QUALITATIVE DISCLOSURE UNDER AMENDED FORM 8-K: THE PREFACE TO AN "AVALANCHE OF TRIVIAL INFORMATION" 1

I. INTRODUCTION

During the 2001 calendar year, investors and non-investors alike witnessed the implosion of some of America’s largest companies. 2 Executives at companies such as Enron Corporation (“Enron”) and WorldCom, Incorporated (“WorldCom”) harnessed accounting improprieties to mislead investors and inflate share prices. 3 By hiding poor earnings in off balance sheet transactions, the executives of these companies were able to manipulate stock prices and create illusory gains that would have impressed Gordon Gecko. 4 Shareholder losses in Enron, WorldCom, Quest, Global Crossing, and Tyco represent market losses in excess of $460 billion; 5 while executives, who likely were cognizant of the actual financial status of these companies, profited from the sale of their individual stock holdings. 6 The public outcry that ensued following the extensive devaluation of the stock market led to significant legislative activity 7 and ultimately to the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”). 8

1. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 448 (1976) (stating that “management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking”).


6. BOSTELMAN, supra note 3, § 2.2.2. Kenneth Lay sold substantial amounts of stock during an employee blackout period, while Enron pension holders watched stock price decline from $13.81 to $9.98 per share. Id.

7. Id. § 2.6 (listing the various House and Senate bills prior to congressional approval of Sarbanes-Oxley).

It has been three and one-half years since the United States Congress enacted Sarbanes-Oxley, and the Securities and Exchange Commission (the "Commission") continues to enact regulations to implement the broad concepts outlined in the original text of Sarbanes-Oxley. In an effort to codify some of these broad concepts, the Commission has amended its Form 8-K Current Report ("Form 8-K") filing requirements. The new Form 8-K adds seven new "triggering" events, the occurrence of which prompts a reporting company to file a Form 8-K with the Commission. In most instances, the Commission requires that the company file its Form 8-K within four days of the occurrence of a "triggering" event, substantially shortening the fifteen-day requirement under the prior Form 8-K. The impetus for this amendment stems from title IV, section 409 of Sarbanes-Oxley ("section 409") and its corresponding amendments to section 13 of the Securities and Exchange Act of 1934. The changes to Form 8-K are designed to prompt an issuer to publicly disclose certain information to the Commission on a "rapid and current basis." While shortening the deadline from fifteen to four days following a "triggering" event may be a reasonable extrapolation of rapid and current reporting precepts, it does not necessarily follow that additional "triggering" events are required to promote the objectives of Sarbanes-Oxley. In fact, this Note concludes that the Commission's implementation of additional Form 8-K filing requirements without clarification of materiality standards will not facilitate the disclosure of information that is "necessary or useful for the protection of investors . . . [or] in the public interest." Instead, these amendments likely will increase the costs of corporate compliance and burden those investors who are the target of the Commission's paternalism by creating an overwhelming torrent of immaterial information. The cumulative effect of increased costs and information overload may undermine shareholder perceptions regarding the importance of a Form 8-K filing and relegate such an occurrence to the status of an expensive course-of-business.

scattered sections of 1, 15, 18, 28, and 29 U.S.C.).


10. Patrick G. Quick, Address at Johnson Controls, Inc. (Feb. 4, 2005); see also Form 8-K, infra note 11.


12. Id.


15. Id.

16. Id.
press release. Additionally, the adverse impact that additional reporting requirements may have upon corporate liability, reporting, and expenses may well overshadow the value of the information they provide.

Because the conduct of corporate officers such as Kenneth Lay, Andrew Fastow, Scott Sullivan, and L. Dennis Kozlowski is indelibly linked to losses of shareholder equity in excess of several billion dollars, any note criticizing the wisdom of post Sarbanes-Oxley disclosure requirements should also address why such requirements are not essential to investor protection and should illustrate that the implementation of these requirements will not afford investors a net increase in protection from the fraudulent conduct of corporate officers. As such, this Note will center upon this question: At what point do the Commission's disclosure requirements cease to provide valuable and protective information for shareholders? Specifically, do the amended Form 8-K disclosure requirements provide greater basis for informed decisionmaking or do such requirements dilute corporate disclosure to the extent that the production of information may impede informed decisionmaking?

This Note will discuss whether the Commission's amended Form 8-K is an effective vehicle to provide shareholders with accurate, timely, and material information. This Note will analyze each of the preceding concerns following a brief discussion of Sarbanes-Oxley and its impact upon shareholder protection measures. Part III will provide a brief history of Form 8-K and describe its current form. Part IV will address the implications of the 8-K requirements under the ambiguous definition of “materiality” as defined by the Staff Accounting Bulletin Number 99 (“SAB 99”) and the Supreme Court of the United States. Part V will question whether the new disclosure requirements of Form 8-K, under the Court's and the Commission's

17. Kenneth Lay is the former Chairman and Chief Executive Officer, Enron Inc.
18. Andrew Fastow is the former Chief Financial Officer, Enron Inc. (Mr. Fastow currently is serving a 10-year sentence for his involvement in the Enron accounting improprieties.)
19. Scott Sullivan is the former Chief Financial Officer, WorldCom Inc.
definitions of materiality, will facilitate a more informed decisionmaking process or instead flood the market with substantively immaterial information.

II. THE SARBANES-OXLEY ACT OF 2002

A. Background Information

In the first year following the collapse of Enron, Congress sought to reform corporate accounting, disclosure, governance, and reporting practices by implementing Sarbanes-Oxley. By its enactment of Sarbanes-Oxley, Congress approved the most sweeping securities legislation since the Securities Exchange Act of 1934. While many of the provisions of Sarbanes-Oxley are laudable for their attempt to provide heightened security for shareholders, some of the regulations promulgated by the Commission in response to Sarbanes-Oxley are overreaching and unnecessary to protect investors, foster confidence in the financial markets, or promote a public interest.

Some of the beneficial changes in corporate governance under Sarbanes-Oxley include the following: the establishment of the Public Company Accounting Oversight Board ("PCAOB"), the requirement of auditor independence, the enhancement of conflicts of interest provisions, and the creation of executive accountability. Arguably, each of these changes was required to restore the confidence of investors whose faith in the market had been severely undermined by the actions of fraudulent executives. Indeed, the requirement for Chief Executive Officer and Chief Financial Officer Certification under Sarbanes-Oxley was an important response to investor contempt for executives who plead ignorance to the fraudulent activity that preceded the decline of their respective corporations.

26. BOSTELMAN, supra note 3, § 2.1.
28. This Note will focus solely on section 409 of the Sarbanes-Oxley Act of 2002 and its ancillary effect upon the United States Securities Exchange Commission Form 8-K, given the Supreme Court's and the Commission's definition of "material."
33. The executives whose conduct was especially abrasive were Kenneth Lay, Andrew Fastow, Scott Sullivan, and L. Dennis Kozlowski. See supra notes 17-20.
35. The accounting irregularities present at Enron, WorldCom, Quest, Global Crossing, and
Oxley reporting environment, investors may be comforted by the requirement that the Chief Executive Officer and the Chief Financial Officer expressly certify that the financial statements of the corporation comply with all regulations and that such statements accurately depict the financial condition of the company. However, Congress, the Commission, and the exchanges still are faced with two prevalent concerns. First, how much regulation is needed to balance investor protections and corporate practices? Second, is the cost of such regulation commensurate with its purported increase in investor protection or confidence?

Rather than addressing specific concerns associated with the economic advisability of a sweeping increase in corporate disclosure, Congress broadly addressed perceived shortcomings within the financial reporting arena by enacting title IV of Sarbanes-Oxley, Enhanced Financial Disclosures.36 As part of this broad reform, Congress charged the Commission with the rulemaking authority to compel issuer disclosure on a “rapid and current” basis.37 Under section 409 of title IV of Sarbanes-Oxley, entitled Real Time Issuer Disclosures, the Commission is empowered to require the disclosure of additional information that it deems “necessary or useful for the protection of investors and in the public interest.”38

B. Section 409

Before Sarbanes-Oxley was enacted, practitioners questioned the value of its sweeping corporate reform.39 In response to Chairman Alan Greenspan’s40 statements advocating Chairman Oxley’s vision of “a pronounced move toward more transparent reporting and improved corporate governance practices in the wake of the Enron collapse,” 41 one practitioner cautioned the


38. Id.
39. See generally Congressional Testimony for Sarbanes-Oxley (H.R. 3763).
40. Alan Greenspan was the Chairman of the United States Federal Reserve Board at the time the Sarbanes-Oxley Act of 2002 was enacted.
committee not “to fix things that aren’t broken.” He further stated, “while the government may still need to take action [to enact legislation to prevent corporate officers from defrauding shareholders], that action should not stifle the ability and initiative of the financial markets to self-correct.” In fact, there is concern that pervasive legislation might actually harm shareholders as the value of their shares may be reduced to reflect the increasing costs associated with corporate legal defenses against plaintiffs’ strike suits rooted in new regulations.

Despite the foregoing market-force argument—and in consideration of the recent large-scale abuses—the United States Congress concluded that additional regulation was necessary. On July 30, 2002, Congress enacted section 409 of Sarbanes-Oxley, which amended section 13 of the Securities Exchange Act of 1934 by adding the following language:

Real Time Issuer Disclosures.
Each issuer reporting under section 13(a) or 15(d) shall disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations of the issuer, in plain English, which may include trend and qualitative information and graphic presentations, as the Commission determines, by rule, is necessary or useful for the protection of investors and in the public interest.

Collectively, this provision of Sarbanes-Oxley, the Commission’s recent amendments to Form 8-K, the ambiguous definition of “material” in TSC Industries, Inc. v. Northway, Inc. and Basic Inc. v. Levinson, and the construction of “materiality” in SAB 99 could create a flood of substantively immaterial disclosures that may overwhelm investors and undermine the significance of an 8-K filing.

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42. Id.
43. Id.
44. Id.
III. COMMISSION RULEMAKING: THE AMENDED FORM 8-K

A. Background

In 1936, the Commission created Form 8-K, which provided companies with the form to be used to file a “current” report. The original Form 8-K was to be filed with the Commission upon the occurrence of certain extraordinary events and afforded a company up to forty days to file its report with the Commission upon the occurrence of these specific events. Since 1936, the timeliness and effectiveness of information provided under the original Form 8-K has been undermined by the proliferation of information via the Internet, television, and telephone in advance of filing. These advancements in communication have precipitated several amendments to the form.

In the years following 1936, the Commission has amended the triggering, disclosure, and filing requirements of Form 8-K to balance shareholders’ needs for timely and accurate information against corporate concerns regarding the escalating costs of disclosure. Notably, in 1977, the Commission amended the filing and disclosure requirements of Form 8-K to require reporting of “some corporate events within five business days after their occurrence and others within 15 calendar days after their occurrence.” In 1998, the Commission proposed substantial amendments that would have expanded the Form 8-K disclosure and shortened its filing requirements to one business day for some items and five calendar days for others.

49. Id.
50. Id. A company was not required to file a report until the tenth day of the month following the month in which the event occurred. Id. This meant that a company that experienced a triggering event on the first of the month would be afforded a forty-day window before disclosure was required. Id.
51. Id.
52. Id.
53. Id.
54. Id. at 2. Under this version, most events triggered the fifteen-day filing deadline. Id.
55. Id. at 3. The Commission proposed to expand Form 8-K to include the following:

(1) timely disclosure of annual and quarterly earnings results of domestic companies; (2) material modifications to the rights of security holders; (3) departure of a chief executive officer, president, chief financial officer or chief operating officer; (4) material defaults on senior securities; (5) notice from an
However, following extensive public comment and the Commission’s inability to reach a consensus on the advisability of the proposed amendments, the proposal was abandoned.\textsuperscript{56}

Nevertheless, Form 8-K again became the target of reform following the 2002 accounting scandals.\textsuperscript{57} Bolstered by congressional amendments to section 13 of the Securities Exchange Act of 1934,\textsuperscript{58} which require “rapid and current”\textsuperscript{59} disclosure of material information, the Commission once again sought to expand Form 8-K.\textsuperscript{60} This time, public opposition was less vocal, and the Commission’s reform efforts ultimately were realized on August 23, 2004, when the amendments to Form 8-K became effective.\textsuperscript{61}

### B. Disclosure Requirement After August 23, 2004

On August 23, 2004, the Commission’s amendments to Form 8-K became effective.\textsuperscript{62} Form 8-K, as amended, attempts to incorporate the concerns expressed in the proposed amendments of 1998,\textsuperscript{63} the “rapid and current” requirement of section 409 of Sarbanes-Oxley, and Alan Greenspan’s vision of “improved transparency” in corporate records.\textsuperscript{64} The Commission seeks to promote the foregoing principles by requiring subject companies to file a Form 8-K upon the occurrence of any of the following events:

1. Entry into a Material Definitive Agreement;
2. Termination of a Material Definitive Agreement;
3. Bankruptcy or Receivership;
4. Completion of Acquisition or Disposition of Assets;
5. Results of Operations and Financial Condition;
6. Creation of a Material Direct Financial Obligation or a Material Obligation under an Off-Balance Sheet Arrangement of a Registrant;
7. Triggering Events that Accelerate or Increase a Material Direct

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\textsuperscript{61} See Del Raso, supra note 41.

\textsuperscript{56} Id. at n.35.

\textsuperscript{57} Id. at 3.


\textsuperscript{59} Id.

\textsuperscript{60} Proposed Rule, supra note 48.

\textsuperscript{61} See Form 8-K, supra note 11.

\textsuperscript{62} Id.

\textsuperscript{63} See Proposed Rule, supra note 48.
Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement;
8. Material Charges under GAAP Associated with Exit or Disposal Activities;
9. Material Impairments;
10. Notice of Delisting or Failure to Satisfy a Continued Listing Rule or Standard; Transfer of Listing;
11. Unregistered Sales of Equity Securities;
12. Material Modification to Rights of Security Holders;
13. Changes in the Registrant’s Certifying Accountant;
15. Changes in Control of the Registrant;
16. Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers;
17. Amendments to the Articles of Incorporation or Bylaws; Change in Fiscal Year;
18. Temporary Suspension of Trading Under Registrants Employee Benefits Plans;
19. Amendments to the Registrant’s Code of Ethics, or Waiver of a Provision of the Code of Ethics;
20. Change in Shell Company Status.65

Of the foregoing twenty items, only three items appear in the same form as they did under the prior Form 8-K, and only three others are substantially similar to their pre-amendment counterparts.66 The remaining items represent additional disclosure requirements or significant alterations to previous requirements.67 Among the added and altered provisions, the term “material” is peppered conspicuously throughout. In fact, seven of the mandatory disclosure items under the amended Form 8-K require an in depth materiality

65. See generally Form 8-K, supra note 11 (emphasis added).
66. See Proposed Rule, supra note 48, see also Form 8-K, supra note 11. The three items of mandatory disclosure under the amended Form 8-K that remain from the prior version of Form 8-K are the following: (1) a change in the control of the registrant, (2) bankruptcy or receivership, and (3) changes in the registrant’s clarifying accountant. The following three items, though expanded, clearly are related to the prior Form 8-K: (1) creation of a material direct financial obligation or creation of a material obligation under an off-balance sheet arrangement; (2) departure of directors or principal officers, election of directors, appointment of principal officers; and (3) amendments to the articles of incorporation or bylaws, changes in fiscal year.
analysis. By increasing the number of mandatory disclosure items that are subject to materiality analysis, the Commission has exponentially expanded both the amount of information that must be reviewed by corporations and the amount of information that will be filed with the Commission.

In addition to expanding Form 8-K reporting requirements, the Commission also amended its filing requirements. Under the previous Form 8-K, most triggering events required a reporting company to file its current report within fifteen calendar days from the date of the occurrence of the event. With its amendments to Form 8-K, the Commission has shortened this timeline substantially. To comply with the amended filing requirements, a reporting company must now file its current report within four business days of most triggering events and within two business days of certain events.

The Commission’s amendments to Form 8-K, while laudable in their attempt to address both timeliness and transparency issues, might undermine the effectiveness of current reporting in the corporate disclosure regime. When viewed in concert with SAB 99 and materiality case law, Form 8-K, as amended, may lead to a deluge of patently immaterial disclosures that could overshadow substantive information. Further, by concurrently shortening the filing requirements and expanding the disclosure requirements, the Commission effectively has mandated the disclosure of information upon minimal review. To avoid the repercussions of untimely filing, corporations may choose to disclose vast amounts of information based only upon a cursory analysis of its materiality. When considered in light of the panoply of information that arguably is material under current standards, the potential flood of information may produce diminishing returns to shareholders.

68. Form 8-K, supra note 11.
69. Form 8-K, supra note 11.
70. See Proposed Rules, supra note 48.
71. Form 8-K, supra note 11.
72. Id.
73. See SAB 99, supra note 23.
75. One such repercussion now could include a loss of a corporation’s well known seasoned issuer status by virtue of its loss of S-3 status for an untimely filed current report.
IV. DEFINING MATERIALITY

A. Introduction

The concept of materiality is crucial to the efficacy of federal securities laws. Rather than expressly legislating statutory guidelines that address every scenario under which disclosure might be required to protect investors, the Commission has adopted a flexible standard of “materiality.” In this role, materiality analysis serves a dual purpose in the federal reporting process. First, materiality analysis shapes the content of mandatory disclosure; specifically mandated information must be disclosed only if it is material. Second, materiality analysis shapes the content of clarifying disclosure; “information not expressly mandated by the disclosure guidelines needs to be reported only if it is material and necessary to make the mandated statements not misleading.” Therefore, materiality analysis pervades many aspects of the securities regulation regime. Nevertheless, defining materiality is a perpetual challenge and an elusive accomplishment.

In August of 1999, the Commission published SAB 99. This publication addressed the following question: “In the staff’s view, may a registrant or the auditor of its financial statements assume the immateriality of items that fall below a percentage threshold set by management or the auditor to determine whether amounts and items are material to the financial statements?” The first sentence in the staff’s interpretive response, in its entirety, was “[n]o.”

Prior to SAB 99, the United States Supreme Court addressed the question of how to determine materiality in the context of public disclosure in the

77. Id.
78. Id.
79. Id.
80. Id.
81. Id. at 368 (citing Dan L. Goldwasser, Disclosure Under the Federal Securities Laws, 623 P.L.I Comm. 279, 284 (1992)).
85. SAB 99, supra note 23.
86. Id.
landmark decision of *TSC Industries, Inc. v. Northway, Inc.* In that case, the Court outlined the proper analysis under the general standard of materiality as follows: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." Although the *TSC Industries* Court limited the application of this analysis of materiality to proxy solicitation under Section 14a-9 of the Securities Exchange Act of 1934, subsequent case law and interpretations have applied this definition to an array of corporate disclosure issues. Most notably, perhaps, in *Basic Inc. v. Levinson* the Court adopted the *TSC Industries* standard of materiality analysis for cases arising under anti-fraud provisions of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

The Court's definition of materiality in *TSC Industries* and its subsequent expansion in *Basic Inc.*, combined with the staff's interpretive response in SAB 99, represent two central indices against which the determination of materiality under current SEC disclosure and reporting regulations must be measured. To discern the possible impact of these materiality standards upon corporations, shareholders, and public interest under the amended Form 8-K, it is imperative to examine the foundations of these current analyses of materiality in greater detail.

**B. Staff Accounting Bulletin No. 99**

1. "Rules of Thumb"

SAB 99 was designed to respond to practitioners' questions regarding whether the threshold for materiality could uniformly be expressed as a quantitative amount. The response underscores the staff's apprehension towards endorsing a bright-line test for materiality and warns management and auditors not to rely solely on percentage thresholds to determine whether

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88. *Id.* at 449.
92. 17 C.F.R. § 240.10b-5 (2006). The Commission promulgated Rule 10b-5 pursuant to its authority under section 10 of the Exchange Act of 1934. Together these provisions prohibit, in connection with the sale of a security, the making of any untrue statement of a material fact or the omission of a material fact that renders disclosures misleading. *Id.*
The predominant concern expressed in SAB 99 addressed the prevalence of certain "rules of thumb" within the financial reporting and auditing arenas used to determine whether a misstatement or omission was material. Specifically, the staff addressed the "rule of thumb" that a misstatement or omission, "in the absence of particularly egregious circumstances, such as self-dealing or misappropriation by senior management," was not material if the quantitative value of such misstatement or omission fell below a five percent threshold.

In its express rejection of this practice, the staff stated "that exclusive reliance on this [five percent] or any percentage or numerical threshold has no basis in the accounting literature or the law." The staff further stated that such "rules of thumb" may only be used as "an initial step in assessing materiality." Therefore, to conduct a thorough analysis of materiality and to avoid liability for misstatements or omissions under federal securities laws, a company must consider other objective factors.

2. Objective Factors: The Qualitative Standard

After expressly rejecting quantitative measures as a sufficient determinant of materiality, the staff suggested other qualitative standards by which materiality may be determined. First, the staff lauded the Financial Accounting Standards Board ("FASB") for its Statement of Financial Accounting Concepts No. 2 ("Statement No. 2"), which explained materiality as follows:

The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the

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94. Id.
95. Id.; see also Miller, supra note 76.
96. SAB 99, supra note 23.
97. Id. While the staff did not specifically address the value from which this five percent threshold was determined, it seems that gross sales were often used as a base factor. Id.; see also Donald C. Langevoort, Taming the Animal Spirits of the Stock Markets: A Behavioral Approach to Securities Regulation, 97 Nw. U. L. Rev. 135, 186 (2002) (stating "[t]he most important question in the bulletin involved the company that makes a tiny upward adjustment in reported earnings (perhaps less than 1%) in order to meet analyst expectations for a particular quarter. The bulletin provides that the small amount is material because the market treats it as important, punishing companies that fall short. Fundamentally, it is hard to imagine how a reasonable investor would treat that data as significant.").
98. SAB 99, supra note 23.
99. Id.
100. Id.
101. Id.
magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.\footnote{102}

Perhaps as a reiteration of its distrust for a solely quantitative measurement of materiality, the staff stressed the precepts contained in Statement No. 2 and maintained that the "[e]valuation of materiality requires a registrant and its auditor to consider \textit{all} the relevant circumstances. . . . Qualitative factors may cause misstatements of quantitatively small amounts to be material. . . ."\footnote{103}

The practical effect of SAB 99 and its eradication of a bright-line materiality test was the expansion of materiality analysis of every mandatory disclosure event.\footnote{104} Further, SAB 99, when considered in context with the United States Supreme Court opinions in \textit{TSC Industries} and \textit{Basic Inc.}, complicates corporate disclosure procedures, under Form 8-K, by subjecting an innumerable amount of events to a determination of materiality based upon the amorphous "reasonable investor" standard, in lieu of an alternative bright-line standard or comprehensive balancing test.\footnote{105}

\section*{C. Material Case Law}

\textbf{1. \textit{TSC Industries, Inc. v. Northway, Inc.}}\footnote{106}

In \textit{TSC Industries}, the United States Supreme Court defined the term "material" in the context of a proxy solicitation and addressed whether the question of materiality may be resolved by summary judgment.\footnote{107} The Court held that the determination of materiality is an objective question and demands a consideration of the information's significance to the reasonable investor.\footnote{108} Accordingly, the Court concluded that summary judgment on the question of materiality is appropriate only where the information is "so

\begin{footnotesize}
\begin{enumerate}
\item[102.] Id.; FASB, \textit{STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS No. 2, QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION} 132 (1980).
\item[103.] SAB 99, \textit{supra} note 23.
\item[105.] Rather than provide any concrete guidance in SAB 99, the staff merely stated that quantitative measurement alone would be insufficient to determine materiality and that "items . . . are qualitatively material apart from any relation to their quantitative materiality." Miller, \textit{supra} note 76, at 383.
\item[106.] 426 U.S. 438 (1976).
\item[107.] \textit{Id.} at 444-45.
\item[108.] \textit{Id.} at 445.
\end{enumerate}
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obviously important to an investor, that reasonable minds cannot differ” on their conclusion of materiality. Each of these conclusions has been supremely important to defining a standard of materiality under securities regulations.

After affirming that the “materiality” of information entails an objective evaluation, the Court sought to define a workable standard to determine the significance of information to the reasonable investor. The Court stated that information is material if there is 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.” To make this determination, there must be a “delicate assessment[] of the inferences a ‘reasonable shareholder’ would draw from a given set of facts and the significance of those inferences to him.” Because this assessment involves a mixed question of law and fact, the Court concluded that this determination is best suited for the trier of fact.

The Court did concede that insistent disclosure based upon this definition of material might accomplish more harm than good.

[If] the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management’s fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.

Nevertheless, the Court defined materiality in terms of a “reasonable investor,” thereby significantly increasing a corporation’s exposure to liability and reducing its ability to resolve the issue of materiality at summary judgment—as few items are so obviously unimportant to shareholders that reasonable minds cannot differ on the question of materiality, as defined in TSC Industries.

In the midst of these considerations, the Court failed to address the impact that its definition of materiality may have upon other aspects of mandatory

109. Id. at 450 (citing Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970)).
110. Id. at 449.
111. Id. at 450.
112. Id.
113. Id. at 448-49.
114. Id.
115. Id.
disclosure.

2. Basic Inc. v. Levinson

In Basic, the Court expressly adopted the TSC Industries standard of materiality for actions under section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)") and Rule 10b-5. As part of this adoption, the Court expanded the potential class of material information by concluding that speculative or contingent information may be material, and therefore, must be disclosed consistent with reporting obligations. Specifically, the Court stated that information regarding a potential merger may be material if its consummation is sufficiently likely. Although the Court conceded that where "the event is contingent or speculative in nature, it is difficult to ascertain whether the 'reasonable investor' would have considered the omitted information significant at the time," it nevertheless concluded that reporting companies must undertake such an evaluation. In fact, the Basic Court added another layer of analysis to the materiality standard to account for speculative or contingent information. To determine whether contingent or speculative information is material, a corporation must evaluate the "probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity" and decide whether there is a substantial likelihood that the disclosure of the potential merger "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."

3. The Basic Impact

The Court’s application of the TSC Industries materiality standard to speculative or contingent events under Section 10(b) and Rule 10b-5 has relegated materiality determination to post-hoc analysis based upon 20/20 hindsight. If a purportedly speculative event does, in fact, occur, a court

117. Id. at 232.
118. Id.
119. Id.
120. Id.
121. Id.
122. Id. at 238.
123. Id. (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)).
124. Id. at 231-32 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).
may view the corporation’s probability analysis with increased scrutiny and suspicion given its knowledge of the ultimate state of affairs. Conversely, a court may conclude that the potential of an admittedly unlikely occurrence should have been disclosed given the magnitude of its eventual effect upon share price. Again, this analysis will be distorted by the occurrence of countless variables and the infusion of perfect hindsight. Because the corporation’s determination of materiality is based upon pro-forma analysis—with its imbedded assumptions and uncertainties—and because the court’s determination of materiality is based upon the wisdom of hindsight, corporate analysis immediately is undermined. Given the relatively unpersuasive nature of an ultimately incorrect prediction against the educative quality of reality and the unlikelihood of determining materiality at summary judgment, a corporation would be wise to conduct the most thorough and in-depth analysis of a speculative event as possible.

However, a corporation’s ability to conduct such analysis is weakened by the disclosure requirement under the amended Form 8-K. For the probability/magnitude analysis in Basic Inc. to provide legitimate guidance, a corporation should have sufficient time from the date of the event to determine whether the probability and magnitude of its occurrence significantly alter “the ‘total mix’ of information made available.” Nevertheless, the expanded disclosure requirements and shortened filing timelines under Form 8-K threaten the efficacy of this standard. If a corporation undertakes to conduct materiality analysis of a speculative event, it will have only four days to determine whether the probability/magnitude of that event triggers its disclosure obligations. This timeline may create an enhanced threat of litigation or regulatory reprisal where circumstances render an event material, under this standard, on the fifth day following the occurrence of the event, potentially exposing the corporation to governmental and private actions.

126. Id.
127. Id. at 572.
128. Id.
129. Id.
130. Once an event occurs, critics can easily maintain that the event was foreseeable and point to several factors that, when viewed in light of the occurrence, clearly support such a contention. Therefore, the educational effect of an occurrence provides critics with the ability to make better pro-forma predictions to contest corporate analysis.
132. Id. at 449.
133. See Form 8-K, supra note 11.
134. The Commission could impose penalties for failing to timely file a current report through an enforcement action, and shareholders could bring suit under Section 10(b) and Rule 10b-5 for an
D. The Convoluted Theory of Materiality

When viewed in concert, SAB 99, *TSC Industries*, and *Basic Inc.* create an expansive analysis of materiality but provide little practical guidance by which a public company may establish an effective disclosure policy. In turn, the "reasonable investor" is left to wonder: by which standard of materiality is Company A measuring its disclosure? Can I assume that Company A's decision to disclose certain "material" information represents the same decision that Company B would make given a substantially similar set of circumstances?\(^{135}\)

Despite this lack of clarity and certain variation, two certainties may be gleaned from the current posture of materiality analysis. First, courts will determine materiality based upon an objective standard, evaluating the "total mix" of information and its effect upon the decisions of a reasonable investor.\(^{136}\) Second, the Commission will conduct qualitative analysis of corporate information, in addition to quantitative analysis, to determine whether the information in question is material.\(^{137}\) Although no immutable standard can be articulated given this framework, it remains the standard by which compliance with federal securities regulation will be measured. It is precisely this lack of clarity that may encourage corporations to set a relatively low standard of materiality to avoid liability, derivative actions, or regulatory reprisal. In turn, this low standard for materiality in corporate disclosure would translate into the disclosure of increasingly *immaterial* information: "an avalanche of trivial information . . . that is hardly conducive to informed decisionmaking."\(^{138}\)

V. ALTERNATIVES TO A COMPLIANCE AVALANCHE

In contrast to the goal of providing information that is "necessary or useful for the protection of investors and in the public interest,"\(^{139}\) the expanded Form 8-K requirements simply will provide investors with more information, the value of which may be questionable. While the goal of facilitating informed decisions among investors certainly is legitimate, its

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135. An introspective investor might even wonder whether he or she is "reasonable" in his or her evaluation of materiality.
136. *TSC Indus.*, 426 U.S. at 449.
138. *TSC Indus.*, 426 U.S. at 448-49.
achievement will not be realized by burying investors in information that will have little effect on the current or future operations of a company. In addition, the amendments to Form 8-K likely will facilitate the disclosure of variant information, irregular reporting among companies, and an influx of substantively immaterial information.

The multiplicative effect of the expansive definition of "materiality" and the enlargement of reporting items under Form 8-K is neither conducive to optimal asset allocation nor informed decisionmaking. Instead, when viewed in consideration of the regulatory environment in which it operates,\textsuperscript{140} Form 8-K likely will place significant additional burdens upon public companies without correlative benefits for investors or the public interest. By its own estimates,\textsuperscript{141} the Commission believes that the amendments to Form 8-K will increase the annual cost of Form 8-K disclosure by $9,900,000, raising issuers' annual costs to $81,377,000.\textsuperscript{142} Where the information that is produced under these costs is determined under the indefinite rubric of materiality, as discussed above, such allocation of corporate capital does not appear to be the most productive use of shareholder capital. Rather, shareholders likely would be better served by either a dividend in that amount or the issuer's reinvestment of that capital into productive assets.

Instead of implementing pervasive regulations and expansive disclosure requirements, the Commission should afford reporting companies opportunities to exercise business judgment and implement self-corrective measures. Despite investor concerns regarding securities fraud and market reactions to the accounting scandals of 2001 and 2002, the financial markets still possess the mechanisms to self-correct.\textsuperscript{143} The mechanisms of self-correction are implicit both in the corporate structure and in its regulatory regime.\textsuperscript{144} Under a traditional corporate structure, investors in a corporate entity receive shares in return for their investment. Each share entitles its

\textsuperscript{140} Examples of regulatory actors within the securities environment include the following: the Securities Exchange Commission Act of 1933, the Securities Exchange Commission Act of 1934, the Sarbanes-Oxley Act of 2002, the requirements of each listing agency, and all the regulations enacted and promulgated pursuant to each of the foregoing.

\textsuperscript{141} See Proposed Rule, supra note 48, at 45. I believe that the Commission's estimates are modest because they fail to account for the training and monitoring necessary to implement a procedure to uniformly identify qualitatively material items. In fact, I seriously doubt whether any procedure can uniformly identify materiality based upon the standards proffered by the Supreme Court and the Commission.

\textsuperscript{142} Id.

\textsuperscript{143} Examples of these mechanisms include the following: voting rights of common shareholders, which afford shareholders the ability to elect directors; established trading markets, which allow shareholders to liquidate investments in which they are not confident; and existing causes of action under federal and state securities regulation.

\textsuperscript{144} See, e.g., DEL. CODE ANN. tit. 8 (2001).
holders to vote and elect a board of directors, which will oversee management and govern the corporation. Further, where the company is subject to the reporting requirements of Form 8-K, its shares likely will be traded on an established financial market, which affords each holder the opportunity to liquidate his investment. In addition, each holder may sue the corporation for losses in connection with the violation of the already comprehensive set of securities laws. To ensure continuity of its board, to avoid excessive trading and depressed share values, and to discourage litigation, a corporation has incentive to implement corporate governance procedures that foster investor confidence, attract investment, reduce dissidence, and provide returns. As such, a corporation might choose to address shareholder distrust by implementing a myriad of innovative and additional corporate governance procedures to ensure that its board of directors is well informed and that its shareholders are well represented. Companies making these changes and implementing these measures would be able to bolster confidence and attract investment. Conversely, companies that choose not to implement reform may become the target of shareholder dissent, scrutiny, and flight. In this way, the market would decide the proper balance of corporate disclosure, shareholder protection, and asset allocation. However, the Commission’s short-sighted emphasis on disclosure may discourage corporate innovation and promote regulatory compliance. In turn, the void in corporate innovation caused by pervasive regulation may actually deprive shareholders of protections they might have otherwise gained through market-fueled reform.

VI. CONCLUSION

Rather than increasing the availability of corporate information and reducing the opportunity for earnings manipulation, the Commission, through its amendments to Form 8-K, has encouraged companies to disclose any information that might be material. Further, instead of providing workable standards the Commission and the courts seemingly have relegated the evaluation of material disclosures to an ex-post determination based upon minor market movements, which only may have been predicated upon prior misstatements or omissions. When faced with this reality, it is not unreasonable to assume that corporations will begin to expend increasing amounts of capital to produce information of diminishing value. Conversely, other companies may conclude that the costs of evaluating information for materiality are greater than the costs of disclosing every potentially material piece of information and create a knee-jerk disclosure policy. Still another effect may be flight of qualified directors from the board out of fear from increasing liability. In any of these events, the shareholders are injured. In
the first scenario, the inefficient allocation of capital may depress earnings or foreclose certain corporate opportunities, such as expansion or research and development. In the second scenario, individual investors are left to wade through oppressive amounts of arguably immaterial information, which may impede their ability to make a reasoned investment decision. In the final scenario, the void of qualified independent directors and the continual fear of strike-suits may undermine corporate viability and reduce a corporation's ability to provide a return for its shareholders.

In short, the Commission's amendments to Form 8-K are counter to an investor's need for timely and accurate material information. Rather than facilitating the disclosure of information that is "necessary or useful for the protection of investors and in the public interest," the Commission has promulgated disclosure requirements that will bury and confuse the very investors it seeks to protect. While the filing of a Form 8-K once implied the occurrence of an "extraordinary" event, the filing of an amended Form 8-K could represent the occurrence of an "extraordinary" event or simply represent a questionably material disclosure valued at less than five percent of the company's gross receipts. The widely variant triggering events under the new Form 8-K likely will diminish its status among public disclosures to that of an intermittent press release, whose issuance may be ignored in a similar manner.

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146. See Proposed Rule, supra note 48.