANS BADER on APRIL 24, 2012 · 0 COMMENTS

in DEREGULATE TO STIMULATE, ECONOMY, FEATURES, LEGAL

Usually, you can advertise and discuss a product, even if not everyone is allowed to buy it. Thanks to the First Amendment, you can advertise a prescription drug even though most people don't have a prescription for it, as the [Supreme Court ruled in 1976](#). You can advertise [liquor](#) and guns, even if minors can't buy them, and [gambling](#). The First Amendment has been held by the courts to protect advertising of all these things. But Massachusetts securities regulators think you shouldn't be allowed to advertise your hedge fund on a website, if it is accessible to Massachusetts residents, even though hedge funds are perfectly legal.

Massachusetts fined Bulldog Investors, an out-of-state hedge fund, \$25,000 because it had a website promoting the hedge fund, and emailed information about the hedge fund to a Massachusetts resident, even though neither he nor the hedge fund intended to enter into a securities transaction, and Massachusetts admits the hedge fund was not trying to sell him anything. Massachusetts argues in essence that the hedge fund needs to shut up to avoid "conditioning the market" for its product, an investment that only "sophisticated" investors with lots of money are legally allowed to buy. Massachusetts' ban is based on the paternalistic desire to keep people in the dark about hedge funds for their own good. (The practical effect of such bans is that even journalists like Deirdre Brennan of FINalternatives have had difficulty reporting on hedge funds and accessing basic information about them, since hedge fund managers are scared to even talk to journalists.)

Keeping people in the dark for their own supposed good obviously doesn't measure up under the Supreme Court's [First Amendment commercial-speech jurisprudence](#), so Massachusetts disingenuously justified the ban in court as a roundabout way of forcing hedge funds to register with government agencies and provide specified disclosures in the course of doing so (a rather ineffectual way of promoting such disclosures, judging from the fact that Bulldog blocked public access to its website, rather than registering, after Massachusetts fined it; Massachusetts relied on the conclusory assertions of a hired expert, Professor Franco, who admitted he had no empirical evidence, and could not even quantify how effective the ban is in forcing hedge funds to register). Amazingly, the

Massachusetts Supreme Judicial Court bought this argument hook, line, and sinker, upholding a trial court ruling in which the judge herself [admitted](#) that “Professor Franco does not purport to quantify the effectiveness of the regulatory scheme, and the Court is not in a position to do so.” Apparently, speech restrictions do not need to achieve anything useful to pass muster in Massachusetts. They just need to be based on a dubious rationale that is invented in response to a First Amendment challenge. As CEI explained in an [amicus brief](#) I submitted on behalf of journalists, academics, and think tanks, that pretextual rationale, invented after-the-fact in litigation, [cannot survive](#) the “intermediate scrutiny” that applies to commercial advertising restrictions, which forbids “[hypothesized justifications](#)” and [post hoc rationales](#) for a regulation that did not [actually motivate](#) the challenged regulation. *See, e.g., Thompson v. Western States Medical Ctr.*, 535 U.S. 357, 373 (2002); *United States v. Virginia*, 518 U.S. 515, 533, 535-36 (1996).

It certainly can’t satisfy the “strict scrutiny” that applies to restrictions on non-commercial speech — some of which is swept up in Massachusetts’ ridiculously broad definition of advertising by hedge funds, which covers even making information available to news reporters, and operates as an impediment to academic researchers. (When Bulldog Investors was forced to make its website go dark, and limit access to it to only insiders with passwords, that left academic researchers like Andrew Weinman, who is now an investment analyst at Howard Hughes Medical Institute, unable to learn more about the hedge fund and how it operated.) The rationale plainly fails even if it were not pretextual, since it results in less speech and less disclosure, not more disclosures. Massachusetts’ claim that its ban complements federal securities laws and promotes their goals is belied by the fact that Congress recently repealed the federal ban on general solicitation and advertising by hedge funds in the JOBS Act (and largely preempted Massachusetts’ own ban, to boot), reflecting its considered judgment (and the judgment of many experts) that such bans harm investors rather than protect them. As CEI’s John Berlau has noted, under Massachusetts’ ban, journalists, academics, students and others who are not wealthy could not gain access to what even Massachusetts conceded was truthful, non-misleading information about hedge funds.

CEI’s [brief](#) was submitted on behalf of [itself](#); the [Cato Institute](#); securities-law expert [Antony Page](#), a law professor at Indiana University-Indianapolis; journalists James McRitchie and Deirdre Brennan; and researchers John Berlau and Andrew Weinman. (James McRitchie is the publisher of CorpGov.net, a website that provides public information concerning corporate governance and shareholder’s rights. John Berlau is a former financial journalist and fellow at CEI who still publishes frequently, writing in publications such as *The Wall Street Journal*, *New York Times*, *Barron’s*, *Politico*, *Christian Science Monitor*, *Washington Examiner*, *Investor’s Business Daily*, *National Journal*, and *National Review*.) Silencing hedge funds is stupid and harmful to the economy and investors in other companies large and small. Bulldog Investors specializes in investing in companies that are undervalued due to lackadaisical or bad management, and then seeking to oust the bad management through proxy battles and other means. (Bulldog adds value to the stock market and the economy by getting rid of bad management.) Learning what a hedge fund like Bulldog Investors is doing is thus useful information even to a small investor who can’t invest in Bulldog itself, due to SEC rules that forbid all but wealthy investors from investing in hedge funds. Enabling a hedge fund to communicate with the public thus benefits not only those people who might thereby learn about and invest in it, but also people who own stock in target companies. Learning about the recent investments of a hedge fund like Bulldog could

also be useful to a reporter who anticipates writing news stories about future corporate battles between management and insurgent shareholders.

Bulldog's case is known variously as *Bulldog Investors General Partnership v. Secretary of Commonwealth of Massachusetts* and as *Bulldog Investors General Partnership v. Galvin*. The Supreme Court will hold a conference on whether to hear the case on May 10. (Bulldog has filed a *petition for certiorari* with the Supreme Court, asking it to grant an appeal of the lower court ruling. The Supreme Court does not have to grant such petitions, although it may do so in the Bulldog case, because of the noteworthy issues it raises, which led to it being featured earlier as a "[petition of the day](#)" at SCOTUSBlog, the web site that covers the Supreme Court.)