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Disclosure Reform—The SEC Is Riding Off in Two Directions at Once

By Roberta S. Karmel*

The U.S. Securities and Exchange Commission ("SEC") is being buffeted by diametrically opposing forces with regard to disclosure policy rulemaking. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 required the SEC to pass rules to compel public companies to make disclosures about conflict minerals, mine safety, and certain payments to foreign governments, all for the purpose of advancing societal goals. Proponents of sustainability metrics have been urging the SEC to adopt standards relating to environmental and other similar matters, and a petition on disclosure of corporate contributions and lobbying expenses by public companies would involve the SEC in another political quagmire. Yet, forces that would deregulate disclosure mandates are also pressuring the SEC, and the JOBS Act of 2012 included some such deregulatory measures. Also, the SEC has embarked on its own initiative for streamlining disclosure obligations. This article discusses these conflicting disclosure initiatives and some of the current academic papers and theories with regard to SEC disclosure policy. I suggest a few possible ways for the SEC to move forward, including scaled and tiered disclosure.

I. INTRODUCTION

The U.S. Securities and Exchange Commission’s ("SEC" or "Commission") primary mandate is investor protection, and it implements this mandate by promulgating full disclosure standards for companies tapping the capital markets. Since the 1980s, the same disclosure standards have applied to issuers making initial public offerings ("IPOs") and to issuers providing information in annual and periodic reports required thereafter. Over the years, the almost-continuous criticism of SEC disclosure policy has inspired efforts to study and reform disclosure obligations. These criticisms and efforts have sometimes been at cross-purposes, resulting in numerous changes and additions to SEC disclosure requirements.

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that amount to information overload. Currently, the SEC is subject to contradictory pressures regarding its disclosure policies.

In the past, advancing societal good was an infrequent use of SEC disclosure policy. One example is corporate disclosure about environmental infractions. Today, however, some political players are attempting to use the federal securities laws to implement social policies to compel large multinationals to behave as “good” corporate citizens. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”) required the SEC to pass rules mandating that public companies disclose their use of conflict minerals from the Congo and directing certain companies to make disclosures about mine safety and payments to foreign governments for resource extraction. These rules were controversial because their purposes departed from traditional concerns for investor protection. As a result, they were strongly opposed by businesses—some of which successfully sued the SEC after the rules on conflict minerals and resource extraction were passed. The SEC proposed revised rules regarding resource extraction on December 23, 2015. Other activists are advocating that public companies disclose political contributions and metrics of sustainability. Two other issues that could add new disclosures are whether the SEC should compel companies to disclose the effects of climate change on their businesses and whether the SEC should make cybersecurity risks a line-item disclosure requirement.

Pushing in the opposite direction from additive social responsibility disclosures are statutory mandates in the Jumpstart Our Business Startups Act (“JOBS Act”) to relieve small businesses of various disclosure obligations previously imposed by the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”) or Dodd-Frank. In addition, the JOBS Act required the SEC to consider the disclosure requirements of Regulation S-K to determine how to modernize and simplify them. Furthermore, the SEC itself has undertaken a project to review its disclosure policies with a view to meeting some of the criticisms from investors and academics that SEC disclosure documents are too lengthy, too prolix, and not sufficiently helpful for making investment decisions. The conflicting disclosures

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7. See JOBS Act § 108.
that the banking authorities and the SEC impose on banks present completely different problems.  

It is difficult to predict how these conflicting political pressures will play out, but if the past is prologue, the SEC will resist both efforts to increase or decrease the disclosure burden of public companies unless new laws force it to do so. The SEC’s internal review of public disclosure requirements may clean up some of the clutter in Regulations S-K and S-X, but it is unlikely to seriously streamline SEC reporting. Attention to the conflicting pressures on the SEC with regard to disclosure policy has compelled at least two suggested avenues for resolving the conflicts.

One proposal is tiered disclosure, which would subject newer and smaller public companies to fewer disclosure obligations, but large multinationals would be required to make a greater number of disclosures, some of which relate to sustainability.  

The JOBS Act has provided such a solution with regard to some disclosure obligations for emerging growth companies ("EGCs"). Another proposal would require companies to furnish sustainability and some other disclosures to the SEC, but not "file" them, thus relieving those companies of liability for defective disclosures. Such a provision was debated with regard to some of the Dodd-Frank disclosure obligations. Other ideas include scaled disclosure that would differentiate the needs of different investor groups or access for sophisticated investors to "pure" information, which is unfiltered by issuers or other intermediaries.

Part II of this article reviews the SEC’s disclosure framework and describes some historical efforts to reform disclosure policies. Part III discusses some recent political and social responsibility proposals for new disclosure requirements; however, governance and executive compensation proposals and disclosures are not discussed, because these items have long been considered material to investors. Part IV explains the deregulatory initiatives of the JOBS Act. Part V describes the SEC’s Division of Corporation Finance reform agenda, and Part VI discusses some of the academic papers on these topics.

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11. See David B.H. Martin & Graham Robinson, To Be or Not to Be "Filed," INSiChtS, Sept. 2003, at 1.


II. A BRIEF REVIEW OF THE DISCLOSURE FRAMEWORK

A. THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934

The drafters of the first federal securities law, the Securities Act of 1933 ("Securities Act"), chose full disclosure over merit regulation as an investor protection technique. Full disclosure regulation is based on the often-quoted theory that "[p]ublicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." The Securities Act therefore permitted any corporation to make a public offering of its securities if it made full disclosure of its business and affairs. To avoid congressional tinkering, a specified list of disclosure items, including the provision of a profit and loss statement and balance sheet, was attached to the Securities Act as Schedule A. According to one of the Securities Act's drafters, this list was the "guts of the bill." Congress required that an independent public accountant certify financial statements filed with the SEC but gave the SEC the power to prescribe the detail and content of financial statements. In addition, Congress authorized the SEC to define "accounting, technical, and trade terms, used in this subchapter [and] to prescribe the form . . . in which required information shall be set forth, the items . . . to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts."20

The Securities Exchange Act of 1934 ("Exchange Act") initially required companies that made a Securities Act–registered public offering and companies listed on a national securities exchange to make annual and periodic disclosures to encourage sound investing. In 1964, amendments to the Exchange Act expanded the universe of companies required to make annual and periodic reports to include companies traded over-the-counter with $1 million in assets and 500 shareholders. This metric was then expanded to include companies with $10 million in assets and 500 shareholders, but in the JOBS Act, it was limited to companies with $10 million in assets and either 2,000 shareholders or

16. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914).
23. See Hugh F. Owens, Comm'n, U.S. Sec. & Exch. Comm'n, Securities Acts Amendments of 1964: Address Before the Federal Securities Acts Seminar 5 (Nov. 20, 1964), https://www.sec.gov/news/speech/1964/112064owens.pdf. At that time, all securities not traded on a national securities exchange were over-the-counter securities and NASDAQ was not a national stock exchange. This reform was based on conclusions by the SEC in its Special Study of the Securities Markets that periodic disclosure and other Exchange Act protections should be extended to all publicly traded issuers, not only to issuers of exchange-listed securities, because of the correlation between lack of disclosure and fraud. H.R. Doc. No. 95, pt. 3, 88th Cong., 1st Sess. 8–10 (Apr. 3, 1963).
500 shareholders who are not accredited investors.24 The Exchange Act also required listed companies—and, after 1964, most publicly traded companies—to make disclosures in their proxy solicitations in connection with their annual meetings.25

Until the early 1980s, the regulations for Securities Act registration statements, Exchange Act annual and periodic reports, and proxy disclosures differed in some significant respects.26 In 1982, the SEC adopted its integrated disclosure regulations.27 Securities Act registration statements, Exchange Act annual and periodic reports, and proxy solicitations all became subject to the same business, operational, and financial statement disclosure requirements. These requirements are set forth in Regulation S-K 28 and Regulation S-X.29 Regulation S-K generally sets forth the substantive disclosures that public companies must make about their businesses, operations, and governance structures, and Regulation S-X sets forth rules for accounting statement presentation. Yet, the SEC has delegated the formulation of accounting principles to the Financial Accounting Standards Board (“FASB”)30 by granting that the principles, standards, and practices the FASB promulgates have “substantial authoritative support” and by denying such authoritative support to contrary promulgations.31 Thus, FASB standards are the only generally accepted accounting principles (“GAAP”) used for SEC reports.

Regulation S-K sets forth the requirements applicable to the content of the nonfinancial portions of SEC-filed documents. It covers such matters as a description of the issuer’s business and property, legal proceedings, securities of the issuer, financial information, management and major securityholders, the format of registration statements and prospectuses, industry guides, and specialized disclosure provisions for roll-up transactions, mergers and acquisitions, asset-backed securities, and oil and gas producers. The detail of Regulation S-K is staggering, but the concept of materiality qualifies the required disclosures. Materiality is defined in SEC Rule 405 as follows: “The term material when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is

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a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.\textsuperscript{32}

The line-item disclosures of Regulation S-K are mandated and do not depend on an independent judgment by registrants as to their materiality. In addition, Securities Act Rule 408 and Exchange Act Rule 12b-20 require that, in addition to line-item compelled information, registrants must include such further material information “as may be necessary to make the required statements, in light of the circumstances . . . not misleading.”\textsuperscript{33}

Tests of materiality in litigation are less straightforward. In \textit{Mills v. Electric Auto-Lite Co.},\textsuperscript{34} the Supreme Court stated that materiality is information that “might have been considered important by a reasonable shareholder” and then added that the test of materiality requires “a significant propensity to affect” investors.\textsuperscript{35} However, in \textit{TSC Industries, Inc. v. Northway, Inc.},\textsuperscript{36} the Court held that “[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”\textsuperscript{37}

Historically, the SEC generally has interpreted materiality to mean economic materiality, but sometimes more qualitative measures have crept into SEC standards. One important example is the SEC’s views regarding disclosure of corporate governance, beginning with the finding in \textit{In re Franchard Corp.}\textsuperscript{38} that disclosure of management integrity is material and continuing with the SEC’s many required corporate governance disclosures concerning the composition of corporate boards and the independence of corporate directors.\textsuperscript{39} Sarbanes-Oxley put some of these disclosure requirements into statutory form and added new disclosure requirements, such as requirements for codes of ethics, attestations by corporate executives to financial statements, and an attestation of outside auditors to a company’s internal controls.\textsuperscript{40} Some of these attestation requirements have now been removed for certain EGCs, but they remain in force for large public companies.

Recently, the Sustainability Accounting Standards Board (“SASB”) was organized as a private sector nonprofit to formulate standards for substantive disclosure in SEC filings on sustainability issues regarding environmental, social, and human capital; innovation; and governance.\textsuperscript{41} SEC Commissioner Daniel Galla-

\textsuperscript{32} 17 C.F.R. § 230.405 (2015) (emphasis added). Of relevance to this article, Item 1.03 requires every environmental law penalty over $100,000 to be disclosed no matter how large the registrant. \textit{Id.} § 229.103.

\textsuperscript{33} \textit{Id.} §§ 230.408, 240.12b-20.

\textsuperscript{34} 396 U.S. 375 (1970).

\textsuperscript{35} \textit{Id.} at 384.

\textsuperscript{36} 426 U.S. 438 (1976) (involving omissions in a proxy solicitation).

\textsuperscript{37} \textit{Id.} at 439.

\textsuperscript{38} 42 S.E.C. 163 (1964).


\textsuperscript{41} See \textit{Sustainability Accounting Standards Bd., Conceptual Framework} 7-8 (Oct. 2013) [hereinafter \textit{Conceptual Framework}].
gher attacked this effort as a third party's improper attempt to "prescribe what should be in corporate filings," a task which is the SEC's responsibility. Furthermore, the SASB has been accused of broadening and misinterpreting the meaning of materiality by asserting that its disclosure guidance could influence decisions that users make concerning a reporting company. Members of the SASB pushed back against these criticisms, noting that both quantitative and qualitative materiality must be considered under SEC regulations and auditing standards.

Current SEC disclosure regulations have become extremely complicated for a variety of reasons, including changing business realities and new capital market practices. Further, enforcement and private securities cases charging public companies with fraud are invariably followed by the demands of regulated entities and their lawyers for more specific disclosure requirements. Regulations S-K and S-X primarily embody the SEC's disclosure regime, but disclosure policies are also scattered throughout SEC forms, interpretative releases, no-action letters, and comment letters on SEC filings; and the courts have articulated them in a variety of securities cases. A generalized materiality test used in antifraud cases has given rise to multiple layers of specific instructions regarding disclosure in SEC regulations and accounting and auditing rules. However, SEC line-item disclosure mandates do not necessarily rise to the materiality level required in antifraud damages actions.

In September 2015, the FASB proposed a new materiality standard for corporate financial disclosures. For decades, the test for materiality has been whether the information could influence the decisions of prospective and current shareholders. The proposed standard would instead afford companies a higher degree of discretion by aligning the FASB's definition of materiality with that of the United State Supreme Court. That standard, enunciated in cases such as Basic Inc. v. Levinson, deems information to be material when a reasonable person is likely to view it as significantly altering the "total mix" of facts about a company.

The FASB stated in its proposal press release that the perceived need to align its materiality standard with that of the Supreme Court was prompted by

45. See In re NVIDIA Corp. Sec Litig., 768 F.3d 1046 (9th Cir. 2014).
49. Id. at 232.
stakeholder complaints about the inconsistency between the two standards and the resultant unpredictability surrounding organizations' potential interpretation of materiality.\textsuperscript{50} The FASB further explained that adopting the Supreme Court's standard provides all companies (public, private, nonprofits, and employee benefit plans\textsuperscript{51}) with the "appropriate use of discretion."\textsuperscript{52} Discretion, the FASB posits, will reduce the amount of immaterial information disclosed, making financial disclosures easier for investors to understand and interpret.\textsuperscript{53}

Nevertheless, the securities industry has heavily criticized the proposal, whose opponents argue that more discretion for companies means less disclosure of information to investors.\textsuperscript{54} Moreover, critics argue that by rendering the standard entirely legal in nature, it will relegate to lawyers disclosure decisions on accounting matters, which should be within the purview of accountants.\textsuperscript{55}

B. POLICY SHIFTS IN DISCLOSURE POLICY

SEC disclosure policy has long been subject to serious controversies, including debates about the appropriate balance between disclosure directed at institutional investors and disclosure for retail investors, the disproportionate burdens of disclosure obligations on smaller companies, and the extent to which SEC disclosure policy should serve as a prophylactic for improving corporate governance and corporate conduct generally. These debates seem to break out with greater force when scandals in the business world erode public confidence in large corporations. The 2008 financial meltdown has evoked extreme political partisanship and confusion as to how the SEC should react to restore investor confidence and encourage capital formation. Nevertheless, over the years, the SEC has steadily focused on improving disclosure regulation and the offering process.

In the late 1960s, SEC Commissioner Frank Wheat led an influential policy study, the Wheat Report,\textsuperscript{56} much of which was aimed at making private placements easier and reducing the likelihood that they would be challenged after the fact by recommending rules for such transactions. These recommendations led to a spate of subsequent rulemaking to make the offering process more efficient.\textsuperscript{57} Efforts to further improve disclosure and offering regulations continued

\textsuperscript{51} Id. at 1.
\textsuperscript{52} Id.
\textsuperscript{53} Id.
\textsuperscript{54} See Letter from Sanford Lewis, Counsel, Inv't Env't Health Network, to Susan M. Cosper, Tech. Dir., Fin. Accounting Standards Bd. (Dec. 8, 2015), http://goo.gl/Q9PazR.
\textsuperscript{55} See Morgenson, supra note 46.
\textsuperscript{57} These efforts culminated in the promulgation of Regulation D, 17 C.F.R. §§ 230.501–508 (2015).
into the 1970s when the SEC organized the Advisory Committee on Corporate Disclosure, which recommended simplifying disclosure policies.\(^{58}\) In particular, the Advisory Committee recommended the single integrated disclosure system,\(^{59}\) which was adopted in the early 1980s.

Yet, the SEC's sensitive payments cases in the mid-1970s\(^ {60}\) set off a clamor for more exacting regulation of public companies. The SEC reacted by holding hearings on corporate governance around the country,\(^ {61}\) and then adopting some new corporate governance disclosure obligations, including disclosures about the independence of directors\(^ {62}\) and new rules concerning management remuneration and undisclosed perquisites.\(^ {63}\)

SEC disclosure policy then was altered by globalization of the capital markets and a large influx of foreign companies into the U.S. capital markets and the SEC disclosure system. The Commission was forced to consider different disclosure regimes in Europe and elsewhere, as well as possible harmonization of U.S. and international accounting regulations.\(^ {64}\) Although the capital markets and disclosure policies grew ever more complex, various task forces and advisory committees recommended modernizing and simplifying the offering process and post-IPO disclosure by registrants.\(^ {65}\)

In 1992, the SEC adopted an integrated disclosure system for small business issuers.\(^ {66}\) Later, in the late 1990s, the SEC imposed a "Plain English" policy on SEC filings.\(^ {67}\) This policy was aimed at retail investors at a time when institutional investors were opting out of the SEC disclosure regime by turning to the private placement markets.\(^ {68}\) Well-known seasoned issuers ("WKSIs")

\(^{59}\) See id.
were insisting on more streamlined registration procedures, and in 2005 the SEC responded with new and complicated rules on public offering procedures.\(^69\)

The bursting of the 1990s technology bubble and the Enron and WorldCom scandals turned the SEC back to domestic problems and the need to implement the rulemaking mandates of Sarbanes-Oxley. Shortly thereafter, the SEC confronted new and more difficult challenges stemming from the 2008 financial meltdown. Dodd-Frank was enacted in 2010 to prevent the meltdown from reoccurring, but before the Commission was able to fully implement its rulemaking and complete the tasks assigned by Dodd-Frank, in 2012 Congress passed the JOBS Act, substituting deregulation for the added regulatory thrust of Dodd-Frank.

This brief, incomplete history of SEC disclosure reforms suggests that the forces buffeting the SEC today are part of a recurring pattern of reformers calling for deregulation and simplification of SEC disclosures while other reformers call for public companies to make more extensive disclosures—particularly those designed to change corporate conduct—and prevent past disclosure failures from reoccurring. In this tug-of-war, advocates for small business are often able to accomplish deregulation, and large multinational companies and institutional investors are often able to opt out of SEC registration requirements through exemptions and special rules. In the process, a bifurcation has developed in the securities markets between truly public markets and private markets, and a divide may be growing between the disclosure requirements imposed on large public companies and those imposed on smaller companies. Perhaps that would not be such a bad result, but it would not lead to greater simplification of the offering and disclosure regimes.\(^70\) Further, the relaxation of Exchange Act registration requirements by the JOBS Act may create a class of quasi-public companies not subject to SEC disclosure regulation.

III. SOCIAL RESPONSIBILITY DISCLOSURE

A. ENVIRONMENTAL DISCLOSURES AND CLIMATE CHANGE

When the National Environmental Policy Act ("NEPA")\(^71\) was passed in 1969, the SEC had no disclosure requirements regarding corporate environmental policy. However, the NEPA instructed all government agencies to interpret and administer their laws in such a way as to protect the environment.\(^72\) Two years later, the National Resources Defense Council ("NRDC") filed a rulemaking petition to require the SEC to include information about the environmental impact


\(^{72}\) See id. § 4332.
of corporate activities. Initially, the SEC did not change its reporting requirements. Instead, the Commission issued a release calling attention to existing provisions concerning how an issuer described its business, as those requirements related to material matters involving the environment. The Commission noted that registered issuers must disclose material legal proceedings involving environmental matters. The NRDC was dissatisfied with this response and sued the SEC in federal court in the District of Columbia to compel the Commission to require public companies to disclose

with respect to each major activity or product: (1) the nature and extent . . . of the resulting environmental pollution . . . ; (2) the feasibility of reducing such pollution . . . ; (3) the prospects for improving that technology; (4) existing and projected expenditures for reducing such pollution . . . ; (5) legal requirements affecting the impact on the environment of the registrant's activities . . . ; and (6) pending or threatened judicial or agency proceedings, whether initiated by private or governmental bodies, challenging the registrant's compliance with environmental protection standards.

This litany of requirements went far beyond the SEC's traditional concept of economic materiality, but the SEC subsequently issued a new release on environmental disclosure requiring the issuer's business description to disclose the material effects that compliance with environmental laws might have on the company's capital expenditures, earnings, and competitive position. The SEC also mandated disclosure of any administrative or judicial environmental proceeding "known to be contemplated by governmental authorities."

The U.S. District Court for the District of Columbia held that the SEC had violated the Administrative Procedure Act in promulgating this release and noted that the SEC was required to interpret the securities laws in accordance with the NEPA's stricture to protect the environment "to the fullest extent possible." On remand, the SEC determined that disclosure regulations under the securities laws are limited to information of an economic nature and that the agency was not required to embrace a broader disclosure because of the NEPA. Although

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77. Id. at 12101.


the lower court once again disagreed with the SEC, the D.C. Circuit Court, focusing on the SEC's sphere of discretion, affirmed the SEC's views on appeal and held that the NEPA did not require the SEC to pass specific disclosure rules.\(^8\)

Despite the SEC's initial reluctance to go beyond a standard economic materiality analysis with regard to environmental disclosures, the agency did take action both in enforcement cases and rulemaking. Only six months after its victory over the NRDC, the SEC issued an order finding that four years of periodic reports filed by U.S. Steel Corporation with the SEC failed to comply with the SEC's environmental disclosure regulations.\(^8\) Simultaneously, the SEC issued an interpretative release announcing new standards for environmental disclosures.\(^8\) The release required issuers to disclose the costs of compliance with environmental protection laws and all administrative proceedings pending or contemplated by regulatory authorities, regardless of whether the amount of money involved was material.\(^8\)

Almost immediately, the SEC had second thoughts about such disclosures and proposed amendments requiring disclosure of “all environmental proceedings, including governmental proceedings, which are material to the business or financial condition of the registrant.”\(^8\) The Commission reasoned that the then-existing environmental provisions resulted in “less readable disclosure documents and [made] it more difficult to identify significant environmental proceedings.”\(^8\) Such a change was made in the SEC's adoption of its integrated disclosure regulations regarding administrative or judicial proceedings “arising under any federal, state or local provision which has been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to the purpose of protecting the environment.”\(^8\) Such a proceeding must be described only if it “is material to the business or financial condition of the registrant.”\(^8\)

The controversy over environmental disclosures of the 1970s is now being reprised regarding climate change and its effects on public companies. In 2010, the SEC offered guidance on this issue—an echo of its first release on environmental disclosures in 1971—reminding issuers of the various provisions of Reg-

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83. Id. at 56924.
85. Id.
86. Id. at 25642.
87. Adoption of Integrated Disclosure System, Securities Act Release No. 6383, 47 Fed. Reg. 11380, 11407 (Mar. 16, 1982) (to be codified at 17 C.F.R. pts. 200, 201, 229, 230, 239, 240, 249, 250, 260 & 274). Disclosure is also required if the amount of the claim or potential monetary sanctions exceeds 10 percent of the assets of the registrant and its subsidiaries on a consolidated basis, and if a governmental authority is a party to such proceeding, it need not be disclosed if sanctions are less than $100,000. Id.
ulation S-K that might be triggered if the costs or consequences of climate change are material.\textsuperscript{88} Four topics that companies should consider in this regard include

the impact of legislations and regulation regarding climate change . . . [w]hen mate-
rial, the impact on their business of treaties or international accords . . ., [w]hether
developments regarding climate change will create new opportunities or risks . . ., [and] [t]he actual and potential material impacts of the physical effects of climate change on their business.\textsuperscript{89}

Some investors and nonprofit groups, including the SASB, are pressuring the SEC for further disclosure requirements.\textsuperscript{90} Whether the SEC will once again submit to a politically motivated agenda for more extensive disclosures seems unlikely after the Commission’s experiences with Dodd-Frank-mandated rulemaking concerning conflict minerals and resource extraction.

B. CONFLICT MINERALS

In Dodd-Frank, Congress decided to achieve a humanitarian goal: ending a violent conflict in the Democratic Republic of the Congo (‘‘DRC’’), where millions of civilians have perished from starvation and disease, and where rape and other human rights violations have been rampant.\textsuperscript{91} Section 1502 of Dodd-Frank mandated that the SEC require registered and reporting companies under the Exchange Act to disclose whether conflict minerals from the DRC or adjoining countries are necessary to the functionality or production of any manufactured products.\textsuperscript{92} The rationale for this provision was that armed groups were financing the DRC’s civil war by exploiting and trading conflict minerals.\textsuperscript{93} Through public disclosure, Congress sought to make the public aware of the source of an issuer’s conflict minerals while promoting due diligence among issuers with respect to their supply chains.

Conflict minerals include tantalum, tin, gold, tungsten, or any other mineral that the Secretary of State has found to be financing the conflict in the DRC or an adjoining country.\textsuperscript{94} Thousands of companies manufacture and sell products

\textsuperscript{88} Commission Guidance Regarding the Disclosure Related to Climate Change, Securities Act Re-


\textsuperscript{90} See, e.g., Jim Coburn & Jackie Cook, Cool Response: The SEC & Corporate Climate Change Re-
porting, CERES (Feb. 2014), http://www.ceres.org/resources/reports/cool-response-the-sec-corporate-
climate-change-reporting. The New York Attorney General has opened an investigation into whether
Exxon Mobil lied to the public and investors about the effect of climate change on the company. See
John Schwartz, Exxon Inquiry Both Mirrors and Contrasts with Tobacco Industry Case, N.Y. TIMES, Nov. 7, 2015, at B3; see also Congressmen Join Call for Federal Probe of Exxon Mobil Disclosures on Climate, 47 SEC.
REG. & L. REP. (BNA) 2125 (Nov. 9, 2015).

\textsuperscript{91} See GAO REPORT, infra note 115, at 1.


\textsuperscript{93} Id. § 1502(a).

containing at least one conflict mineral. Conflict minerals are found in mainstream electronic products, phones, computers, automobile parts, hearing aids, pacemakers, jet engines, metal wires, and many other consumer products.

The SEC carried out its conflict minerals mandate by adopting Rule 13p-1 and Form SD. The rule applies to any issuer that files reports with the SEC under section 13(a) or 15(d) of the Exchange Act, including domestic companies, foreign private issuers, and smaller reporting companies. If conflict minerals are necessary to the functionality or production of a product that the company manufactures. The rule applies to companies that contract for the manufacture of products with conflict minerals. In the face of many conflicting comments, the SEC determined not to include a de minimis exception for companies that use only a tiny amount of conflict minerals.

The SEC proposed requiring disclosure about conflict minerals in an issuer’s annual report on Form 10-K, 20-F, or 40-F. The final rule, however, requires disclosure on a special Form SD to be filed several months after the annual report. Although the SEC initially proposed that information about conflict minerals be “furnished” to rather than “filed” with the SEC, the final rule requires that the information be filed. This distinction makes a difference with respect to the potential liability of an issuer for faulty disclosure.

Once an issuer determines it is covered by the conflict minerals rule, it must conduct a reasonable country-of-origin inquiry to determine whether its conflict minerals originated in the DRC or other covered countries. The rule does not provide detailed guidance or a definition of what is “reasonable” with respect to its required conflict minerals diligence. If the issuer ascertains that its conflict minerals originated in the DRC or other covered countries—or has reason to believe the minerals may have originated there—the issuer must exercise “reasonable” due diligence on the source and chain of custody of its conflict minerals. An issuer must also certify a third-party audit of those products that have not been found to be DRC conflict-free.

According to the SEC’s final rule, if the issuer determines that the conflict minerals it uses originated in the DRC or other covered countries, it must report on Form SD that its products are not “DRC conflict-free” and make that report available on its website. Alternatively, an issuer may report that its products are

95. Id. at 56287.
96. Id. at 56288.
97. Id. at 56279.
98. Id. at 56295.
99. Id. at 56298–304. By requiring that this report be “filed” and not simply “furnished,” issuers are subject to greater potential liability.
100. See id. at 56303–04; see also Conflict Minerals Update, supra note 12.
103. Id.
104. Id. at 56320.
105. Id. at 56310.
"DRC conflict-free" or temporarily report that its products are "DRC conflict-undeterminable." Large issuers may so report for two years; smaller issuers may do so for four years.\textsuperscript{107}

The estimated costs of the conflict minerals rule are huge but contested. The SEC estimated that it would cost companies approximately $3–4 billion to develop compliance programs and $207–609 million to maintain compliance.\textsuperscript{108} The National Association of Manufacturers estimated that the conflict minerals compliance costs would range between $8–16 billion.\textsuperscript{109} A Tulane Law School study estimated compliance costs at $7.93 billion.\textsuperscript{110}

Section 1502 has little or nothing to do with the SEC's usual concerns of investor protection or securities market policing, as underlined by the provision in Dodd-Frank that requires the Secretary of State, in consultation with the U.S. Agency for International Development, to submit to Congress a strategy to address the illicit trade in conflict minerals.\textsuperscript{111} While in theory this legislation should lead to tangible results by exposing the sources of the materials used to produce issuers' merchandise, regulation is problematic. Global Witness, an NGO pushing for these disclosures, reported that a majority of filings were inadequate because companies had not taken the necessary steps to understand the humanitarian consequences associated with their supply chains.\textsuperscript{112} Still, a spokesperson for this organization claimed that the Dodd-Frank provisions and the SEC rule were having a salutary impact on the war in the DRC.\textsuperscript{113}

What primarily hindered the SEC conflict minerals mandate's effectiveness was the Department of Commerce's inability to "indicate whether a specific facility processes minerals that are used to finance conflict in the Democratic Republic of the Congo or an adjoining country."\textsuperscript{114} Essential to this rule's efficacy is issuers' ability to identify the sources of their "conflict minerals" to determine whether they originate in the DRC or adjoining countries. If the Department of Commerce cannot identify the origins of conflict minerals that fund violence, how can the SEC reasonably expect issuers to do so? Not only does the Department of Commerce have additional resources to investigate refineries and smelters across the world, but its own incomplete report released in September 2014 was overdue by over a year, giving the Department more time to investigate than

\textsuperscript{106} Id. at 56309.
\textsuperscript{107} Id.
\textsuperscript{109} Id.
\textsuperscript{110} Id. at 1334.
\textsuperscript{111} Dodd-Frank § 1502(c)(1)(A).
\textsuperscript{112} See Yin Wilczek, NGOs Issue Mixed Verdict on First-Ever Conflict Minerals Reports, 46 SEC. REP. & L. REP. (BNA) 1116 (June 9, 2014).
\textsuperscript{113} See id.
issuers were given under the statute.\footnote{115} The SEC should not have expected issuers to file operational due diligence reports of their supply chain conflict minerals in June 2014 when no list of smelters/refiners sourced by the DRC or adjoining countries was publicly available.

The business community has enjoyed some recent success in invalidating SEC rules because the agency did not conduct a satisfactory cost-benefit analysis or for other reasons.\footnote{116} The National Association of Manufacturers sued the SEC to invalidate the conflict minerals rule and was partially successful in \textit{National Ass'n of Manufacturers v. SEC.}\footnote{117} Although the SEC was unable to quantify the rule’s benefits, the D.C. Circuit Court declined to strike down the rule pursuant to a policy-based cost-benefit analysis; however, the court did hold that a part of the rule was a “name and shame” disclosure obligation that violated the First Amendment of the U.S. Constitution because it required companies to tell consumers that their products were ethically tainted.\footnote{118} The plaintiffs made a number of arguments charging the SEC’s rulemaking as “arbitrary and capricious” under the Administrative Procedure Act; however, all of those arguments were rejected judicially.\footnote{119}

A more serious challenge addressed the SEC’s cost-benefit analysis. The securities laws do not contain a specific requirement for a cost-benefit analysis. However, the Exchange Act does prohibit the SEC from adopting any rule “which would impose a burden on competition not necessary or appropriate to advance the purposes of securities laws.”\footnote{120} Further, the SEC is required to “consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”\footnote{121} The plaintiff claimed that the SEC violated these provisions because it did not adequately analyze the costs and benefits of the final rule.\footnote{122}
In some prior decisions based on these provisions, the D.C. Circuit imposed a so-called cost-benefit obligation on SEC rulemaking,\(^\text{123}\) and it has been unclear how this analysis would play out when the SEC is following a congressional mandate and Congress has not made a cost-benefit analysis. In the conflict minerals case, the D.C. Circuit held that the SEC “exhaustively analyzed the final rule’s costs” and determined that the rule would “impose competitive costs, but [has] relatively minor or offsetting effects on efficiency and capital formation.”\(^\text{124}\) The plaintiff did not dispute these findings but argued that the SEC failed to determine whether the conflict minerals rule would achieve its intended purpose.\(^\text{125}\)

The SEC determined that Congress intended section 1502 to achieve compelling social benefits, but the agency lacked data that would have enabled it to quantify those benefits.\(^\text{126}\) The court held that this acceptance of legislative intent was reasonable because the SEC had no choice under the statute but to promulgate a disclosure rule.\(^\text{127}\) Further, the rule’s benefits would occur half a world away in the midst of an opaque conflict about which little reliable information exists, and concern a subject about which the Commission has no particular expertise. Even if one could estimate how many lives are saved or rapes prevented as a direct result of the final rule, doing so would be pointless because the costs of the rule—measured in dollars—would create an apples-to-bricks comparison.\(^\text{128}\)

The D.C. Circuit then held that a critical component of the conflict minerals rule was contrary to the First Amendment.\(^\text{129}\) Rule 13p-1 requires an issuer that uses conflict minerals to describe its products as not “DRC conflict-free” in its report to the SEC and on its website.\(^\text{130}\) The court held that compulsion of conflict minerals disclosures is prohibited by the First Amendment.\(^\text{131}\) Although it is commercial speech, the court determined that compulsion cannot be upheld as a requirement reasonably related to the State’s interest in preventing fraud or deception.\(^\text{132}\) Further, the court stated that this disclosure is not clearly factual and nonideological; therefore it is not entitled to “rational basis” review under Zauderer v. Office of Disciplinary Counsel.\(^\text{133}\) Rather, the conflict minerals disclosure effectually compels an issuer to tell consumers that its products are ethically tainted.


\(^\text{124.}\) Nat’l Ass’n of Mfrs., 748 F.3d at 369.

\(^\text{125.}\) Id.

\(^\text{126.}\) Id.

\(^\text{127.}\) Id.

\(^\text{128.}\) Id.

\(^\text{129.}\) Id. at 373.

\(^\text{130.}\) Id. at 370.

\(^\text{131.}\) Id. at 373.

\(^\text{132.}\) Id. at 371 (citing R.J. Reynolds Tobacco Co. v. FDA, 696 F.3d 1205, 1213 (D.C. Cir. 2012)).

\(^\text{133.}\) Id. at 370–71 (citing 471 U.S. 626, 651 (1985)).
The court held that the compelled statement that an issuer's products are not “DRC conflict-free” must be tested under Central Hudson Gas & Electric Corp. v. Public Service Commission.134 This case requires the government to show that a substantial government interest is directly and materially advanced by the restriction and that the restriction is narrowly tailored.135 Because the SEC did not provide any evidence that it chose the least restrictive means of achieving its goals, the D.C. Circuit struck down this part of the rule and sent the case back to the district court.136

Although the SEC stayed the effective date of compliance with those parts of the conflict minerals rule subject to the circuit court's First Amendment ruling, issuers were nevertheless required to file their first Form SD disclosure statements.137 Yet, two SEC commissioners issued a statement in favor of staying the entire rule on the grounds that the D.C. Circuit court opinion suggests that the entire conflict minerals rule contravenes the First Amendment and, therefore, that the district court should invalidate the rule as a whole.138

The D.C. Circuit Court then decided American Meat Institute v. U.S. Department of Agriculture.139 This case, concerning the labeling requirements of deli meats, specifically overruled National Ass'n of Manufacturers' interpretation of Zauderer, stating, “[g]overnment interests in addition to correcting deception can be invoked to sustain a disclosure mandate under Zauderer.”140 On rehearing, the D.C. Circuit Court in National Ass'n of Manufacturers decided that Zauderer was inapplicable because the conflict minerals disclosures were not advertising and the SEC's rule did not pass the Central Hudson intermediate standard.141 Moreover, even if the compelled disclosures were commercial speech, the statute and regulations violated the First Amendment.142 Therefore, the court adhered to its original ruling that to the extent that the statute and rule require corporations to state in an SEC filing and on their websites that any of their products have not been found to be conflict-free, the SEC's final rule violates the First Amendment.143 A strong dissent argued that the conflict minerals disclosures were “purely factual and uncontroversial information.”144

135. Id. at 372 (citing Cent. Hudson, 447 U.S. at 564–66).
136. Id. at 372–73.
139. 760 F.3d 18 (D.C. Cir. 2014).
140. Id. at 27.
141. Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015). The SEC and Amnesty International have petitioned for an en banc rehearing of this decision.
142. Id. at 524.
143. Id. at 530.
144. Id. at 538–39 (Srinivasan, J., dissenting).
Ultimately, the Department of Commerce’s inability to trace DRC and adjoining countries’ conflict minerals to refining and smelting plants around the world inherently undermines this statutory scheme’s effectiveness. If the government cannot figure out the source of the conflict minerals that it is trying to eliminate from production, issuers cannot realistically be expected to satisfy the high standard set out in the SEC’s rule. Eligible issuers can be expected to continue to spend millions of dollars on a disclosure requirement unrelated to investor protection. The D.C. Circuit Court’s decision puts regulated issuers and the SEC in an awkward situation because companies have already attempted to comply with most of the conflict minerals rule for two years and yet do not have to analyze or form an opinion as to whether their products are “conflict-free.” Moreover, the court’s holding that a “name and shame” disclosure violated the First Amendment could invalidate other SEC disclosure rules.

C. MINE SAFETY VIOLATIONS

Section 1503 of Dodd-Frank requires issuers that operate mines to include mine safety information in their Exchange Act periodic reports.145 This disclosure requirement is modeled on the safety requirements already imposed on mines under the Federal Mine Safety and Health Act of 1977 (“Mine Act”).146 The operation of section 1503 includes no materiality criterion for the disclosures. For each coal mine that the issuer or its subsidiary operates, the issuer must report the total number of violations of mandatory health or safety standards that could significantly or substantially affect mine safety or human health under Mine Act section 104147 for which the operator received a citation from the Mine Safety and Health Administration; violations, citations, and imminent danger orders from the Mine Safety and Health Administration; the total dollar value of proposed assessments; the total number of mining fatalities in the company’s mines; and other actions of the Mine Safety and Health Administration.148

These provisions, aimed at enforcing the Mine Act, are “name and shame” provisions similar to the provisions the D.C. Circuit Court struck down in the conflict minerals case. The disclosure requirements adopted by the SEC apply only to mines located in the United States but apply equally to all U.S. mines regardless of their size.149 The Commission does not permit issuers to group mines by project or geographic proximity for disclosure purposes.150

150. Id. at 8.
specifies no particular presentation requirements, although the Commission recommends "tabular" presentation of data where possible.\textsuperscript{151}

The Commission received comments requesting that the disclosures required under section 1503 be "furnished" to the Commission rather than "filed," arguing that the disclosure requirements of section 1503 were not aimed at providing investors with information material to investment decisions.\textsuperscript{152} Thus, commentators argued, such Exchange Act filings should not be actionable pursuant to section 18 of the Exchange Act.\textsuperscript{153} The commentators' views, however, were contested by other commentators who argued that disclosures relating to the health and safety risks of mines operated by registered issuers are indeed material to investors.\textsuperscript{154} The Commission agreed with the latter group, noting that disclosures filed as a part of a periodic report are routinely required to be filed with the Commission under Exchange Act Rule 13a-14 and 15d-14 certifications.\textsuperscript{155} As a result, section 1503 errors or omissions in disclosures will expose issuing mining companies to potential liability under section 18 of the Exchange Act, governing all periodic reports.\textsuperscript{156}

The same information that the SEC requires regarding mine safety was already on the website of the Mine Safety and Health Administration, so the efficacy of the SEC disclosures might be questioned. According to an empirical study by four University of Chicago Booth School of Business professors, however, there has been an approximately 11 percent decrease in mining-related citations and injuries since the SEC rules went into effect.\textsuperscript{157} At the same time, there has also been a decrease in the productivity or profitability of the mining companies subject to the SEC regulations.\textsuperscript{158} Whether the mining safety disclosures are material to investors is another question, but the authors suggest that investor pressure may be responsible for the increased preoccupation with safety of mining companies.

\textbf{D. RESOURCE EXTRACTION}

Section 1504 of Dodd-Frank requires the SEC to issue rules requiring issuers that extract oil, natural gas, or minerals to disclose payments made to the U.S. or foreign governments for the purpose of the commercial development of oil, natural gas, or minerals.\textsuperscript{159} It is often referred to as the \textit{Publish What You Pay} Section.\textsuperscript{160} This provision's goal was to empower citizens of resource-rich countries.
to hold their governments accountable for the wealth these resources generate. According to Senator Richard Lugar, the provision mandated transparency and sought to fight corruption and authoritarianism in countries with abundant natural resources, to increase the reliability of commodity supplies, and to promote greater energy security.161 A number of development, anti-corruption, and anti-poverty organizations, as well as citizens of developing countries, supported this requirement's passage.162 The National Resource Governance Institute characterized section 1504 as a “powerful tool that allows investors to properly assess risk and citizens to see the value placed on their natural resources.”163 Once again, the SEC was put to work for a cause extending beyond the scope of investor protection, promulgating rules not necessarily tied to any concept of materiality.

Under SEC Rule 13q-1 and amendments to Form S-D implementing Dodd-Frank section 1504, disclosure was required if resource extraction issuers were required to file annual reports with the SEC and if they engaged in the commercial development of natural gas, oil, or minerals.164 Firms indirectly involved in the commercial development of these resources, such as pipe or drill manufacturers, were exempt from the disclosure requirements.165 This rule applied to both foreign and domestic issuers, affecting an estimated 1,100 issuers.166 Pursuant to Dodd-Frank, issuers were previously required to comply with the new rule for fiscal years after September 30, 2013.167 However, American Petroleum Institute v. SEC vacated this rule on July 2, 2013, mooting this deadline.168

Under Rule 13q-1 issuers also had to disclose payments made to governments by the issuers' subsidiaries or other controlled entities.169 Section 1504 of Dodd-Frank differed from the conflict minerals provisions and resulting rules because these payments did have a de minimis exception.170 De minimis payments were single or multiple payments that equaled less than $100,000 during the most recent fiscal year.171

The types of payments Rule 13q-1 covered included taxes, fees, bonuses, dividends, royalties, production entitlements, and infrastructure improvements.172 Issuers were to disclose the type and total amount of payments for each project and to each government.173 They were required to include the total amount of

161. 156 CONG. REC. S3815–16 (daily ed. May 17, 2010).
162. See Jack, supra note 160.
165. Id. at *15.
166. Id. at *5.
167. Id. at *7.
172. Id.
173. Id.
payments by category, the currency used to make the payments, and the financial period in which the payments were made.\textsuperscript{174} Issuers also were required to disclose the business segment that made the payments, the government that received the payments, and the project to which the payments related.\textsuperscript{175} The rule included guidance on projects that must be disclosed, but the term “project” was left undefined because, according to the SEC, that term is commonly understood by resource extractors.\textsuperscript{176} The Commission required issuers to present their information in an “interactive data format,” which had to be made available online to the public.\textsuperscript{177}

Commissioner Gallagher dissented from the SEC’s adoption of Rule 13q-1.\textsuperscript{178} He highlighted the fact that while the initiative has a desirable moral goal of increasing government accountability, the SEC is not the appropriate agency by which to achieve that goal.\textsuperscript{179} Further, Gallagher was concerned over the \textit{de minimis} exception, claiming that it was so low that it effectually excluded nothing, and opined that countries with state-owned oil and gas companies such as Russia, China, and Iran would reap competitive advantage because they do not operate under such a costly disclosure regime.\textsuperscript{180} The American Petroleum Institute (“API”) opposed the SEC’s rule for the same reasons, also arguing that compliance with the disclosure requirements would impose significant costs on affected issuers. The CEO of the API stated in 2012 that “the rule as written would impose enormous costs on U.S. firms and put them at a competitive disadvantage against government-owned oil giants not subject to the rule.”\textsuperscript{181} For these reasons, the API, the U.S. Chamber of Commerce, the Independent Petroleum Association of America, and the National Foreign Trade Council filed suit against the SEC on October 10, 2012, to challenge the validity and appropriateness of section 1504.\textsuperscript{182}

In \textit{American Petroleum Institute v. SEC}, the D.C. Circuit Court vacated Rule 13q-1.\textsuperscript{183} The court found that the SEC incorrectly interpreted section 13(q) of the Exchange Act and, more specifically, that Congress did not require

\begin{itemize}
\item 174. Id. at *4.
\item 175. Id.
\item 176. Id.
\item 177. Id. at *43.
\item 179. See id.
\item 180. See id.
\item 181. Sarah N. Lynch, Business Groups Sue SEC over Dodd-Frank Anti-Bribery Rule, REUTERS (Oct. 10, 2012, 8:18 PM EST), http://www.reuters.com/article/us-sec-lawsuit-idUSBRE8991NL20121011. Note that in response to this statement, Senator Ben Cardin stated in favor of the rule: “[I]ncreased transparency will not put companies that comply at a competitive disadvantage but will reduce the risks for U.S. investors and it will allow citizens in resource-rich countries to hold their leaders accountable. API wants to push us back to a time when the U.S. had few tools to add accountability and stability to the inherently unstable energy sector.” Jack, supra note 160.
\item 182. See Jack, supra note 160.
\end{itemize}
reports filed under 13(q) to be publicly disclosed. The court reasoned that "[s]ection 13(q) requires disclosure of annual reports in subsection (2)(A), but says nothing about whether the disclosure must be public or may be made to the Commission alone. Neither the dictionary definition nor the ordinary meaning of 'report' contains a public disclosure requirement." The court further argued that section 13(q) expressly addresses public availability of information in the following subsection, (3)(A), establishing a different and more limited requirement for what must be publicly available than for what must be annually reported. Topping things off, the Exchange Act as a whole uses the word "report" to refer to disclosures made to the Commission alone.

Finally, because the Commission believed that section 13(q) required complete public disclosure, it did not consider the appropriateness of independently imposing such a rule pursuant to its discretionary rulemaking power. This lack of consideration, Judge Bates concluded, rendered Rule 13q-1 procedurally deficient.

The court also found that the SEC's denial of any exemption from disclosure for issuers operating in countries that prohibit payment disclosure was arbitrary and capricious. The court noted that failure to accommodate this exemption "could add billions of dollars of costs to affected issuers, and hence have a significant impact of their profitability." By extension, these consequences would also have the effect of "drastically increas[ing] the Rule's burden on competition and cost to investors." By the Commission's own estimates, "billions of dollars are on the line." The court also acknowledged that the lack of exemption would incentivize other countries to adopt disclosure prohibitions similar to those in countries like China, Qatar, Angola, and Cameroon. This result would not serve the congressional goal of advancing international transparency efforts.

The district court did not consider the plaintiff's First Amendment claim regarding compelled speech, thus differing from the conflict minerals decision, which spoke directly to the topic of compelled speech. The SEC did not appeal this judgment and instead went to work on a new rule. The district court's decision spared issuers from the section's immediate reporting requirements, but adoption of a new and improved SEC rule was probably inevitable.

184. Id. at 16.
185. Id.
186. Id. at 24.
187. Id. at 20.
188. Id. at 22–23.
189. Id. at 24.
190. Id. at 23.
191. Id. at 21.
192. Id. at 11.
194. See infra text at notes 195–97.
After coming under fire from some Democrats in Congress\textsuperscript{195} and from an order from a U.S. district court in Massachusetts,\textsuperscript{196} the SEC re-proposed resource extraction rules on December 11, 2015.\textsuperscript{197}

The new proposal generally provides that both U.S. and foreign companies that (1) file annual reports with the SEC and (2) engage in the commercial development of oil, natural gas, or minerals are required to disclose the type and total amount of payments made by such companies to a foreign government or the U.S. government for each project.\textsuperscript{198} The revised rule is largely similar to the original rule with only slight changes to reflect the district court’s decision to vacate. In particular, the re-proposed rule still requires public disclosure of payments made to governments for resource extraction and does not exempt disclosures that foreign law would otherwise prohibit.\textsuperscript{199} Both provisions were grounds on which the court invalidated the old rule.\textsuperscript{200} Instead, issuers may apply for, and the SEC may grant, exemptive relief on a case-by-case basis, drawing upon Exchange Act precedent.\textsuperscript{201} The advantage of such an approach, as the SEC espouses, is that “such an approach would permit [the SEC] to tailor the exemptive relief to the particular facts and circumstances presented, such as by permitting alternative disclosure or by phasing out the exemption over an appropriate period of time.”\textsuperscript{202}

The newly proposed rule covers those entities that file annual reports with the SEC pursuant to either section 13 or section 15(d) of the Exchange Act and engage in the commercial development of oil, minerals, or natural gas.\textsuperscript{203} Registered investment companies are exempt from the proposed rule, but it covers EGCs, smaller reporting companies, and government-owned companies.\textsuperscript{204}

The activities the proposed rule covers include exploration, extraction, processing, export, and acquisition of a license for such activity.\textsuperscript{205} The proposal seeks only to cover those activities directly connected to the commercial development of oil, natural gas, or minerals; it does not cover ancillary activities. Therefore, services such as marketing, investing in hardware, or preparatory services would not be covered by the proposed rule.\textsuperscript{206}


\textsuperscript{198} Id. at 80078.

\textsuperscript{199} Id. at 80082.


\textsuperscript{201} Resource Extraction Release, supra note 197, at 80082.

\textsuperscript{202} Id.

\textsuperscript{203} Id. at 80059.

\textsuperscript{204} Id. at 80068.

\textsuperscript{205} Id. at 80069.

\textsuperscript{206} Id. at 80070.
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Companies engaged in covered activities must disclose the total amount of each payment made to foreign governments or the U.S. government in furtherance of their covered activities.207 The proposed rule carves out an exemption for de minimis payments, which are payments for less than $100,000 (or the equivalent if made in a foreign currency).208 As proposed, disclosure is required for payments in the form of taxes, royalties, fees, production entitlements, bonuses, and dividends, as well as payments for infrastructure improvements.209 Additionally, the proposed rule contains an anti-evasion provision that requires disclosure of any activity or payment not included in one of the aforementioned enumerated categories that is part of a scheme to avoid the statutory disclosure requirements.210

The trade groups that litigated against the SEC's rule in American Petroleum Institute remain strongly opposed to the rule and claim that disclosures would make them less competitive with foreign-government-owned oil and gas companies.211 The European Commission adopted a rule similar to the SEC's resource extraction rule for large undertakings and public interest entities as amendments to the EU's Transparency and Accounting Directives for large undertakings and member states are supposed to implement these provisions no later than July 2015.212 Moreover, there is no indication that Europe intends to pull back on this regulation because of the litigation and lobbying by oil and gas companies in the United States, and therefore the same companies subject to the SEC rule may soon be required to make similar disclosures in any event.213 The National Resource Governance Institute expects that foreign countries will continue to endorse and build upon the reporting standard introduced by section 1504.214 The newly proposed rule also allows for foreign companies to substitute foreign-made disclosures for those required under section 1504, if the SEC determines that the rules of the foreign jurisdiction where the disclosures were first made are "substantially similar" to section 1504.215

As the foregoing indicates, the SEC is being buffeted by conflicting political forces within the Commission, in Congress, and in the courts with regard to a resource extraction rule. It therefore is not surprising that the SEC has had so much difficulty drafting a rule likely to withstand negative scrutiny by the D.C. Circuit.

207. Id. at 80059.
208. Id. at 80063.
209. Id. at 80059.
210. Id. at 80072.
211. See Tricchinelli, supra note 195.
212. EY, DISCLOSING GOVERNMENT PAYMENTS IMPLICATIONS FOR THE OIL AND GAS INDUSTRIES 1 (2013). This publication has a helpful table comparing SEC Regulation 13(q) and European Union requirements.
213. Id.
E. POLITICAL CONTRIBUTIONS

After the U.S. Supreme Court decided Citizens United,216 the Committee on Disclosure of Political Spending, co-chaired by Professor Lucian Bebchuk of Harvard Law School and Robert J. Jackson of Columbia Law School, sent a petition to the SEC to start a rulemaking proceeding to require disclosure of corporate political contributions.217 This petition has proven controversial. Two different issues are involved concerning disclosure of political spending: campaign contributions and lobbying activities. The SEC has received more than 1,200,000 comments supporting the petition, which two former SEC chairs have endorsed.218 The petition’s formal support is derived from a diverse array of constituents; public interest groups, federal lawmakers, trade unions, and major investor firms have all officially endorsed the petition.219 For the agency, this level of response has been unprecedented, reflecting this issue’s social and political significance.220 Indeed, petitioners note that investor polls, shareholder proposals, and policy statements of some large institutional investors demonstrate an increasing desire to review companies’ political expenditures.221 The issue is political: bills have been introduced in Congress both to compel the SEC to mandate such disclosures and to prevent the SEC from mandating such disclosures.222

The Committee’s petition asserts that investor interest in corporate spending on politics is increasing. This interest did not spring up overnight; in 2006, 85 percent of polled shareholders perceived a lack of transparency surrounding issuing companies’ political contributions.223 By the end of 2014, over one million comments had been sent to the SEC urging the agency to move on this petition.224 Further, shareholder proposals on this subject have been increasing in

221. Corporate Political Spending Petition, supra note 217, at 3.
222. See Rob Tricchinelli, House Committee Approves $1.48B for SEC, Tearing Up Conflict with Senate on Funding, 46 SEC. REG. & L. REP. (BNA) 1258, 1259 (June 30, 2014); Democrats Unveil Legislation to Require Shareholder Say on Political Spending, 46 SEC. REG. & L. REP. (BNA) 775 (Apr. 29, 2013).
223. Corporate Political Spending Petition, supra note 217, at 6.
number. In 2013, seventy proponents filed fifty proposals on lobbying disclosures; forty were put to a vote, averaging 26 percent investor support.225 Institutional investors have also endorsed the proposed disclosure requirements; TIAA-CREF and the Council of Institutional Investors are but two of many institutional entities that have released public statements in favor of the petition to advance the “best interests of shareholders.”226

Even the U.S. Supreme Court is believed to have indirectly endorsed the public disclosure of political expenditures. In a statement made in Citizens United v. Federal Election Commission, Justice Kennedy noted that "with the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters."227 The operative word in that statement is can; issuers are not currently required to make such disclosures of expenditures, regardless of how accessible such statements may be through the Internet.228 It appears that the “can” will remain the operative word in this respect until the SEC decides otherwise.

However, strong opposition to these proposals and the rulemaking petition remains. One argument against the petition is that such expenditures must be reported to the Federal Election Commission, but such disclosure does not capture contributions to trade associations that engage in lobbying activity on behalf of industry groups.229 Some publicly traded corporations disclose political spending voluntarily, but comparing these disclosures is difficult because each company discloses different data.230 Some opponents of the petition argue that the petition has been advanced by those seeking “to pressure corporations to stop funding political activities altogether.”231 The fear remains that issuing companies disclosing their political contributions will be subject to political retaliation by those whom the organization did not support. Others believe that the SEC has no place regulating campaign finance in the first place. Blair Latoff


226. See Corporate Political Spending Petition, supra note 217, at 16.


Holmes, the executive director of media relations at the U.S. Chamber of Commerce, stated that "[c]ampaign finance reform is not, has never been, and should never be a function of the SEC."232 Advocates for the SEC’s involvement in campaign finance remind opponents of the precedents for such involvement; in 1994, the SEC adopted rules to stop “pay to play” in the municipal bond market,233 and in 2010 the SEC promulgated rules limiting the political fundraising ability of pension fund advisers.234 The Committee’s rulemaking petition was taken off the SEC’s agenda for 2014 without any formal explanation. To date, SEC Chairwoman Mary Jo White has not determined whether such rulemaking will be pursued in the future.235 Robert J. Jackson, the associate professor at Columbia Law School who helped submit the original petition, is not surprised by the petition’s removal from the SEC agenda. He noted that the “[SEC’s] new agenda is geared toward advancing proposals that are mandated by Congress, so it is not surprising that a non-mandatory initiative has dropped off the radar screen for now.”236 However, he, like so many others, remains confident that the SEC will eventually revisit and adopt the proposed rule.237 Lisa Gilbert, the director of Public Citizen’s Congress Watch, stated that while the SEC’s dismissal of this issue is “disappointing, it’s not the end of the rule.”238 This optimism appears well grounded in light of the petition’s overwhelming and unprecedented support.239

Since SEC Chairwoman Mary Jo White joined the agency, Republican lawmakers in the U.S. House of Representatives, as well as both SEC Republican commissioners, have been pressuring her to drop the political spending issue.240 Their reasoning is that the petition was highly partisan and politicized and could “drag the agency into a political fray.”241 Various business groups share these concerns, arguing that such politicized disclosures are unlikely to be of material significance to most shareholders and thus do not merit disclosure under federal law.242 Many of these arguments are fueled by partisan concerns.

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232. Winkler, supra note 228.
233. See id.
234. See id.
236. See ElBoghdady, supra note 220.
237. See id.
238. See id.
239. See Carey L. Biron, Record Response Urges SEC to Require Disclosure of Corporate Political Spending, MINT PRESS NEWS (Sept. 11, 2014), http://www.mintpressnews.com/record-response-urges-sec-require-disclosure-corporate-political-spending/196419/ (Lucian Bebchuk, director of the Corporate Governance Program at Harvard Law School and one of a group of academics who, in 2011, submitted the original petition on the issue, said at a press conference: "[T]he overwhelming support from public comments the petition has attracted, and the strength of the arguments for transparency put forward in the petition, provide a strong case for SEC initiation of the rulemaking process.").
241. Id.
242. Id.
over the petition’s possible consequences; the SEC’s deferral of this issue has invited accusations that the SEC has unduly succumbed to political pressures.\footnote{See Iris Dorbian, \textit{Activists Urge SEC to Require Disclosure of Political Spending}, \textit{CFO.com} (Sept. 5, 2014), \url{http://www.cfo.com/regulation/2014/09/activists-urge-sec-require-disclosure-political-spending/}.} Professor Jackson has criticized the SEC for “turning its back on investors’ interests because of Republican objections,”\footnote{See Lynch, supra note 181.} pointing out that the SEC must retain its status as a politically independent agency.\footnote{See ElBoghdady, supra note 220; see also Paul Blumenthal, supra note 231.} In response to these partisan pressures and arguments, White assures legislators that she is “apolitical” and will defer objective assessment of the petition for future review by her staff as a part of the SEC’s long-term agenda.\footnote{See Press Release, H. Comm. on Appropriations, House Approves Fiscal Year 2016 Consolidated Appropriations Package (Dec. 18, 2015), \url{http://appropriations.house.gov/news/document?DocumentID=394340}.}

In any event, the SEC will not be adopting any rules regarding disclosure of political contributions this year; a provision written into the policy riders of the 2016 Omnibus Appropriations Bill, passed on December 18, 2015, explicitly prohibits the SEC from doing so during fiscal year 2016.\footnote{Lisa Gilbert, \textit{SEC Can Still Work on a Corporate Political Disclosure Rule}, \textit{The Hill} (Dec. 22, 2015, 3:00 PM), \url{http://thehill.com/blogs/pundits-blog/finance/264036-sec-can-still-work-on-a-corporate-political-disclosure-rule}.} A group of congressional leaders led by New York Senator Charles Schumer was quick to inform the SEC via an open letter that the language of the bill does not prohibit the Commission from preparing, researching, or investigating potential rules, however.\footnote{Id.} In urging the SEC to remain committed to the issue, the letter stated, “The ability of corporate executives to spend company resources for political purposes . . . raises significant investor protection and corporate governance concerns . . . . Without transparency or disclosure, executives are free to spend funds invested by shareholders without accountability or monitoring.”\footnote{Petition for Rulemaking on Corporate Political Spending, No. 4-637 (Aug. 3, 2011).} So far, the SEC has not indicated that it has taken any measures to develop rules for the future.

At least one NGO has sought to force the SEC to enact a political contribution disclosure rule. In May 2014, Citizens for Responsibility and Ethics in Washington (“CREW”), led by named plaintiff Stephen Silberstein, submitted a petition for rulemaking to the SEC.\footnote{Silberstein v. SEC., No. CV 15-722 (RMC), 2016 WL 29253 (D.D.C. Jan. 4, 2016).} The SEC subsequently did not act on the petition. Silberstein then brought suit against the SEC in the United States District Court for the District of Columbia seeking to compel the Commission to act on CREW’s petition under the Administrative Procedure Act (“APA”).\footnote{Id.} On January 4, 2016, Judge Rosemary Collyer dismissed the suit, writing that: “Since the SEC has not denied the petition and Mr. Silberstein has not asserted that the SEC failed to act in response to a clear legal duty, it follows that he failed to state a
valid APA claim upon which relief can be granted." The decision effectively holds that the SEC is not obligated to respond to petitions by NGOs and private citizens seeking to set the SEC's rulemaking agenda.

F. CYBERSECURITY

The seriousness of cybersecurity breaches and the resulting financial risks became publicly apparent after 2010; therefore, Dodd-Frank did not mandate cybersecurity disclosures by public companies. Discussions about how and when registrants should make cybersecurity disclosures is more squarely within traditional investor protection concerns than, for example, conflict minerals disclosures. Yet, disclosures about such breaches are at least as important to customers of firms as to their investors, so there is still a question of the SEC’s appropriate role in monitoring cybersecurity and cybersecurity disclosures for public companies not involved in the securities industry. The SEC’s oversight of cybersecurity by securities firms and the infrastructure of the financial markets go considerably beyond disclosure matters and will not be discussed here.

On December 19, 2013, Target Corporation disclosed that approximately forty million credit and debit card account numbers had been hacked from its system between November 27, 2013, and December 15, 2013. Target later announced on January 10, 2014, that the breach also involved a second group of up to seventy million people. According to Target’s 10-K filed on March 14, 2014, more than eighty legal actions were filed against the company as a result of this breach, and $61 million in pretax data breach-related expenses were recorded in the fourth quarter of 2013. The company anticipated insurance proceeds of $44 million to reduce its financial exposure. In addition to the costs of remediation, the potential problems and interruptions from this breach disrupted or reduced operational efficiency and adversely affected customer confidence. SEC Commissioner Luis A. Aguilar noted that this incident serves as "one of the most prominent examples of the wide-ranging and potentially devastating consequences of cyber-attacks." This incident, unfortunately, reflects a growing threat to registrants; the SEC reports that issuers’ growing dependence on digital technology has resulted in more frequent and severe cybersecurity incidents. The seriousness of this threat cannot be understated;

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251. Id. at *5.
253. Id.
255. Id.
Jim Comey, director of the FBI, expects that the cybersecurity threat will soon “eclipse” that posed by terrorism.\textsuperscript{258}

In response to this trend, the Division of Corporation Finance issued disclosure guidance in October 2011 on cybersecurity for public companies, with an emphasis on risk factor disclosures consistent with Item 503(c) of Regulation S-K. This guidance instructed companies, \textit{to the extent material to a reasonable investor}, to make appropriate disclosures of: (1) “aspects of the registrant’s business or operations that give rise to material cybersecurity risks and the potential costs and consequences”; (2) outsourced functions with material cybersecurity risks; (3) “[d]escription of cyber incidents . . . that are individually, or in the aggregate, material”; (4) “risks related to cyber incidents that may remain undetected for an extended period”; and (5) “[d]escription of relevant insurance coverage.”\textsuperscript{259}

There are various places in the Form 10-K annual report where reporting companies could place cybersecurity disclosures. Though there is no explicit disclosure requirement specifically referring to cybersecurity risks and incidents, the Division of Corporation Finance has declared that material cybersecurity risks must be disclosed and described as risk factors provided they are material under Regulation S-K.\textsuperscript{260} In fact, the Division of Corporation Finance noted that the omission of such risks may effectually render other required disclosures misleading.\textsuperscript{261} Cybersecurity risks should thus be described in some or all of the following areas pursuant to Regulation S-K: risk factors, MD&A, description of business, legal proceedings, and financial disclosures.\textsuperscript{262} To omit cybersecurity risks in these sections would be to ignore the reality that in today’s technologically integrated world, there exists “a substantial risk that a cyber-attack [on an issuer] could cause significant and wide-ranging market disruptions and investor harm.”\textsuperscript{263}

Any cybersecurity risk materially affecting an issuer’s operations, products, professional relationships, or competitive standing merits inclusion in an issuer’s description of business. Any data breach that may result in a material threatened claim, lawsuit, or regulatory investigation should be disclosed in an issuer’s legal proceedings section pursuant to Regulation S-K. Cybersecurity risks that impose substantial costs on an issuer, either through remediation or prevention, must similarly be included in financial statement disclosures.\textsuperscript{264} Any anticipated

\begin{itemize}
\item \textsuperscript{258} Threats to the Homeland: Hearing Before the S. Comm. on Homeland Security & Gov’t Affairs, 113th Cong. 59 (2013) (statement of Hon. James B. Comey, Jr., Director, Federal Bureau of Investigation); see also supra note 257.
\item \textsuperscript{259} Cybersecurity Disclosure Guidance, supra note 257.
\item \textsuperscript{261} See id.
\item \textsuperscript{262} See id.
\item \textsuperscript{263} Aguilar, supra note 256.
\item \textsuperscript{264} Roth, Ortiz & Blair, supra note 260.
\end{itemize}
impairment of an issuer’s ability to report information accurately because of a cybersecurity risk or event should also compel an issuer to discuss that risk in the disclosure control and procedures section. Ultimately, the guidance promulgated by the Division of Corporation Finance should compel registered issuers to “identify their critical digital assets and the risks that impact them” so that these risks may be appropriately addressed and disclosed to investors. After all, such risks endanger not only the issuer but also investors and the market as a whole. Commissioner Aguilar reminded the public during a speech at the New York Stock Exchange that the consequences of cybersecurity extend “beyond the impact on the [issuing company],” and that, as a result, issuing companies should “consider [the threat’s] impact on others.” The consequences of a cybersecurity attack may adversely affect an issuer, but, by extension, may devastate the lives of a company’s customers and investors.

Issuers must employ different regulatory lenses before and after a cybersecurity incident. Although the guidance cautions against boilerplate disclosure, it indicates that “the federal securities laws do not require disclosure that itself would compromise a registrant’s cybersecurity.” The Division has issued over fifty comments to companies regarding their cybersecurity disclosures. In addition, the SEC has begun enforcement investigations where disclosures have been inadequate. The SEC’s focus is on both disclosure and controls. Both disclosures about past incidents and disclosures about ongoing risks are required.

Despite the guidance comment letters offer, pressure has been applied to the SEC to do more about cybersecurity disclosures. In April 2013, Senator Jay Rockefeller requested that the SEC elevate its guidance on cybersecurity disclosures. In the aftermath of the Target debacle and other high-profile cybersecurity breaches, the SEC held a Cybersecurity Roundtable (“the Roundtable”) on March 26, 2014. In response to calls for action, Chairwoman Mary Jo White began the Roundtable discussion by emphasizing the importance of cybersecurity to the “integrity of our market system and consumer data protection.” One question discussed at the Roundtable was whether the 2011 Division of

265. Id.
266. Id.
268. Id.
269. Id. (quoting remarks made by Commissioner Aguilar).
271. Id.
272. Id.
273. Id.
275. See White, Opening Statement, supra note 257.
Corporation Finance guidance was sufficient or whether more disclosure about cyber risks and breaches should be required, even if not material, and if so, whether such disclosure should be a line-item disclosure or otherwise be better highlighted by the SEC.\textsuperscript{276} The SEC also has opened investigations into whether a number of companies have properly handled and disclosed cyberattacks.\textsuperscript{277} Commissioner Aguilar has expressed the view that reporting such attacks should go beyond the impact on the company to disclose the attack’s effect on customers and others.\textsuperscript{278} While cybersecurity breaches remain unaddressed by federal securities laws, falling instead within the umbrella of materiality, Commissioner Aguilar urges company boards to invest more time and resources in identifying and addressing cybersecurity risks.\textsuperscript{279} Such efforts should produce outlines delineating how companies should disclose cyberattacks to investors.\textsuperscript{280} In the wake of several high-profile cyberattacks and the SEC roundtable discussion, cybersecurity has arrived safely within “the domain of investor protection and corporate boards,” catalyzing efforts toward the modernization of information security.\textsuperscript{281}

Most recently, Congress has entered the conversation regarding cybersecurity disclosure. On December 17, 2015, Republican Senator Susan Collins of Maine and Democratic Senator Jack Reed of Rhode Island introduced the Cybersecurity Disclosure Act of 2015.\textsuperscript{282} If passed, the bill would require SEC reporting companies to disclose the cybersecurity expertise or experience represented on their boards of directors or to disclose what other steps such companies have taken to identify or evaluate appropriate nominees for the board.\textsuperscript{283} The bill does not define “cybersecurity expertise” but instead commands the SEC to define what constitutes “expertise and experience in cybersecurity, such as professional qualifications to administer information security program functions or experience detecting, preventing, mitigating or addressing cybersecurity threats.”\textsuperscript{284} The proposal is currently before the Senate Committee on Banking, Housing, and Urban Affairs for further review and consideration.\textsuperscript{285}

\begin{itemize}
\item \textsuperscript{276} See White, Path Forward, supra note 1.
\item \textsuperscript{277} Two Primary Theories, supra note 270.
\item \textsuperscript{278} See Dave Michaels, Hacked Companies Face SEC Scrutiny over Adequacy of Risk Disclosure, Controls, 46 SEC. REG. & L. REP. (BNA) 1307 (July 7, 2014).
\item \textsuperscript{279} See id.
\item \textsuperscript{280} See Lynch, supra note 267.
\item \textsuperscript{282} See S. 2410, 114th Cong. (2015).
\item \textsuperscript{283} See id.
\item \textsuperscript{284} Id. § 2(c).
\item \textsuperscript{285} See Kevin M. Lacroix, Senate Bill Would Require Disclosure Concerning Corporate Boards’ Cybersecurity Expertise, D&O Diary (Jan. 6, 2016), http://www.dandodiary.com/2016/01/articles/cyberliability/senate-bill-would-require-disclosure-concerning-corporate-boards-cybersecurity-expertise/.
\end{itemize}
G. SUSTAINABILITY

Many large public companies, including 95 percent of the Global Fortune 250, voluntarily report matters relating to sustainability.\(^{286}\) This practice is also known as corporate responsibility ("CR") reporting, or corporate environmental, societal, and governance ("ESG") reporting.\(^{287}\) The dominant standard for such reporting was initially developed in a report by the Global Reporting Initiative ("GRI"), a joint venture of Ceres and Tellus, two U.S. nonprofit organizations.\(^{288}\) According to the GRI, a company's sustainability reporting is "about the economic, environmental and social impacts caused by its everyday activities."\(^{289}\) The reporting also "presents [an] organization's values and governance model and demonstrates the link between the strategy and its commitment to a sustainable global economy."\(^{290}\)

In 2010, the International Integrated Reporting Council ("IIRC") was formed as an international body to develop a framework for defining material information about an organization's strategy, governance, performance, and prospects, as well as the social, environmental, and economic context within which it operates.\(^{291}\) The European Union has already embraced compulsory sustainability reporting. In spring 2014, the European Parliament passed a law that will go into effect in 2017, requiring publicly traded companies with more than 500 employees to report on nonfinancial sustainability factors.\(^{292}\)

Partly in response to these developments, the SASB was organized to establish sustainability accounting standards for ESG reporting. This is a fairly high-powered organization, with former New York City Mayor Michael Bloomberg as chair, and former SEC Chairwoman Mary Shapiro as vice-chair.\(^{293}\) The SASB's goal is to establish accounting standards for use by publicly listed companies in disclosing material sustainability issues on Form 10-K and in other standard SEC filings.\(^{294}\) The SASB views its role as "extending accounting infrastructure to

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\(^{288}\) Id. at 1064.


\(^{290}\) Id.


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material . . . ESG factors. Sustainability accounting standards are intended as a complement to financial accounting standards, such that financial fundamentals and sustainability fundamentals can be evaluated side by side to provide a complete view of a corporation's performance. The SASB argues that investors will therefore be able to compare peer performance with regard to sustainability, direct capital to more sustainable enterprises, and understand sustainability risks and opportunities.

The sustainability topics that the SASB will address include environment, social capital, human capital, business model, innovation, leadership, and governance. The SASB will develop its sustainability accounting standards at industry levels, looking at the characteristics of various industry groups according to their extensive license to operate, use of common capitals, and high costs on society and negative environmental externalities.

Although the SASB has articulated its mission and methodology in terms of the materiality of ESG information, it will include the viewpoints of non-investors in its development of regulatory standards. Further, sustainability reporting is necessarily nonfinancial to some extent. It may be difficult for the SASB to maintain traditional concepts of materiality because GRI and IIRC concepts of materiality go beyond investor protection to embrace the needs of additional stakeholders. The GRI defines materiality as information that "may reasonably be considered important for reflecting the organization's economic, environmental and social impacts or influencing the decisions of stakeholders." The IIRC defines a matter as "material if it is of such relevance and importance that it could substantially influence the assessments of providers of financial capital with regard to the organization's ability to create value over the short, medium and long term."

The SASB's work is controversial; SEC Commissioner Daniel Gallagher attacked it, saying it usurps the role of the SEC in setting disclosure standards. The SASB also has been criticized for broadening and misinterpreting the meaning of materiality. These criticisms may be premature and unfair. The SASB asserts that its materiality standards are in line with the U.S. Supreme Court's definition of materiality in TSC Industries, Inc. v. Northway, Inc. Thus, the

296. Id.
298. Id. at 17-18.
299. Id. at 9-12.
300. See id. at 3.
303. See Gallagher, supra note 42; see also Gunther, Murray & Gunther, supra note 43.
304. See supra note 303.
305. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (defining materiality as "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"); see Legal FAQs,
SASB reasons that it has neither mandated new disclosure nor usurped the SEC’s power. Instead, it contends that it has identified the sustainability topics likely to constitute “material information” and that therefore should be disclosed in SEC filings. In its reply to criticisms, the SASB has asserted that it is not an activist organization and that its role is to assist companies that “are at risk for not disclosing material sustainability information in the Form 10-K,” or that disclose “material sustainability information in [inadequate] boilerplate language.”

The relationship between the SASB and other standard setters is fluid. Jean Rogers, SASB’s founder and executive director, notes that the Board has frequently been asked whether it seeks to compete with GRI, the organization that “pioneered a sustainability reporting framework used by companies and other entities around the world.” Answering in the negative, Rogers explained that “[the SASB is] designing for a very specific mechanism, which is the Form 10-K. [The SASB] consider[s] [itself] the floor and GRI more of the ceiling. In other words, [its framework defines] the minimum set of things that are highly material and would be recognized as such by the SEC.”

The SASB is patterned to some extent after the FASB, which began as a private sector standard-setting body for financial accounting principles. Because the SEC recognized the FASB’s pronouncements as “authoritative,” the FASB has functioned as a body with great power in setting accounting standards. If the SEC should similarly recognize the standards developed by the SASB, the SASB would have similar stature, but even if the SEC does not do so, the standards developed by the SASB will likely influence SEC disclosure policies and the disclosure practices of public companies. Many of the topics this subpart has discussed would seem to fall within the bailiwick of the SASB, but it remains to be seen how the SASB will develop its standards, how these will interface with the IIRC and other international standards, and to what extent any new nonfinancial standards will gain acceptance as disclosure items with public companies and the SEC.

IV. THE JOBS ACT’S PROVISIONS

A. STATUTORY PROVISIONS

The JOBS Act was passed on April 5, 2012, to assist entrepreneurs wishing to go public by reducing the regulatory burdens of the federal securities laws and


306. Legal FAQs, supra note 305.

307. Id.


310. Id.
simplifying the offering process. Of relevance to this article is the relief granted to EGCs from normal disclosure requirements in IPOs. Of further relevance is the fact that EGCs are not necessarily required to become registered and reporting companies under the Exchange Act.

An EGC is defined as a domestic or foreign issuer that has annual gross revenues of less than $1 billion. A public issuer will remain an EGC until the earliest of the following: the last day of a fiscal year during which it had gross revenues of $1 billion or more, the last day of the fiscal year following the fifth anniversary of its IPO, the date on which it has issued more than $1 billion in nonconvertible debt during the previous three-year period, or the date on which it becomes a “large accelerated filer” (has a public float greater than $700 million). EGCs have the option to use exemptions provided to them or, alternatively, forgoing those exemptions and complying with requirements for all other issuers.

EGCs have reduced obligations under the JOBS Act with respect to financial reporting. The JOBS Act allows EGCs to present only two (rather than three) years of audited financial statements in an IPO registration statement, and the EGC need not present selected financial data for any period prior to the earliest audited period in the IPO registration statement or in subsequent registration statements so long as the company remains an EGC. EGCs will not be subject to new or revised financial accounting standards until such standards apply to companies that are not reporting companies under the Exchange Act. Also, any rules of the Public Company Accounting Oversight Board (“PCAOB”) requiring mandatory firm rotation or supplementary information about an audit and an issuer’s financial statements will not apply to an audit of an EGC. Importantly, the JOBS Act grants an exemption for an EGC from section 404(b) of Sarbanes-Oxley, which requires an attestation report on an issuer’s internal financial reporting controls from its auditors. This exemption lasts as long as the issuer remains an EGC.

EGCs are also relieved of some of the more burdensome disclosure and other requirements concerning executive compensation. EGCs can omit the compensation discussion and analysis (“CD&A”), provide compensation disclosure for the top three (instead of the top five) executive officers for two years (instead of three years), and provide a summary compensation and outstanding equity awards table (instead of including all six required tables). Importantly, EGCs are also exempt from nonbinding executive compensation arrangement votes (“say on pay”) for up to three years after loss of EGC status.

311. See infra text at notes 315–23.
313. Id. § 101(a).
316. Id.
319. Id.
321. Id.
At least as important as the relaxed disclosure provisions for EGCs is that companies that have raised funds from shareholders without going through a registered public offering can avoid the annual and periodic reporting provisions of the Exchange Act.\textsuperscript{322} An issuer will no longer be required to register its securities under Exchange Act section 12(g) until it has 2,000 shareholders or 500 shareholders that are not accredited investors.\textsuperscript{323}

\section*{B. Market Practices}

The reduction of disclosure rules for EGCs was a response to SEC mandates that many entrepreneurial companies had found either difficult or obnoxious. Yet, not all EGCs have taken full advantage of these provisions. In particular, the relaxed financial reporting requirements have been met with mixed acceptance. A majority of EGCs have provided three years of audited financial statements—as required for all other issuers—despite their ability to provide only two years.\textsuperscript{324} Most likely, underwriters and investors have demanded three years so they can compare EGCs’ financial information to non-ESG IPO issuers. In 2012, approximately 75 percent of EGC IPOs included three years of audited financial statements, with most EGCs including five years of selected financial data.\textsuperscript{325} In 2013, 56 percent included three years of audited financial statements, and approximately half of those issuers included three years of selected financial data.\textsuperscript{326} Issuers that elected to provide two years of audited financial statements also tended to provide only two years of selected financial data.\textsuperscript{327}

An issuer’s decision to provide two rather than three years of financial data tends to be “company and transaction specific.”\textsuperscript{328} Those companies that opt for less disclosure believe more financial data would add little value to their stories, particularly if they are developing companies with little history.\textsuperscript{329} But marketing considerations and pressure from underwriters have led most EGCs to decline to take advantage of the two-year financial data allowance.\textsuperscript{330}

Although EGCs are not immediately required to comply with new or revised GAAP financial accounting standards, 80 percent of issuers in 2012 EGC IPOs and 76 percent of issuers in 2013 EGC IPOs elected to opt out of the exemption and comply with up-to-date GAAP for three reasons.\textsuperscript{331} First, there is a fear that

\begin{itemize}
  \item \textsuperscript{322} Id. § 501, 15 U.S.C. § 78l(g) (2012).
  \item \textsuperscript{323} Id.
  \item \textsuperscript{325} Id.
  \item \textsuperscript{326} Id.
  \item \textsuperscript{327} Id.
  \item \textsuperscript{328} Id.
  \item \textsuperscript{329} See id.
  \item \textsuperscript{330} See Deanna Kirkpatrick, The JOBS Act and IPOs, REV. SEC. & COMMODITIES REG., Mar. 19, 2014, at 71.
  \item \textsuperscript{331} SKADDEN ARPS, supra note 324.
\end{itemize}
EGCs will be viewed unfavorably by the public in comparison with their fully GAAP-compliant competitors. Second, EGC IPO registration statements must still account for the “then-current accounting disclosures required by Regulation S-X.” Third, auditors are uncomfortable with an audit that is not fully compliant with current GAAP standards. On the other hand, EGCs have overwhelmingly accepted the exemption from including in annual reports an auditor attestation report on the reliability of internal controls in financial reporting; virtually all EGCs assert that they intend to take advantage of the exemption to save time and money. A review of fifty-seven second annual reports filed in March 2014 for EGCs that went public in 2012 indicates that not one registrant voluntarily submitted to the internal controls audit provision of section 404(b) of Sarbanes-Oxley.

Limited executive compensation disclosure exemptions were largely embraced. Seventy-five percent of EGCs elected to take full advantage of the exemptions in 2012. In 2013, 80 percent of issuers in EGC IPOs took advantage of reduced disclosure with the majority of issuers omitting the CD&A section, filing only the two required tables, and limiting disclosure to the minimum three executives over the minimum two-year period. The JOBS Act disclosure provisions have provided an interesting experiment for SEC disclosure policy. On the one hand, the relaxed disclosure requirements resulted from the business community’s pushback regarding Sarbanes-Oxley and other provisions regarded as onerous. On the other hand, underwriters and the securities markets demanded that EGCs provide accounting information that the JOBS Act did not mandate. Perhaps as the SEC embarks on the reform of its disclosure provisions, it should provide similar opportunities for private ordering in this area.

C. REGULATION A AND CROWDFUNDING DISCLOSURE

The SEC has created simplified disclosure templates for expanded Regulation A and crowdfunding offerings, both mandated by the JOBS Act as limited public offerings for small businesses. In April, the SEC adopted amendments to Regulation A and other rules to implement section 401 of the JOBS Act and provide an exemption from registration for offerings up to $50 million. These rules

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332. See id.
333. Id.
334. See id.
335. Id.
337. SKADDEN ARPS, supra note 324.
338. Id.
339. See infra notes 340 & 342.
created Tier 1 offerings of up to $20 million annually, including no more than $6 million on behalf of selling securities holders, and Tier 2 offerings of up to $50 million annually, including no more than $15 million on behalf of selling shareholders.\footnote{341} In addition, after a lengthy rulemaking process, the SEC passed the crowdfunding rules in November 2015.\footnote{342} Crowdfunding uses the Internet to raise capital for a wide range of projects, typically seeking small contributions from a large number of individuals.

The crowdfunding rules cover the issuers eligible to use crowdfunding, the procedures they must follow, and the qualifications for selling intermediaries—brokers or crowdfunding portals—through which the issuers must make crowdfunding offerings. The rules permit a company to raise a maximum aggregate amount of $1 million through crowdfunding offerings over a twelve-month period.\footnote{343} Because of the risky nature of these offerings and the concern that investors who participate in these offerings may be defrauded, the amount individual investors can invest in the aggregate for all crowdfunding offerings is limited. If an investor’s annual income or net worth is less than $100,000, the maximum he or she can invest is the greater of $2,000 or 5 percent of the lesser of annual income or net worth.\footnote{344} If both annual income and net worth are equal to or more than $100,000, the maximum allowed investment is 10 percent of the lesser of annual income or net worth.\footnote{345} Further, the aggregate amount of securities sold to any investor through all crowdfunding offerings may not exceed $100,000.\footnote{346}

Disclosure requirements for Regulation A offerings were left to the SEC to prescribe, both as to initial offerings and continuing disclosure.\footnote{347} With regard to crowdfunding offerings, however, Congress prescribed necessary disclosures for initial offerings and continuing disclosure, which the SEC implemented in the crowdfunding rules.\footnote{348} Information about the issuer’s business and business plan is required, as well as the purpose of the offering and use of proceeds, but the SEC took a flexible approach as to how these matters should be discussed.\footnote{349} Among other things, disclosure of related-party transactions and an equivalent of a management discussion and analysis were relaxed.\footnote{350}

Of particular interest in terms of simplified and less expensive disclosure are the requirements for financial statements, which are based on the amounts of

\footnotesize{\begin{itemize}
  \item \footnote{341} Id. at 21807.
  \item \footnote{343} Id. at 71389.
  \item \footnote{344} Id.
  \item \footnote{345} Id.
  \item \footnote{346} Id. at 71390.
  \item \footnote{348} Id. § 4A(b)(1), (4), 15 U.S.C. § 77d-A(b)(1), (4) (2012).
  \item \footnote{349} Crowdfunding Release, supra note 342, at 71401.
  \item \footnote{350} Id. at 71406–07.
\end{itemize}}
securities offered and sold within the preceding twelve months. For issuers offering $100,000 or less, the principal executive officer must certify the disclosures of the amount of total income, taxable income, and total tax as reflected in the issuer's federal income tax returns as true and complete.\footnote{351} If financial statements that a public accountant who is independent of the issuer has reviewed or audited are available, the issuer must provide those and need not provide the information on income tax returns.\footnote{352}

If an issuer is offering more than $100,000 but not more than $500,000, or the issuer is offering more than $500,000 but not more than $1 million and is relying on the crowdfunding exemption for the first time, the issuer must provide financial statements reviewed by an independent public accountant.\footnote{353} If audited financial statements are available, however, the issuer must provide them.\footnote{354} Issuers that have previously sold securities in reliance on the crowdfunding exemption must provide audited financial statements by an accountant independent of the issuer.\footnote{355}

All issuers relying on the crowdfunding exemption must file with the SEC and provide to investors and their intermediaries a complete set of their financial statements, including balance sheets, statements of comprehensive income, statements of cash flows, statements of changes in stockholders' equity, and notes to the financial statements.\footnote{356} Statements that are not audited must be labelled as non-audited.\footnote{357} Further, all financial statements must be prepared in accordance with U.S. GAAP.\footnote{358}

The SEC's final crowdfunding rules also provide for ongoing reporting requirements for issuers that take advantage of the exemption. An annual report must be filed with the SEC and posted on the issuer's website no later than 120 days after the end of the fiscal year covered by the report.\footnote{359} The financial statements in the annual report need not be audited but can be certified by the principal executive officer of the issuer to be true and complete in all material respects.\footnote{360} If audited reports are available, however, they must be provided and the certification is not necessary.\footnote{361} The general content of the annual report, in addition to the financial statements, should be the same as the information required in an offering statement.\footnote{362} Although the disclosure costs should be less than the costs of preparing the initial offering statement, annual updates

are important because securities sold in a crowdfunding offering will be freely tradeable after a year.\footnote{363}{Id. at 71420.}

As Commissioner Kara Stein pointed out when the crowdfunding rules were passed, the accounting provisions are a compromise between investor protection, where an accountant opines in an audit on the accuracy of financial statements, and the cost of an audit to a start-up small business.\footnote{364}{Kara M. Stein, Comm’r, U.S. Sec. & Exch. Comm’n, Statement on the Adoption of Regulation Crowdfunding (Oct. 30, 2015), http://www.sec.gov/news/statement/statement-on-adoption-of-regulation-crowdfunding-stein.html.} The JOBS Act forced the SEC to create new disclosure templates for crowdfunding offerings. How market practices will evolve and whether this experiment will influence SEC efforts to simplify disclosure requirements generally remains to be seen.

V. THE SEC’S REVIEW PROJECT

A. THE REVIEW OF REGULATION S-K REPORT

One of the studies required of the SEC under the JOBS Act was a review of the disclosure requirements in Regulation S-K for the purposes of modernizing and simplifying disclosure requirements and reducing compliance costs for EGCs.\footnote{365}{JOBS Act § 108.} Although various disclosure reform efforts have transpired since the 1960s, SEC Chair Mary Jo White welcomed this mandate as an opportunity to reform disclosure requirements for all issuers and to encourage support and input from market participants.\footnote{366}{See Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, The SEC in 2014: Address at the 41st Annual Securities Regulation Institute (Jan. 27, 2014), http://www.sec.gov/News/Speech/Detail/Speech/1370540677500#.U46kxSdgjIy; White, Path Forward, supra note 1; Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, The Importance of Independence: Address at Fordham Law School (Oct. 3, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370539864016.} The SEC staff published its review of Regulation S-K in December 2013.\footnote{367}{U.S. SEC. & EXCH. COMM’N, REPORT ON REVIEW OF DISCLOSURE REQUIREMENTS IN REGULATION S-K (2013), http://www.sec.gov/news/studies/2013/reg-sk-disclosure-requirements-review.pdf [hereinafter S-K REPORT].} The S-K Report supported Chair White’s call for holistic review.

On October 15, 2013, Chair White addressed the National Association of Corporate Directors ("NACD") and emphasized two major themes in disclosure reform: (1) improving efficiency through modernization and (2) harmonizing sources of disclosure requirements.\footnote{368}{See White, Path Forward, supra note 1.} Intermittent disclosure reform since the 1960s has driven an “information overload” that challenges the effectiveness of current disclosure requirements for purposes of protecting investors.\footnote{369}{See id.} First, concerning efficiency, Chair White raised three key questions: (1) whether specific disclosure requirements are unnecessary, too industry-specific, outdated, or simply not wanted by investors; (2) whether information is readily available elsewhere; and (3) whether information repetition can be avoided and achieved
Second, Chair White acknowledges the many sources contributing to lengthy and complex disclosure requirements. The Commission itself is responsible for myriad Commission releases, staff interpretations, and guidance. Complex disclosure stems from pressures beyond those imposed by the Commission, such as congressional mandates, investor demands, and dated industry guides.

In December 2013, the Commission released the report on Regulation S-K disclosure requirements, which reiterated themes and goals articulated by Chair White in her October 2013 NACD address—specifically, the need for comprehensive review beyond Regulation S-K. Although the S-K Report is predominantly a historical overview of the disclosure regime, it does articulate the SEC staff’s approach to disclosure reform.

The S-K Report begins by outlining the scope of review, which excludes recently adopted regulations for specific transactions. Part III of the S-K Report considers requirements for reform in seven categories. Each section is divided by disclosure items and is followed by (1) background information, (2) summary of substantive changes to date, (3) description of scaled requirements or exemptions provided, and (4) discussion of relevant comments submitted.

With respect to modernizing Regulation S-K, the staff recommends: (1) further information gathering and review, based on staff research and input from market participants; (2) conducting economic analysis for cost-effective improvements; and (3) devising a framework for such review and analysis. The staff believes that a comprehensive approach (wholesale review of substance and procedure) is preferable to a targeted approach (“topic by topic” review of substance and procedure); comprehensive review, although time consuming, will allow the staff to harmonize sources of disclosure requirements and consolidate rules. According to the staff, the framework for disclosure reform should (1) be principles-based, (2) scale according to issuer size, (3) include an evaluation of systematic methods of delivery and presentation of information, and (4) improve readability and accessibility.

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370. See id.
371. See id.
372. See id.
373. S-K REPORT, supra note 367, at 4 (discussing the exclusion of Regulation AB and Regulation M-A from the review). The staff is considering review of Regulation M-A and seeks input from market participants. Id. at 102.
374. Id. at 30–91.
375. Id. at 93–94, 97.
376. Id. at 94–95.
377. Id. at 95–97.
378. Commissioner Daniel M. Gallagher argued for a targeted approach out of fear that comprehensive review would “risk spending years preparing an offensive so massive that it may never be launched.” Daniel M. Gallagher, Comm’r, U.S. Sec. & Exch. Comm’n, Remarks at the 2nd Annual Institute for Corporate Counsel (Dec. 6, 2013), http://www.sec.gov/News/Speech/Detail/Speech/1370540462287#. The staff admits comprehensive review will be time consuming and did not release a timeline in the S-K Report. S-K REPORT, supra note 367, at 104.
380. Id. at 97–99.
Within Regulation S-K, the staff emphasizes specific areas for reform: (1) risk-related requirements, (2) requirements relating to a registrant’s business and operations, (3) corporate disclosure requirements, (4) executive compensation requirements, (5) offering-related requirements, (6) exhibit requirements, and (7) general requirements under Item 10.381 The S-K Report also encourages the review of issues that interplay with Regulation S-K, which include (1) criteria for EGC status, (2) standards in industry guides (many of which are outdated), (3) financial reporting requirements under Regulation S-X, and (4) disclosure requirements in rules and forms.382 The staff has not articulated a timeframe for the proposed plan of action.383

B. IMPLEMENTATION—THE DISCLOSURE EFFECTIVENESS INITIATIVE

In a speech before the American Bar Association, Keith Higgins, Director of the Division of Corporation Finance, relayed the Division’s plan of review.384 The Division will first focus on business and financial disclosures generally found in periodic or current reports.385 The initial review will also analyze industry guides and form-specific disclosure requirements.386 The second phase of the review will consider how to modernize disclosure requirements.387

As of April 2014, the Division was in the process of forming teams to review specific requirements in Regulation S-K and industry guides for determining whether requirements are outdated or redundant.388 In the interim, Director Higgins called on lawyers for support. Director Higgins stressed that diligent lawyering can improve disclosure effectiveness by reducing repetition in disclosure, focusing disclosure with more specific language, and eliminating outdated information such as obsolete disclosures.389

The Federal Regulation of Securities Committee and the Law and Accounting Committee of the Business Law Section of the American Bar Association formed a working group, chaired by former Division of Corporation Finance Chief Counsel and Associate Director Thomas J. Kim, to respond to the Division’s request for comments. This committee has submitted two extensive comment letters to the SEC. One letter recommended changes to Regulation S-X intended to

(i) improve the quality and utility to investors of certain financial disclosures; (ii) enhance consistency and reduce redundancy within financial disclosure requirements; (iii) facilitate registrant preparation of required disclosures and promote investor understanding of their significance; and (iv) replace unnecessarily detailed

381. Id. at 99–102.
382. Id. at 102–04.
383. The staff, however, recognizes that it will be a time consuming and costly endeavor. Id. at 96, 104.
385. Id.
386. Id.
387. Id.
388. Id.
389. Id.
and complex disclosures with more focused and concise disclosures that highlight meaningful information regarding a registrant's business, key risks and financial condition and results of operations.390

The second letter focused on recommended changes to Regulation S-K concerning materiality, the elimination of duplicate disclosures, and the consolidation of guidance and obsolescence.391 These letters contain many useful suggestions but represent incremental, not radical, changes. Yet, such incremental changes are both more feasible and more likely to be implemented than more sweeping amendments to the SEC's disclosure rules would be.

As part of this initiative, the SEC released a request for comment on proposed changes to Regulation S-X disclosures for certain entities other than the registrant.392 These proposals relate to financial information about acquired businesses, unconsolidated subsidiaries, guarantors and issuers of guaranteed securities, and affiliates whose securities collateralize registered securities. Specifically, the release proposes changes to Rules 3-05, 3-09, 3-10, and 3-16 of Regulation S-X.393 Further similar requests for streamlining disclosure can be anticipated as the Disclosure Effectiveness Initiative moves forward.

As the SEC's Disclosure Effectiveness Initiative has progressed, the director of the Division of Corporation Finance has suggested some possible reform ideas beyond simply amending Regulations S-K and S-X. These are scaled disclosure initiatives, which amount to a principles-based approach to disclosure and a company file that would better suit today's technology and would be updated as material events occur.394

VI. BALANCING INVESTOR AND OTHER DEMANDS

The enormous growth of the private placement markets has blurred the distinction between public and private companies. The JOBS Act recognized this problem but made matters worse. There are two lenses through which one may view the different disclosure requirements placed on companies of different sizes. Under the Exchange Act, companies become reporting companies because their securities are registered pursuant to (i) section 15(d) because they have made a registered public offering under the Securities Act, (ii) section 12(b) because they list on a national securities exchange, or (iii) section 12(g) because

393. See id.
they have a sufficient number of shareholders and total assets. The Section 12(g) was added to the Exchange Act in 1964 and required any issuer with $1 million in assets and 500 shareholders of record to register its securities and become a reporting company. The JOBS Act changed the number of shareholders necessary to trigger section 12(g) registration to 2,000 shareholders of record, provided that 1,500 are accredited investors. Further, employees who received shares in an employee compensation plan that was exempt from Securities Act registration are not counted as shareholders of record.

The metric of shareholders of record in triggering Exchange Act registration is obsolete. While the number of record shareholders and amount of assets were convenient ways to distinguish publicly traded companies from other issuers in 1964, that metric does not take into account developments in the clearance and settlement of securities transactions. Public companies no longer have their share ownership recorded in the names of beneficial shareholders. Rather, shares are held in the nominee names of financial institutions and securities depositaries to facilitate clearance and settlement. Ascertaining the number of beneficial owners of such issuers or the number of nonaccredited beneficial owners would be a next-to-impossible task.

Under the Securities Act, there are four categories of issuers, all subject to different disclosure and other requirements when offering their securities: WKSIs, seasoned issuers, unseasoned reporting issuers, and non-reporting issuers. If non-reporting companies make a public offering, they must do so by filing a registration statement on Form S-1, a long-form full disclosure document that is subject to the SEC staff's review and comment process. Thereafter, they generally become a reporting company. After companies have been reporting companies for twelve calendar months, they become seasoned issuers and may offer securities on Form S-3, a shorter registration form than Form S-1. They are also allowed to incorporate information in their filed Exchange Act documents by reference. When Form S-3 was initially approved, eligibility was conditional upon a common stock float of $75 million, but this requirement was eliminated in 2007. In 2005, the SEC created a new category of filers, WKSIs, that became entitled to make common stock and debt offerings pursuant to an automatic shelf registration process that was not subject to any SEC staff review. For such offerings, WKSIs were any issuers with a common stock market capitaliza-

395. Exchange Act §§ 12(b), (g), 15(d), 15 U.S.C. §§ 78l(b), (g), 78o(d) (2012).
396. At first, the SEC (by rule) raised this amount to $3 million in 1982, then to $5 million in 1986, then to $10 million in 1996. See Langevoort & Thompson, supra note 70, at 355 n.81.
398. Id. § 502.
399. See Langevoort & Thompson, supra note 70, at 355.
tion of $700 million. Another alternative to using record ownership to determine an issuer's status under the Exchange Act registration requirements was utilized when the SEC passed rules making it easier for foreign issuers to de-register. One metric that a foreign issuer can use other than number of record shareholders is annual average daily trading volume. If average daily trading volume over a twelve-month period in the United States is no more than 5 percent of worldwide trading volume, de-registration is permitted.

The rule adopted under the JOBS Act that deregulates Exchange Act registration requirements was related to the growth of the private placement market and the development of marketplaces for the resale of privately placed securities. Further, companies with Internet-based business models and other new business entities have exhibited a strong desire to avoid or substantially delay becoming SEC registrants, even though their principals have wanted to tap outside capital. One reason behind this desire may be that Sarbanes-Oxley and Dodd-Frank have created more onerous obligations with regard to governance and disclosure. All of these developments have led to a reconsideration of which companies should be considered "public" companies subject to the full force of SEC disclosure requirements.

This reconsideration has taken a number of different forms. Kara Stein, a current SEC commissioner, has suggested that perhaps disclosure obligations should scale to the needs of different investor groups. The procedure of scaling disclosure requirements is complicated by the challenge of effectively differentiating certain investor groups. For instance, the distinction between institutional and retail investors is difficult. Still, such distinctions have been made with regard to qualified institutional buyers, accredited investors, and other investors for purposes of unregistered private placements and, more recently, for crowdfunding offerings by EGCs. But even large institutional investors have different views about, for example, sustainability disclosures. Activist hedge

402. Id. at 44727.
403. Id. at 44729.
404. Id.
406. See Guttentag, supra note 10, at 174–76.
407. E.g., Langevoort & Thompson, supra note 70, at 338–39 (Facebook story).
408. See Karmel, Realizing the Dream, supra note 39; see also Roberta Romano, The Sarbanes-Oxley Act and the Making of Quack Corporate Governance, 114 YALE L.J. 1521 (2005). Another reason may be a desire to maintain control by entrepreneurs against possible interference by activist investors. Yet, because disparate voting stock is permitted in the United States, such control can be maintained even in public companies with a large capitalization. See Out of Control, ECONOMIST (Sept. 20, 2014), http://www.economist.com/news/finance-and-economics/21618889-more-worlds-big-stockmarkets-are-allowing-firms-alibaba-sideline.
fund investors may consider such matters irrelevant; government pension funds may consider them important. What may be considered "disclosure overload" for one investor group could simultaneously be regarded by another as insufficiently informative. The director of the Division of Corporation Finance has advanced the theory that, given different informational needs, disclosure requirements could be tailored in accordance with the demands and interests of distinct investor groups.

While various investor groups have diverging informational expectations, what many groups can agree on is the fact that more disclosure is not necessarily better disclosure. Commissioner Stein noted that the evolution of federal securities laws has given rise to an era "with hundreds of pages per filing for some large issuers," prompting investors and issuers alike to petition the Commission for reductions in disclosure requirements. The sheer volume and complexity of the disclosures mandated by the SEC can render them "very hard to evaluate" by investors and quite expensive to prepare for issuers. While "removing redundancies" and eliminating archaic disclosure requirements may begin to streamline disclosures, Commissioner Stein has stated that such practices, while helpful, should not be the Commission's "central focus." In 1967, then-SEC Chairman Manny Cohen pointed out that "[b]etter disclosure is not at all synonymous with less disclosure." Commissioner Stein agrees with that sentiment. Still, Director of the SEC's Division of Corporate Finance Keith Higgins noted that many investors still demand more disclosure from issuers rather than less. The call for less disclosure is loud but short of uniform, though the call for more streamlined disclosure appears uncontested. Nevertheless, there appears to be no direct correlation between the amount and the quality of disclosure, at least in the eyes of the Commission. Therefore, Commissioner Stein seeks to shift the Commission's attention away from the amount of disclosure and toward the development of better disclosure.

A key to achieving better disclosure may lie in affording companies more flexibility. Such flexibility may come in two forms. According to Director Higgins, one may be a principles-based approach to disclosure that would allow issuers "to provide disclosures that it believes are material to investors." The second

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412. See id.
413. Stein Remarks, supra note 409.
416. Stein Remarks, supra note 409.
418. See Higgins, Disclosure Effectiveness, supra note 8.
419. See id.
420. Stein Remarks, supra note 409.
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form of potential flexibility can be afforded by the adoption of a “company file” procedure, which would allow companies to update information on the same time schedule required for filings. This company file could be organized into tabs, accessible through the company page on sec.gov, including “Business Information,” “Financial Information,” and “Governance Information.”

Director Higgins has asserted that investors perspectives must be represented in determining disclosure requirements, but “for investors with voracious appetites for information, the need for company disclosures can be boundless.” Accordingly, balance must come into play and the SEC must consider “the compliance costs for companies and the potential impact on efficiency, competition, and capital formation.”

Many of these ideas have been introduced in a recently published mammoth concept release on Regulation S-K, which is likely to dominate further discussion of the SEC’s disclosure reform project. Among many other requests for comments are inquiries as to whether a principles-based disclosure system should change traditional concepts of materiality. Yet, it will take some convincing for companies to gamble with the timing of the offering or their legal liability by experimenting with disclosure and not disclosing items that may be material.

Professor Tom Lin has contributed to the conversation regarding the need for better disclosure by noting that the emergence of computerized trading has made obsolete the reasonable investor standard, which was long embraced by the Commission and courts alike. He notes that the modern reasonable investor is often not a reasonable person at all but computerized artificial intelligence that suggests and places trades based on complex algorithmic functions. Reliance on algorithmic investment management is widespread; almost every entity investor with significant assets under management uses advanced technological programs to manage investment portfolios. Not only has this evolution significantly expedited the trading process, reducing the average time spent contemplating a trade from days to seconds, but this adaptation has greatly skewed the playing field in favor of investors who can afford cutting-edge trading technology. The advantages offered by advanced trading technology are considerable; investors may access far greater amounts of information and, more importantly, reduce latency on trade executions. It has been demonstrated that “investors with more resources can regularly outperform other investors in the marketplace without such technology.”

In short, Lin argues that reasonable investors are no longer succeeding in accordance with their skill but rather in accordance

422. Id.
423. Id.
424. Id.
427. Id. at 495.
428. Id. at 501 (citing Erik F. Gerding, Code, Crash, and Open Source: The Outsourcing of Financial Regulation to Risk Models and the Global Financial Crisis, 84 WASH. L. Rev. 127, 130-35 (2009)).
429. Id. at 489.
430. Id.
with their means. Similarly, the reasonableness of trades is no longer based on human rationalization but is rather dictated by digital automation. This modern reality erodes many of the critical assumptions upon which the Securities Act's disclosure requirements have been founded.

Another challenge to the current disclosure model is posed by Professor Henry Hu, who believes that stock issuers disclose information to investors in a manner that offers only distorted and coarse depictions of reality. The issuer, Hu argues, may distort reality by furnishing biased characterizations of raw information for investors. This distortion, however, is not necessarily intentional. Hu argues that "it can be difficult for even the most well-intentioned of intermediaries to craft good depictions of reality, especially when that reality is highly complex." Part of this difficulty can be attributed to shortcomings in the depiction tools themselves, offering the means to develop only "coarse outlines of the [complex] objective reality." Another obstacle that issuers face in providing objectively accurate disclosures lies in their fully comprehending objective reality. Hu notes that misunderstandings naturally flow from financial complexities, which can inadvertently distort the disclosures offered to investors. To eliminate these distortions, Hu suggests a "pure information" approach whereby issuers offer investors raw data from which investors may draw their own objective conclusions. This approach ultimately removes any distorting gloss the issuer intentionally or unintentionally places over disclosures.

Professor Hu also has analyzed the problems with SEC requirements for disclosure by banks in light of competing disclosure requirements now imposed by the bank regulators, which are more interested in the well-being of individual banks and the stability of the financial system than in investor protection. In view of these overlapping requirements, Hu argues that bank disclosure documents are unduly prolix yet opaque. Further, the SEC's Bank Industry Guide, which dates back to 1976, is quite antiquated.

Professors Langevoort and Thompson have suggested that more stringent disclosure requirements should be imposed on public offerings than on annual reporting because of the selling efforts associated with public offerings. Such a regime would, however, take securities regulation back to the long-criticized problems of disparate disclosure that led to the SEC's integrated disclosure rule-making initiatives in the early 1980s. These academics have also suggested that for purposes of Exchange Act registration and reporting, average daily trading

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431. Id.
432. Id. at 496.
433. Hu, Too Complex, supra note 14, at 1601.
434. Id. at 1608.
435. Id. at 1609.
436. Id.
437. Id. at 1611.
438. Hu, Disclosure Universes, supra note 9, at 569.
439. Id. at 571.
440. Id. at 590–92.
441. See Thompson & Langevoort, supra note 70.
volume is a better metric than number of shareholders of record.\textsuperscript{442} Langevoort and Thompson characterize the requisite number of shareholders for "publicness" under the JOBS Act as arbitrary and believe that the line between public and private companies is better drawn using trading activity rather than investor subscription as the defining metric.\textsuperscript{443} They also recognize that some of the disclosure obligations placed on large public companies have an impact on constituencies beyond investors, and that these other constituencies are demanding greater transparency from issuers. The extent to which "securities regulation is about social, political, and economic interests, in addition to investor protection and capital formation, has been seriously underestimated.\textsuperscript{444} To claim that the sustainable disclosure movement is limited to investor protection may be politically persuasive, but is nevertheless disingenuous.\textsuperscript{445} Moreover, as demonstrated by the conflict minerals story, requiring public companies to make disclosures in SEC documents for reasons other than investor protection is a convenient hook for reformers.

Reconciling the different pressures for disclosure reform being exerted on the SEC may require differentiating between large public companies, especially multinationals, and other companies that have tapped the capital markets but have a more limited footprint. Size and trading volume are probably better metrics in this regard than number of shareholders, but other possible lenses have been suggested. Professor Dombalagian has argued that regulatory privileges and obligations under the securities laws should be parcelled out depending upon suitability, efficiency, and representativeness.\textsuperscript{446} He envisions tiers of companies subject to different disclosure requirements, depending upon whether nonaccredited investors are shareholders, whether there is an efficient exchange or similar market for the pricing of an issuer's securities, and whether an issuer's stock is included in recognized indices.\textsuperscript{447} Professor Dombalagian recognizes that large public corporations may maintain relationships with many constituencies beyond shareholders so extensively "that their corporate decision making may reverberate throughout the national and international economy."\textsuperscript{448} Accordingly, SEC disclosure is a handy tool for corporate social responsibility advocates.

Professor Guttentag also recommends a tiered disclosure regime whereby companies that have a market capitalization of less than $35 million or fewer than 100 beneficial shareholders would have an automatic exemption from full disclosure mandates.\textsuperscript{449} Larger firms could opt into another regime if they

\textsuperscript{442} Langevoort \& Thompson, supra note 70, at 360.
\textsuperscript{443} Id. at 338.
\textsuperscript{444} Id. at 372-33.
\textsuperscript{446} Dombalagian, supra note 10, at 653.
\textsuperscript{447} Id. at 698-99.
\textsuperscript{448} Id. at 666.
\textsuperscript{449} See Guttentag, supra note 10, at 156–57.
are willing to restrict the liquidity of their stock trading, and the biggest public companies would be required to comply with the full panoply of SEC disclosure mandates.450

One idea for putting tiered disclosure in place is to look at the capitalization and impact of public companies in the capital markets. Another route would be to require new sustainability disclosures to be furnished to the SEC and made available to interested investors and others but not require that such disclosures be filed. Limiting the liability of companies for such disclosures, similar to what was accomplished in Regulation FD, would be helpful in mitigating the pushback from business groups with respect to such disclosures.451 In connection with the SEC's promulgation of rules with regard to resource extraction, business interests argued that their reports should be furnished to the SEC but not made public, and the D.C. Circuit agreed that Dodd-Frank permits that approach.452 Yet, if reports on any subject are filed in such a confidential manner with the SEC, they certainly cannot be justified in the name of investor protection. Nevertheless, the D.C. Circuit suggested the SEC could aggregate the information included in the individual reports and release a consolidated summary of the data to the public.453

At one time, corporations received charters from legislatures and were viewed as public agencies with limited franchises and public responsibilities.454 Free incorporation changed this paradigm,455 but even as late as the 1930s, when the securities laws were passed, it was argued that when a company taps the public for capital it becomes a public body with obligations to its shareholders.456 The free market ideologies of the late twentieth century, particularly the law and economics movement, challenged such ideas and argued that corporations should be able to operate free of many legal constraints because the market would impose optimum disclosure and other standards.457 Disillusion with such ideas set in after the financial market meltdown of 2008, but Dodd-Frank simply imposed a plethora of command and control (and exceedingly expensive) regulations on large public companies (especially financial institutions) without any serious rethinking, beyond preventing systemic risk, of the investor protection mantra.

In the 1980s, in response to the merger and takeover activities of that period, the stakeholder model held out a promise of a new idea of corporate responsibility, but stakeholder statutes were invoked primarily by managers who were attempting to fend off hostile takeovers. In today's world, it is important to think of some new corporate and securities principles for holding large corporations responsible beyond the narrow view of investor protection measured by

450. See id.
452. See supra text accompanying notes 183–86.
455. Id. at 22.
share price. Otherwise, more and more obligations, including disclosure obligations, will be placed on such companies by legislative fiat. Nevertheless, it does not make sense to place the responsibility for enforcing sustainability and other social responsibility goals upon the SEC in the name of investor protection.

VII. CONCLUSION

Congressional use of the federal securities law to compel disclosure of social and political goals is likely to continue. In at least one instance, Congress dispensed with the need for SEC rulemaking when it directly compelled public companies to report on their dealings with Iran. Yet, others in Congress and on the Commission itself are opposed to using disclosure policy under the federal securities laws for purposes other than investor protection. Such an adversarial and partisan battle puts the SEC in a difficult position. It is therefore unlikely that disclosure reform will move beyond incremental changes either in the direction of additional requirements for social and political disclosures that are not related to metrics of financial materiality or in the direction of simplifying existing mandates in Regulations S-K and S-X.

Despite the impetus to reduce disclosure burdens and simplify disclosure, the movement for standards of sustainability and their disclosure in SEC documents seems to have gathered some traction, and there probably will be continuing pressure on the SEC to recognize or adopt some of the standards the SASB has set. Even if the Commission does not recognize SASB standards in the same way it has recognized FASB standards, these standards will influence many public companies’ disclosures.

One way in which the SEC could deal with the conflicting pressures to compel companies to disclose more with regard to SASB standards and similar social and political matters without further complicating disclosure documents would be to follow the approach of the conflict minerals rule. That is, the SEC could require companies to file (or furnish) information about various matters on the agenda of social and political interest groups in side filings, rather than putting such information in a company’s annual report or other periodic filings or offering documents. Further, if such information did not give rise to issuer liability under the antifraud rules, there might not be so much pushback against such new requirements. Yet, if the SEC must produce a cost-benefit analysis for the promulgation of new disclosure rules, the agency might be hard pressed to determine the benefits against great costs unless Congress mandates the disclosures. Whether Congress will do so probably depends upon the political composition of future Congresses. The SEC also will be undoubtedly influenced by the final outcome of the ongoing litigation with respect to the new conflict minerals and resource extraction rules in the courts.

Another possible route the SEC might take in reconciling the various demands for disclosure reform would be to tier public companies for purposes of Exchange Act reporting in the same way in which it has tiered companies under the Securities Act to allow WKSIs to tap the capital markets without complying with all of the regulations applicable to issuers engaging in first-time public offerings. The SEC will have to do so to some extent to comply with rulemaking under the JOBS Act and could take further steps in this direction. In so doing, the SEC should find a more satisfactory metric than number of record shareholders in distinguishing between large and small public companies. Some of the ideas this article discusses, such as market capitalization, would be a good place to start. Other possible metrics would be balance sheet assets, number of employees, number of countries in which the issuer does business, and good or bad citizenship record based on citations by other regulatory agencies or criminal prosecutions by state and federal regulators. Nevertheless, the SEC should not be put in the position of enforcing other regulatory statutes such as the NEPA.

Although any of the SEC’s efforts to require disclosure obligations beyond an investor protection materiality standard on Exchange Act reporting companies will be met with criticism, the EU has essentially already done so. In order to protect and assist U.S. companies that are complying with the new EU sustainability standards, the demands being made for cybersecurity compliance and disclosures to customers, climate change inquiries, and other social responsibility issues, it will be difficult if not impossible for the SEC to avoid wading further into the swamp of disclosures relating to social and political issues.

Yet, simply adding more and more disclosure requirements to Regulation S-K cannot be the right answer to responding to the pressure for political and sustainability disclosures and greater accountability and transparency by public companies. Also, in responding to the pressures by start-ups for the ability to raise capital without complying with traditional disclosure requirements, Congress and the SEC must avoid being blinded by the romance of entrepreneurship in crafting exemptions that may provide opportunities for widespread fraud. SEC disclosure policy is based on valid historical experience. The Commission needs to resist both undue path dependency and unwarranted experimentation.