REAL-TIME DISCLOSURE OF SECURITIES INFORMATION VIA THE INTERNET: REAL-TIME OR NOT RIGHT NOW?

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The laws governing the disclosure of financial information to public markets have not kept pace with the advancing technology currently used by the financial markets to manage their business. This Note examines the possibility of real-time or near real-time disclosure of financial information by securities issuers. The history and current status of the laws governing disclosure are central to this discussion. In addition, it is necessary to analyze the current structure of the capital markets, including the rise of the individual investor and the role of the Internet. This Note argues that the time is right for adoption of a system of real-time disclosure of financial information via the Internet.

I. INTRODUCTION

Despite the rapidly advancing technology through which the financial markets of the 1990s and beyond conduct their business, many of the laws governing the disclosure of financial information to public markets in the United States were enacted during the 1930s. Ironically, the situation confronting the 107th Congress while debating the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"), resulting from Congress' reevaluation of disclosure systems following the Enron debacle, was not unlike the situation the 73rd Congress confronted in the 1930s.[1] In both situations, the investing public was clamoring for more relevant, reliable, and timely disclosure of material information.[2] After seven decades of a system of disclosure that had been more or less undisturbed, Harvey Pitt, the former Chairman of the Securities and Exchange Commission ("SEC"), heralded the use of the Internet as a disclosure medium at a meeting of the American Institute of Certified Public Accountants: "[The k]ey to disclosure reform is the Internet,

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1. *Years of the 1st through 108th Congresses (1789-2004)*, *at* http://www.senate.gov/reference/congresses1.pdf (last visited Apr. 14, 2004).

2. The purpose of the Securities Act of 1933 was "to provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof, and for other purposes." Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77aaa (2000)).

which enables investors to access as much or as little information as they need, in more or less real-time . . . ."[3]

The possibility of real-time or near real-time disclosure by securities issuers prompts two related questions. First, what is the current state of the law concerning disclosure by issuers over the Internet? Second, is a system of real-time disclosure via the Internet the preferred model of disclosure in terms of the levied costs and benefits borne by issuers, self-regulatory organizations ("SROs"), and the investing public? To answer the first question, Part II explores the history of disclosure under the securities laws, from their inception to the period immediately preceding the enactment of Sarbanes-Oxley. Part III hypothesizes that current, real-time disclosure of material information via the Internet is the preferred model of disclosure given the structure and composition of the capital markets, the rise of the individual investor in the capital markets, and the accessibility of the Internet to the investing public.

II. BACKGROUND

A. Periodic Disclosure Under the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act")

For over fifty years, the disclosure requirements of the Securities Act and the Exchange Act did not overlap. In 1982, however, the SEC "created a unified approach to disclosure under both acts."[4] Securities Act Release No. 33-6,383 "integrate[d] the disclosure systems under the various Federal securities laws and simplifie[d] and improve[d] the disclosure requirements imposed under these systems."[5] The Securities Act and the Exchange Act are at the heart of the periodic disclosure model that has dominated the law of securities regulation in the United States for nearly seventy years.

The SEC's rules under the Exchange Act require disclosure at quarterly and annual levels, with specified significant events reported on a more current basis.[6] This periodic disclosure system requires that an issuer file an annual report with the SEC no later than ninety calendar days after the end of the fiscal year, quarterly reports no later than forty-five calendar days after the end of the first three quarters of the issuer's fiscal year, and current reports on Form 8-K for a number of specified events, generally within five or fifteen days after the event's occurrence.[7]

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3. *Pitt's Four-Step Plan for Disclosure*, INVESTOR REL. BUS., Nov. 12, 2001, *available at* 2001 WL 8080697 [hereinafter *Pitt's Four-Step Plan*].

4. ALAN R. PALMITER, SECURITIES REGULATION: EXAMPLES & EXPLANATIONS 19 (2002).

5. Adoption of Integrated Disclosure System, Exchange Act Release No. 33-6,383, 47 Fed. Reg. 11,380 (Mar. 16, 1982).

6. *See* 17 C.F.R. §§ 240.13a-1, 13a-11, 13a-13, 15d-1, 15d-11, 15d-13 (2003).

7. 17 C.F.R. § 249.308 (2003).

B. Increasing Support for Real-Time Disclosure

The Internet is fast becoming the preeminent informational resource for institutional and retail investors. Over 40% of analysts use corporate Web sites on a daily basis, while 59% of retail investors "rely on the Internet as their primary source for company news."[8] The SEC has recognized the importance of the Internet medium to the investment community since the Internet's commercial infancy, and has sought to provide guidance on the use of the Internet as a disclosure tool. The SEC first published guidelines concerning the use of electronic media to deliver information to investors in 1995.[9] The 1995 Release gave issuers guidance concerning the electronic delivery of prospectuses, annual reports, and proxy solicitation materials under the Securities Act, the Exchange Act, and the Investment Company Act of 1940.[10] The SEC followed the 1995 Release with its 1996 Electronic Media Release,[11] followed by Securities Act Release No. 7516,[12] which addressed the use of electronic media in the context of offshore sales of securities and investment services, and Securities Act Release No. 7759, Section II.G,[13] which addressed the use of electronic media in the context of cross-border tender offers. The SEC became increasingly more active in issuing guidance on disclosure and transaction execution via the Internet in the late 1990s, but the watershed event in the SEC's move away from a system of periodic disclosure and closer to a real-time disclosure system came with its adoption of Regulation FD on August 10, 2000,[14] effective October 23, 2000.[15]

1. Regulation FD

Regulation FD promotes a reduction of selective disclosure of projections and other material inside information by requiring full and fair disclosure of that information.[16] Furthermore, "[i]n promulgating Regulation FD, the SEC took a significant first step in integrating

8. GREG RADNER, CORPORATE COMMUNICATIONS BROADCAST NETWORK, USING THE WEB TO TELL YOUR STORY *available at* http://www.ccbn.com/_pdfs/whitepapers/ir_website.pdf (2002).

9. Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 33-7,233, 60 Fed. Reg. 53,458 (Oct. 6, 1995) [hereinafter 1995 Release].

10. *Id.*

11. Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Securities Act Release No. 33-7,288, 61 Fed. Reg. 24,644 (May 9, 1996) [hereinafter 1996 Release].

12. Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore, Exchange Act Release No. 33-7516, 63 Fed. Reg. 14806 (Mar. 27, 1998).

13. Cross-Border Tender and Exchange Offers, Business Combinations and Rights Offerings, 64 Fed. Reg. 61,382 (Nov. 10, 1999).

14. Selective Disclosure and Insider Trading, Securities Act Release No. 33-7,881, 65 Fed. Reg. 51,716 (Aug. 15, 2000).

15. *Id.*

16. 17 C.F.R. §§ 243.100-03 (2003).

existing disclosure channels by recognizing the Internet as a method for public dissemination and encouraging public dissemination of material non-public information, through lower-cost technology of telephonic conference call systems and the Internet."[17] As one commentator noted:

> In adopting Regulation FD, the SEC concluded that the Internet makes it easier for issuers to disseminate information broadly and that "the market is best served by more, not less, disclosure of information by issuers." Issuers have therefore concluded that increased public disclosure is necessary and a growing number of companies are providing detailed information on their Web sites to assist investors and analysts to develop their own projections.
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> Increased Web site disclosure with adequate advance notice makes it possible for companies to continue to meet with analysts and respond to their questions without violating Regulation FD. The SEC interprets Regulation FD as permitting an issuer to selectively disclose to analysts information that is not important to the ordinary investor if all information that is independently material has been made public.[18]

In addition, one report, drafted by then SEC Commissioner Laura Unger, indicates that the SEC should do more to encourage the use of the Internet as a disclosure tool. The report examines Regulation FD one year after its effective date and includes a number of recommendations for increasing its effectiveness.[19] The report states that "[t]he Commission should embrace technology to expand opportunities for issuers to disseminate information online. The Commission should make clear that options such as adequately noticed [Web site] postings, fully accessible webcasts and electronic mail alerts would satisfy Regulation FD."[20] The report further notes that "[t]he Commission should encourage issuers to post written transcripts of webcast presentations and to archive webcasts and transcripts on their [Web sites]."[21] As the SEC noted in its May 4, 2000 interpretation, "[t]he increased availability of information through the Internet has helped to promote transparency, liquidity, and efficiency in our capital markets."[22]

Since the 1995 Release, the SEC has proactively offered both limited encouragement and guidance in the use of the Internet as a tool for complying with the disclosure requirements set forth in securities

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17. Charles M. Nathan & David W. Hsia, *Beyond Radio Silence: Projecting the Future with Regulation FD*, 1315 PLI/Corp 421, 434 (June 2002).

18. Bruce A. Mann, *Want That New FD to be Easier: Try a Projection Template*, BUS. L. TODAY, Sept./Oct. 2001, at 26.

19. LAURA S. UNGER, SECURITIES AND EXCHANGE COMMISSION, SPECIAL STUDY: REGULATION FAIR DISCLOSURE REVISITED, *at* http://www.sec.gov/news/studies/regfdstudy.htm (Dec. 2001).

20. *Id.*

21. *Id.*

22. Use of Electronic Media, Securities Act Release No. 33-7,856, 65 Fed. Reg. 25,843-01, 25,844 (May 4, 2000).

laws and regulations.[23] "Generally, the SEC has taken a cautious pro-technology stance on some of the issues raised by the advent of the Internet."[24] This tempered, pro-Internet environment has received increased attention as a result of the recent enactment of Sarbanes-Oxley.

2. A New Age for Securities Regulation: The Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 was signed into law on July 30, 2002. President George W. Bush, in a speech immediately before signing the Act, stated that "[u]nder this law, CEOs and chief financial officers must personally vouch for the truth and fairness of their companies' disclosures. Those financial disclosures will be broader and better for the sake of shareholders and investors."[25] The provisions set forth in Sarbanes-Oxley clearly demonstrate that Congress values more timely and accurate disclosure of material information.[26] Moreover, the enactment of Sarbanes-Oxley seems to signal that the SEC's growing acceptance of the Internet as a disclosure medium has finally been met with Congressional approval.

Sections 403(a) and 409 of Sarbanes-Oxley are of particular importance in that they provide for either improvements in the timeliness of information reported to the investing public, or incentives for issuers to provide periodic reports to the investing public via a corporate Web site.[27] Section 403(a) of Sarbanes-Oxley amended Section 16(a) of the Exchange Act to require:

> Every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security (other than an exempted security) which is registered pursuant to section 12, or who is a director or an officer of the issuer of such security, shall file the statements required by this subsection with the Commission . . . (2) TIME OF FILING. – The statements required by this subsection shall be filed . . . (C) if there has been a change in such ownership, or if such person shall have purchased or sold a security-based swap agreement . . . involving such equity security, *before the end of the second business day following the day on which the*

23. *See, e.g.*, Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports, Securities Act Release No. 33-8,128, 68 Fed. Reg. 17,880-01 (Apr. 14, 2003).

24. John S. D'Alimonte et al., *Securities Law in the New Millennium*, 75 ST. JOHN'S L. REV. 49, 67 (2001).

25. President's Remarks on the Sarbanes-Oxley Act of 2002, 38 WEEKLY COMP. PRES. DOC. 1283, 1284 (July 30, 2002).

26. *See, e.g.*, 148 CONG. REC. E 1451 (daily ed. July 29, 2002) (statement of Rep. Sununu).

> By establishing for the first time a requirement for real-time corporate disclosure, the bill will better protect investors. Companies will now have to disclose any information that would materially affect the company's financial health. That is the kind of information that can never be, and should never be, withheld from the public. Accurate and clear financial disclosure will enable better investment decisions to be made based on a company's true financial performance.

Id.

27. 15 U.S.C. § 78p(a) (2000).

> *subject transaction has been executed*, or at such other time as the Commission shall establish, by rule . . . .[28]

Furthermore, Section 403(a) amends Section 16(a)(4) of the Exchange Act to require that:

> (A) a statement filed under subparagraph (C) of paragraph (2) shall be filed electronically; (B) the Commission shall provide each such statement on a publicly accessible Internet site not later than the end of the business day following that filing; and (C) the issuer (if the issuer maintains a corporate website) shall provide that statement on that corporate website, not later than the end of the business day following that filing.[29]

Section 409 amends Section 13 of the Exchange Act and provides for "rapid and current" disclosures of "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 . . . ."[30] Section 409 does not, however, define "rapid and current" disclosures, thereby affording the SEC the opportunity to dictate how quickly an issuer must divulge information concerning material changes, and specifically, what constitutes "material changes in the financial condition or operations of the issuer."[31]

Additionally, on September 5, 2002, the SEC adopted final rules that accelerated the filing deadlines for quarterly reports on Form 10-Q and annual reports on Form 10-K that are filed by companies that qualify as "accelerated filers."[32] Specifically for calendar year filers, the filing deadline was reduced from forty-five days for quarterly Form 10-Q reports filed during 2003, to forty days for reports filed during 2004, and then to thirty-five days for those filed during 2005 and thereafter.[33] Similarly, the filing deadline was reduced from ninety days for annual Form 10-K reports filed for the year ending December 31, 2003, to sixty days for reports filed for the year ending December 31, 2004 and thereafter.[34] In the same SEC Release, the SEC noted that:

> [t]he vast majority of commenters—representing investors, investor groups, companies and professional associations—supported the proposals that would require disclosure concerning [Web site] access to company reports. Accordingly, we are adopting the disclosure requirement substantially. . . . [W]e have arranged for

28. *Id.* (emphasis added).
29. *Id.*
30. 15 U.S.C. § 78m(l) (2000).
31. *Id.*
32. Acceleration of Periodic Report Filing Dates and Disclosure Concerning Website Access to Reports, Exchange Act Release No. 33-8,128A, 67 Fed. Reg. 58,480 (Sep. 16, 2002).
33. *Id.* at 58, 482.
34. *Id.*

> real-time access to companies' electronically-filed periodic reports through our Internet [Web site].[35]

Furthermore, accelerated filers must disclose the company's Web site address, regardless of whether the company makes available on its Web site its annual report on Form 10-K, current reports on Form 8-K, and all amendments to those reports.[36] If the filer does not make its filings available, the filer must disclose its reasons for not doing so and indicate whether the company will voluntarily provide free electronic or paper copies of its filings upon request.[37]

Clearly, the SEC is signaling the need to modernize, perhaps revolutionize, the existing disclosure rules "in order to enhance the responsiveness and efficiency of the public markets."[38] Former SEC Chairman Pitt "identified . . . initial areas [of disclosure modernization that] the SEC would be looking into . . . . [S]ince the Internet allows timely dissemination, it may be possible to move away from periodic reporting to a more real-time disclosure model."[39] Pitt also commented that "[i]n that type of system, public companies might be required affirmatively to disclose unquestionably material information when it arises and becomes available, even if the information is learned before the next-scheduled periodic report is due to be filed."[40] The move to a system of real-time disclosure has been building momentum, as is evidenced by the rules and regulations promulgated by the SEC prior to the passage of Sarbanes-Oxley, such as Regulation FD and various SEC releases, as well as the statutory language of Sections 403 and 409 of Sarbanes-Oxley. In addition, the statements of former SEC Chairman Pitt during his tenure as Chairman made it clear that he was a staunch supporter of such a system. Although support for a real-time disclosure system is growing, a number of challenges remain.

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35. *Id.*

36. *Id.* at 58, 493.

37. *Id.* Beginning with reports for fiscal years ending on or after December 15, 2002, accelerated filers must disclose the following in their annual reports on Form 10-K:

> the company's web address, if it has one; whether the company makes [the filings] available free of charge on or through its website, if it has one . . . ; [i]f the company does not make the filings available in this manner, the reasons it does not do so (including, where applicable, that it does not have an Internet [site]); and [i]f the company does not make its filings available in this manner, whether the company voluntarily will provide electronic or paper copies of its filings free of charge upon request.

Id.

38. Steven E. Bochner & Samir Bukhari, *The Duty to Update and Disclosure Reform: The Impact of Regulation FD and Current Disclosure Initiatives*, 1324 PLI/Corp 721, 738 (Aug. 2002).

39. *Pitt's Four-Step Plan, supra* note 3.

40. *Id.*

III. THE CHALLENGES TO A REAL-TIME DISCLOSURE SYSTEM

A. Threat of Suit and Premature Disclosure of Developments

Given the current framework of liability under the securities laws, critics of a real-time disclosure regime argue that requiring issuers to disclose all material changes "leaves them vulnerable to second-guessing by regulators and private plaintiffs about which developments need to be disclosed and which do not."[41] The prospect of being second-guessed by securities regulators or plaintiffs in private class-action suits regarding the materiality of a piece of information tends to breed conservatism.[42] The alternative is to have the issuers disclose everything "that in hindsight could be regarded as significant."[43] However, they then run the risk of disclosing developments that are premature. Premature disclosure could, for example, damage confidential negotiations regarding a merger or a sale of a business, or even worse, encourage speculative trading in the issuer's stock.[44] In other words, premature disclosure could possibly create precisely what a real-time disclosure system is designed to prevent: a drastic increase in the volatility of the securities markets that triggers an increase in disclosure-related litigation.

1. Regulation FD as a Proxy for a Real-Time Disclosure System

The closest existing substitute for a real-time disclosure model, the SEC's Regulation FD, is enforceable only by the SEC.[45]

> While the SEC declined to limit or define the materiality concept in Regulation FD in any practical way, it made sure that issuers would not face the prospect of private lawsuits if they failed to interpret and apply the concept [of materiality] properly. None of the proposals for real-time disclosure made to date would preclude a private right of action.[46]

If a move to a real-time disclosure system will not affect the existing framework of liability under the securities laws, presumably the only way to facilitate a real-time disclosure system is to limit or redefine the concept of materiality.

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41. David B. Harms & Justin Smith, *Lawmakers and Regulators Respond to the Enron Collapse: We Need New Rules*, 1321 PLI/Corp 39, 68 (Apr. 2002).

42. *See* Steven E. Bochner & Ignacio E. Salceda, *Over the Wall: Handling Securities Analysts' Conference Calls, Earnings Forecasts, and Reports Effectively*, 1149 PLI/Corp 131, 138 (Nov. 1999).

43. Harms & Smith, *supra* note 41, at 68.

44. *Id.*

45. 17 C.F.R. §§ 243.100-03 (2003) (There is no private right of action under Regulation FD.).

46. Harms & Smith, *supra* note 41, at 70.

2. Materiality

In promulgating Regulation FD, the SEC responded to critics' concerns that "materiality is too vague a concept to serve as the standard that governs the day-to-day conduct of issuers in the real world," and adopted a categorical approach whereby it identified categories of material events requiring disclosure on Form 8-K.[47]

> [I]n June 2002, the SEC proposed rules that would require eleven new items and events to be reported on Form 8-K and would accelerate the filing deadline for Form 8-K to within two business days from the triggering event instead of the current five to fifteen day time periods. Examples of the proposed new triggering events include entry into or termination of a material agreement or letter of intent outside of the ordinary course of business, termination of a business relationship that results in a loss of at least 10% of the company's revenue, and an event triggering a material direct or contingent financial obligation, including any default or acceleration of an obligation.[48]

However, Section 409 of Sarbanes-Oxley, which provides for "rapid and current [disclosures of] such additional information concerning material changes in the financial condition or operations of the issuer,"[49] seems to suggest that Congress would prefer the SEC not adopt a categorical approach. Furthermore, Section 409 seems to suggest that Congress accepts the concept of materiality, as it exists today, as sufficient. Commentators disagree: "The Staff of the SEC has stated that it does not contemplate implementing a 'continuous' disclosure regime in response to Section 409, but rather more timely disclosure as contemplated by the proposed amendments to the Form 8-K."[50]

B. The Duty to Update, the Duty to Correct, and the Costs of Implementation

"[T]he duty to update concerns a disclosure that was accurate when made but is no longer true due to subsequent intervening events or circumstances."[51] As one commentator noted:

> [n]either the securities acts nor SEC rules prescribe a specific duty to update . . . [and] [i]n the past, the SEC has avoided imposing a duty to update . . . . The SEC does, however, acknowledge the existence of a duty to update, following the decision in *Backman v.*

47. *Id*. at 69.

48. KATTEN MUCHIN ZAVIS ROSENMAN, NEXT STAGE OF SARBANES-OXLEY ACT WILL IMPOSE NEW BURDENS ON AUDIT COMMITTEES AND EXECUTIVES 5 (Aug. 2002) [hereinafter NEXT STAGE OF SARBANES-OXLEY]; s*ee also* Additional Rule 8-K Disclosure Requirements and Acceleration of Filing Date, 17 C.F.R. pts. 228, 229, 240 & 249 (2003), *available at* http://www.sec.org/rules/proposed/33-8106.htm.

49. 15 U.S.C. § 78m(l) (2000).

50. NEXT STAGE OF SARBANES-OXLEY, *supra* note 48, at 5–6.

51. Bochner & Bukhari, *supra* note 38, at 729.

Polaroid Corporation. Cases dealing with the duty to update are inconsistent and reflect some confusion with the concept.[52]

In *Backman v. Polaroid Corp.*,[53] the court equivocated on the issue of whether a duty to update exists, stating that "[w]e may agree that, in special circumstances, a statement, correct at the time, may have a forward intent and connotation upon which parties may be expected to rely. If this is a clear meaning, and there is a change, correction, more exactly, further disclosure, may be called for."[54] The more recent decisions of *Stransky v. Cummins Engine Co., Inc.*,[55] *Eisenstadt v. Centel Corp.*,[56] and *Gallagher v. Abbott Labs.*, [57] all Seventh Circuit cases, indicate that some courts are highly skeptical of recognizing a duty to update. The court in *Gallagher* held that there is no continuous duty to update on the part of the issuer.[58] The Seventh Circuit reasoned that federal securities laws do not require continuous disclosure but rather, only require issuers to file periodic reports.[59] Therefore, the Court concluded that updates are not required every time something "material" occurs, but only on the next periodic filing date.[60] The Seventh Circuit's rejection of a duty to update appears to turn on the fact that issuers are subject to a periodic disclosure system, and that the concept of a duty to update runs counter to the principles inherent in such a system.[61] Therefore, under the Seventh Circuit's reasoning, a duty to update *would* arise under a real-time disclosure system. In other words, regardless of the courts' stance on the subject of the existence of a duty to update under a periodic disclosure system, it seems as though few, if any, would argue that a duty to update does not arise under a real-time disclosure system.

A duty to update requirement in a real-time disclosure system would impose heavy burdens on issuers. A real-time disclosure system, assuming that the material information the issuer disseminates is correct at the time of disclosure, would require the issuer to monitor each piece of information to determine if the information is rendered false by future circumstances or developments. This would invariably create greater incentive for issuers to try to limit the disclosure of marginally material information, information that should be disclosed but for which disclosure is not required. This is true because each piece of information that is released to the public markets imposes additional costs and that disclosure may provide little or no additional benefits to the issuer. For

52. *Id.*
53. Backman v. Polaroid Corp., 910 F.2d 10 (1st Cir. 1990).
54. *Id.* at 17.
55. Stransky v. Cummins Engine Co., Inc., 51 F.3d 1329, 1332 (7th Cir. 1995).
56. Eisenstadt v. Centel Corp., 133 F.3d 738, 746 (7th Cir. 1997).
57. Gallagher v. Abbott Labs., 269 F.3d 806, 809 (7th Cir. 2001).
58. *Id.* at 810.
59. *Id.* at 809.
60. *Id.*
61. *Id.*

example, the information is immediately reflected in the issuer's stock price, but the information, arguably, is of little or no value to the issuer after the information is so incorporated into the stock price. However, the information may retain some value to the investing public on a going-forward basis because the information remains part of the total mix of information available to the investing public when making their investment decisions. Issuers will be required to expend resources to monitor material information released to the public markets, which will dramatically increase issuers' cost of compliance.

Furthermore, a real-time disclosure system will increase the costs to issuers associated with the existing requirement of a duty to correct. "The duty to correct is straightforward: If an issuer said something that was not accurate at the time the statement was made . . . an immediate duty exists to correct the misleading disclosure."[62] In the duty to correct context, the costs to issuers would increase dramatically due to the sheer volume of information that would be disclosed in a real-time disclosure system. A greater amount of false and misleading information would be released invariably because the volume of information disclosed would increase dramatically under such a system. This number would undoubtedly increase as the volume of information released to the investing public increased. Not only would this expose the issuer to a greater likelihood of disclosure-related litigation, but it would also increase the real costs to issuers. Issuers would start to expend even greater resources in order to ensure that any potentially misleading information released was corrected in a timely fashion. In addition, issuers would allocate even more resources in order to ensure that misleading information was not disseminated in the first place. Ultimately, these additional costs would be borne by the issuers' shareholders, the very stakeholders such a system is designed to protect.

C. Issuers' Information Technology Departments

As a practical matter, a real-time disclosure regime may not be readily implemented, given the status of issuers' information technology departments. Undoubtedly, issuers "will need a souped-up analytics infrastructure to report wide-ranging events,"[63] but "lack of integration among financial-reporting tools, legacy systems, non-automated consolidation processes, and outdated business processes may make it difficult for many [issuers] to provide more detailed financial filings more often and faster."[64] Furthermore, "[o]f the 87 IT managers who took part in a recent *InformationWeek* Research survey of 175 business-technology

62. Bochner & Bukhari, *supra* note 38, at 728–29.

63. Cathleen Moore, *Parsing Sarbanes-Oxley*, INFOWORLD, *at* http://www.infoworld.com/article/03/07/11/27FEsarboxguide_1.html (July 11, 2003).

64. Jennifer Zaino, *Will Your Company Pass SEC Compliance?*, INFORMATIONWEEK.COM, *at* http://www.informationweek.com/story/showArticle.jhtml?articleID=6500902 (Feb. 25, 2002).

managers, 20% question whether their [information technology] units will be able to perform adequately" to meet the potential new accounting regulations and laws.[65] Yet, 51% of the study's eighty-seven information technology managers report that the necessary technology is already in place and that financial reporting is already being delivered electronically to the SEC.[66] Another 17% of the study's eighty-seven managers say that they could be prepared in six months or less, should the need arise.[67] However, "almost one-third of [information technology] executives aren't so confident about a fast turnaround, reporting that they aren't sure when their company will be capable of delivering their financial reports electronically."[68]

D. Growing Gap Between Book and Market Values: The Quality of Information

It may be argued that additional costs imposed on issuers as a result of a move to a real-time disclosure system, would only be justified if the quality of information, not just the quantity of information, were improved. In other words, if the information reaching the public markets through the existing periodic disclosure system lacks relevance to prospective investment decisions, simply increasing the volume and frequency of that information will not reduce stock price volatility or make issuers more transparent. Some argue that "as the information age has advanced . . . balance sheets have become less relevant as measures of true value, [and] there has been relatively little change in the regulatory requirements for disclosure, including the contents of the financial statements that form the heart of our corporate disclosure system."[69] In addition, "[t]he growing gap between balance sheet and market values tells us that we will need something different in the future, as more and more companies earn their profits from intangible assets. Failure to properly value intangibles can result in distorted valuations, volatility and, perhaps, a bubble."[70]

Few doubt that intangible assets such as knowledge or intellectual capital comprise an increasingly large portion of issuers' core assets, but existing accounting principles do not provide for adequate disclosure of such assets. The lack of disclosure of such assets arises from the difficulty in valuing intangible assets. While few would argue that intangible assets are without value to the issuers who control them, accounting regulators' failure to provide for adequate disclosure of such

65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.*
69. Robert E. Litan & Peter Wallison, *Corporate Disclosure in the Internet Age*, THE FINANCIAL TIMES, *available at* http://www.brookingsinstitution.org/views/op-ed/litan/20000524.htm (May 24, 2000).
70. *Id.*

assets conveys that intangible assets have zero value. As a result of the lack of disclosure of intangible assets, there has been increasing divergence between the book values, i.e., accounting values, and the market values, of issuers. As the gap between book and market values increases, the reliability, relevance, and usefulness of the book values reported by issuers decreases dramatically. As Baruch Lev, Professor of Accounting and Finance at New York University's Leonard N. Stern School of Business, describes:

> In the past several decades, there has been a dramatic shift, a transformation, in what economists call the production functions of companies–the major assets that create value and growth. Intangibles are fast becoming substitutes for physical assets. At the same time, there has been complete stagnation in our measurement and reporting systems. I'm not talking only about financial reports and Internet investments but also about internal measurements – accounting and reporting inside companies. These systems all date back more than five hundred years.[71]

If SEC and accounting regulators continue to insist on accounting rules that do not properly value intangible assets, the usefulness of accounting information will be dramatically reduced under either a periodic or real-time disclosure system. One could argue, therefore, that requiring issuers to release more "bad" information under a real-time disclosure system simply imposes additional costs on such issuers, with only marginal benefit to the investing public. The only way the investing public will realize any additional value under a real-time disclosure system is if accounting rules are adjusted to accommodate for accurate recordation of intangible assets.

E. Internet Fraud

Critics of a real-time disclosure system further argue that such a system would only increase incidents of securities fraud. "The same features of the Internet that have made it an expedient vehicle for gathering and disseminating information—broad coverage, speed, low costs—have made it an easy vehicle for the perpetration of frauds."[72] "With over forty million [Web sites] and a plethora of chat rooms, regulation is certainly a daunting task,"[73] but most of the regulation has

71. Alan M. Webber, *New Math for a New Economy*, FAST COMPANY, *at* http://www.fastcompany.com/online/31/lev.html (Jan. 2000).

72. Roberta S. Karmel, *Regulatory Initiatives and the Internet: A New Era of Oversight for the Securities and Exchange Commission*, 5 N.Y.U. J. LEGIS. & PUB. POL'Y 33, 38–9 (2001–2002) (citing David M. Bartholomew & Dena L. Murphy, *The Internet and Securities Regulation: What's Next?*, 25 SEC. REG. L.J. 177, 194 (1997)).

73. Edwin L. Klett & Rochelle L. Brightwell, *Internet Crime – Modern-Day Piracy*, 4 LAWYERS J. 6, 15 (2002), *available at* http://www.klettrooney.com/newsroom/attorney_articles/internet_crime.pdf.

involved "touting, Ponzi and pyramid schemes, and 'pump and dump' stock manipulations,"[74] perpetrated by non-issuers.

The SEC has responded quickly to the increasing threat of securities fraud perpetrated via the Internet. "In 1998, the SEC created an Office of Internet Enforcement ("OIE") to administer a comprehensive program of surveillance, training, investigation, and prosecution."[75] As of March 1, 2001, the SEC had brought more than 200 Internet-related enforcement actions against over 750 named individuals and entities.[76]

IV. WHY REAL-TIME DISCLOSURE COULD WORK

A. The Delivery of Reliable, Timely, and Material Information as a Result of a Myriad of Technological Innovations

1. The Internet

The Internet, and the development of a robust, global communications infrastructure through which issuers can disseminate timely information in a cost-effective manner, have been the catalyst for the debate surrounding the practicality of real-time disclosure. As the SEC notes, "[t]he significantly reduced time periods for the capture and analysis of information and significant technological advances since [the time periods for filing periodic reports] were last revised necessitate a new consideration of the timing of mandated disclosure to the markets."[77] Moreover, "[t]he use of the Internet by issuers and investors alike has transformed the marketplace and had the beneficial effect of promoting transparency, efficiency, and liquidity in the capital markets."[78] Overall, the Internet is the base upon which a real-time disclosure regime will rest.

2. Streaming Media

Streaming media is defined as "the transmission of a media clip, over a network, so that it begins playing back as quickly as possible."[79]

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74. Karmel, *supra* note 72, at 39.

75. *Id.*

76. Press Release, Securities and Exchange Commission, SEC Charges Twenty-Three Companies and Individuals in Cases Involving Broad Spectrum of Internet Securities Fraud (Mar. 1, 2001), http://www.sec.gov/news/press/2001-24.txt.

77. Press Release, Securities and Exchange Commission, SEC to Propose New Corporate Disclosure Rules (Feb. 13, 2002), http://www.sec.gov/news/headlines/corpdiscrules.htm.

78. Stephen A. Glover & Gillian McPhee, *Guidelines on the Use of Electronic Media* § 1.06, Cyber Securities Law, *at* http://www.cybersecuritieslaw.com/articles/glover1.htm (last visited Jan. 28, 2004).

79. Netlingo Dictionary of Internet Words: A Glossary of Online Jargon with Definitions of Terminology, *at* http://www.netlingo.com/lookup.cfm?term=stream%20or%20streaming/ (last visited

Also known as Webcasting, streaming media has made it possible for issuers to disseminate all types of corporate information, from earnings reports and analyst calls, to product launches and technology updates, to investors in real-time.[80] Since the adoption of Regulation FD on August 10, 2000 streaming media has become increasingly popular as a disclosure tool.

The implementation of the disclosure rules set forth in Regulation FD generated a "new wave of activity on the Internet," in which "companies [were] turning to Web-based media events to spread the word."[81] Although "[i]ssuers still turn[ed] to press releases most frequently as a tool of information dissemination" following the adoption of Regulation FD, Webcasting "[was] met with great enthusiasm."[82] "[B]etween October 1, 2000 and April 23, 2001, the number of corporate [W]ebcasts on [a wire service's] service quadrupled from the same period twelve months earlier (three thousand to eleven thousand)."[83] Fair Disclosure Financial Network ("FDfn"), "the world's largest transcriber and webcaster of corporate earnings conference calls . . . transcribes more than 5,000 calls [each quarter] . . . [many of which] are transcribed as they are happening, providing [investors with] immediate access to conference call text."[84] According to analysts, "worldwide content distribution traffic revenues from corporate streaming will rise to around 400 million dollars by 2005."[85]

While streaming technology facilitates the real-time dissemination of corporate information to investors, other developing technologies allow issuers and investors to compile and analyze financial and operational information in real-time.

3. Extensible Business Reporting Language

Developing financial reporting technology will also make real-time disclosure more practical. The recent development of Extensible Business Reporting Language ("XBRL"), "an open specification

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Jan. 28, 2004) (Streaming is "an Internet data transfer technique that allows users to see video and hear audio files without lengthy download times. In other words, it is the live flow of digital information.").

80. *See, e.g.*, IBM Investors, *at* http://www.ibm.com/investor (last visited Jan. 28, 2004).

81. Dan Gebler, *New SEC Rules Create Web Excitement*, NEWSFACTOR NETWORK, *at* http://www.newsfactor.com/story.xhtml?story_id=6234 (Dec. 2000).

82. Unger, *supra* note 19.

83. *Id.*

84. *Corporate Profile for Fair Disclosure Financial Network, dated January 17, 2003*, BUSINESS WIRE, *at* http://www.findarticles.com/cf_0/m0EIN/2003_Jan_17/96549661/p1/article.jhtml (Jan. 17, 2003).

85. Stefan Stanislawski, *Corporate Streaming is Poised for Growth Analysys*, *at* http://www.analysys.com/default.asp?Mode=article&iLeftArticle=876&m=&n= (last visited Oct. 20, 2003).

[developed by XBRL International][86] that uses XML-based data tags to describe financial data in business reports and databases, is gaining credibility as a standard for companies to electronically supply consistent financial statements to regulatory authorities [via the Internet]."[87] XBRL may be potentially very useful because it "can be used to digitally publish financial statements and other accounting disclosures for organizations of all makes and sizes."[88] An XBRL financial statement is defined as "a digitally enhanced financial statement, which includes information like the balance sheet, income statement, statement of equity, statement of cash flows, notes to the financial statements as well as the accountant's report."[89] Overall, there are many benefits of XBRL, including:

> (1) the efficient preparation of financial statements in that such statements will be created one time and rendered many times, be it to the printer, to lenders, private investors, on Web sites, or as regulatory filings; (2) full interoperability with other financial and analytical applications; (3) a simplification of the way financial data is extracted and used by various members of the financial information supply chain . . . by using Extensible Markup Language (XML), an open standard format, to communicate financial reporting data; (4) automated [audit processes and] analysis; (5) re-usability of information, i.e. significantly less re-keying of financial information; and (6) receipt of the reporting information in the format the user prefers.[90]

Additionally, "XBRL provides a consistent framework that works for all companies and financial statements."[91] XBRL International also "sponsors the creation of dictionaries of tags (called "taxonomies") that allow the preparation of financial information relative to different accounting and reporting standards,[92] including, United States Generally Accepted Accounting Principles, International Accounting Standards, and Japanese Generally Accepted Accounting Principles. In other words, XBRL is a mechanism by which users of financial information could automatically compare financial statements prepared using disparate accounting principles. XBRL International asserts that, "[t]here is only one way to achieve this consistency: XML (not PDF, HTML, raw text, SGML, or any other method). The goal is to create a

86. XBRL International is a global not-for-profit organization whose members include over 200 companies and organizations, including some of the world's leading accounting, financial, government, and software organizations.

87. Eileen Colkin, *New Language Spurs Electronic Information Filing*, INFORMATION WEEK, *at* http://www.informationweek.com/story/IWK20020215S0004 (Feb. 18, 2002).

88. XBRL Frequently Asked Questions*, at* http://www.xbrl.org/whatisxbrl/index.asp?sid=14 (last visited Oct. 15, 2003).

89. *Id*.

90. *Id.*

91. XBRL Frequently Asked Questions, *at* http://www.xbrl.org/whatisxbrl/faqdetails.asp?faqid=12 (last visited Oct. 8, 2003).

92. *Id*.

standards-based method to prepare, publish in a variety of formats, exchange and analyze financial statements across all software formats."[93]

XBRL is gaining popularity. It has been adopted as the mandatory electronic-filing format by twenty-four regulators worldwide, including the Federal Deposit Insurance Group in the United States, Inland Revenue in the United Kingdom, and Deutsche Bank AG in Germany.[94] A recent survey conducted on behalf of XBRL International by the American Institute of Certified Public Accountants indicates that two-thirds of accounting software vendors either have already XBRL-enabled at least one of their accounting software packages, or will do so by December 2004.[95] Internationally-recognized firms such as Morgan Stanley, Reuters, and Microsoft all currently use XBRL to report financial information.[96] The SEC, which has been "slow to move on the language," recently published information for companies about XBRL on "the Electronic Data Gathering Analysis and Retrieval system that the SEC uses to store and process filings submitted electronically."[97]

XBRL also appears to be gaining popularity among SROs, including the over-the-counter trading market, the National Association of Securities Dealers Automated Quotation ("NASDAQ"). In collaboration with Microsoft Corporation and PricewaterhouseCoopers, NASDAQ developed an XBRL demonstration downloadable from the NASDAQ Web site in order to provide "a snapshot of how information reported by companies in the XBRL format will be more efficiently, accurately, and timely consumed and analyzed by investors, analysts, and other users."[98]

Ultimately, the investing public "can obtain the company reported information tagged in XBRL over the Internet at the speed of a mouse click."[99] In other words, XBRL-tagged information that is reported on an issuer's Web site may be collected in real-time by the investing public in a form that facilitates instantaneous, multi-dimensional comparison and analysis. XBRL technology may indeed make real-time global disclosure of audited financial information a reality.

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93. *Id.*

94. John S. McCright, *XML Variant Consolidates Business Reporting,* EWEEK, *available at* http://www.eweek.com/print_article/0,3668,a=42649,00.asp (June 2, 2003).

95. Press Release, XBRL, Survey Finds Two-Thirds of Accounting Software Vendors Have Released or Are in Process of Releasing XBRL-Enabled Products (Aug. 5, 2003), *at* http://www.xbrl.org/newsandevents/pressdetails.asp?pressid=62.

96. *Id.*

97. Colkin, *supra* note 87.

98. NASDAQ, XBRL, *at* http://www.nasdaq.com/xbrl/ (last visited Oct. 8, 2003).

99. NASDAQ, *More: FAQs*, *at* http://www.nasdaq.com/xbrl/iishome3/just.htm (last visited Jan. 28, 2004).

4. Enterprise Business Intelligence

As issuers are called upon to disclose information to the investing public in real-time, it will be imperative that issuers leverage technical solutions that will allow them to gain an enterprise-wide view of corporate operations in real-time. This will facilitate timely, complete disclosure of all relevant material information. Business intelligence software which "enable[s] organizations to organize, analyze, and report on operational data to make better decisions"[100] may be the solution. As an industry white paper describes, business intelligence software gives companies the ability to leverage existing data systems in order to "track a business's key metrics and gauge the health of the organization."[101] Issuers employing business intelligence software will be able to collect, analyze, and disseminate information in real-time using existing data systems.

Information Builders, Inc., a business intelligence software provider, states that the latest generation of business intelligence software will allow issuers "to integrate real-time information from all corners of [the] enterprise and make it instantly accessible to all users in a way [the users can] easily interpret using familiar tools."[102] "Business intelligence vendors such as Cognos, Crystal Decisions Inc. and Business Objects Inc. combine various Internet-based technologies with thin clients to push business reporting tools further down into a company's operations, making it possible for line personnel to have the reports they need along with sophisticated analytics."[103] Business intelligence software is the tool by which issuers will be able to collect and analyze in-house information in real-time, thus facilitating rapid disclosure of such information to the investing public.

B. A Real-time Disclosure System Will Improve the Quality of Disclosures, Reducing the Potential for Accounting Fraud and Financial Crisis

The periodic disclosure system fails to provide the public markets with relevant, reliable information on a timely basis. As former SEC Chairman Pitt points out, "[d]isclosures to investors are now required only quarterly or annually, and even then are issued long after the quarter or year has ended. This creates the potential for a financial

100. Rebecca Wettemann, *The ROI from Business Intelligence,* CIO, *at* http://www2.cio.com/analyst/report657.html (Dec. 2, 2002).

101. COGNOS, INC., HOW SMART COMPANIES WIN WITH BUSINESS INTELLIGENCE: THE VALUE OF BI IN A CHALLENGING ECONOMY 3, *available at* http://www.dw-institute.com/download/ww14/03_Cognos.pdf (2002).

102. INFORMATION BUILDERS, WEBFOCUS BROCHURE 4, *at* http://www.informationbuilders.es/pdfs/webfocus5.pdf (2003).

103. Pimm Foxx, *IT, Business Intelligence in Harmony,* COMPUTERWORLD, *at* http://www.computerworld.com/softwaretopics/crm/story/0,10801,71586,00.html (Jun. 3, 2002).

'perfect storm.' Information investors receive can be stale on arrival and mandated financial statements are often arcane and impenetrable."[104] In addition:

> [a]dvocates of real-time disclosure have long argued that investors in a public company's securities need to know what management knows about the company when they know it, and that making investors wait for news on a merely quarterly basis is woefully out of step with the way securities markets function today.[105]

These advocates argue that the recent democratization of the securities markets, by way of enhanced information dissemination, can and should translate into even greater transparency of public companies. In fact, supporters of a real-time disclosure system argue that the democratization of the securities markets has inured yet another right in the equity stakeholder: unfettered access to all material information held by a public company. Advocates of real-time disclosure need only point to the Enron debacle, a financial crisis emblazoned in the memories of anyone who has participated in the public markets in recent years, as proof of the need for rapid, real-time disclosure. Equity stakeholders, assisted by the deluge of material information that would come with real-time disclosure from public companies, would be highly effective watchdogs who would guard against misleading and fraudulent conduct by public companies. Timely information would give equity stakeholders and regulators more ammunition with which to strengthen pleadings and avoid motions to dismiss in private suits, as well as more direct evidence in disciplinary proceedings brought against public companies engaged in misleading or fraudulent conduct.[106] In other words, a continuous stream of material information would help ensure corporate compliance with a wide variety of laws and regulations.

C. Real-Time Disclosure Rules are Already in Place in Listing Standards

Advocates of a real-time disclosure regime suggest that such a regime already exists in the public markets, and they cite the listing standards of the three largest stock exchanges in the United States as proof of their contention. The New York Stock Exchange ("NYSE") Listed Company Manual states:

> [a] listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the

104. Harvey Pitt, *How to Prevent Future Enrons*, WALL ST. J., Dec. 11, 2001, at A18, *available at* http://www.sec.gov/news/speech/spch530.htm.

105. Harms & Smith, *supra* note 41, at 64–65.

106. *See* Private Litigation Securities Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (1995) (codified as amended in scattered sections of 15 U.S.C. §§ 77–78).

> most important and fundamental purposes of the listing agreement which the company enters into with the Exchange.[107]

Similarly, the American Stock Exchange ("AMEX") Company Guide suggests that a "listed company is required to make immediate public disclosure of all material information concerning its affairs."[108] NASDAQ has a similar listing requirement.[109] Advocates of a real-time disclosure regime argue that the presence of real-time disclosure requirements in the listing standards of these three major stock exchanges suggests unwavering support of real-time disclosure by the self-regulatory organizations. Critics argue the contrary, however, suggesting that:

> [a]n exchange that does not specifically enforce the language of its rules can afford to be imprecise and over-broad because no one cares. It is a classic bargain of mutual convenience: lawyers advise firms that the language is not enforced, and firms safely ignore it. The exchanges enjoy whatever positive public relations come from having the language in their listing manuals.[110]

The lack of enforcement by these three exchanges does give the listing standard rules regarding real-time disclosure an aspirational quality, but that does not suggest that such rules are wholly without merit. Such rules signal that the three largest stock exchanges in the United States value rapid dissemination of information by listed companies so as to "[e]nsure timely disclosure of information that may affect security values or influence investment decisions, and in which shareholders, the public and the Exchange have a warrantable interest."[111]

V. CONCLUSION

Ultimately, the issue is not whether the United States should adopt a system of real-time disclosure, but, rather, when the United States should adopt such a system. The widespread acceptance of streaming media, the development of XBRL, and the enhanced ability of issuers to receive enterprise-wide information in real-time through the use of business intelligence software suggest that the time is right, from a technological perspective, for a real-time disclosure system. The

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107. NEW YORK STOCK EXCHANGE, LISTED COMPANY MANUAL § 202.05, *available at* http://lcm.nyse.com/cpgdata/nlcs/lcm/lcm.nsf/53581f15f2b755d0852568ca0060b3e3/22203811bcd0214e85256b04007c140e (last modified July 1, 1992) [hereinafter NYSE MANUAL].

108. AMEX Company Guide § 402, *at* http://wallstreet.cch.com/AmericanStockExchangeAMEX/AmexCompanyGuide/PART4/DISCLOSURESS401-404/072F000348.asp (Dec. 1, 2003).

109. Dale Arthur Oesterle, *The Inexorable March Toward A Continuous Disclosure Requirement for Publicly Traded Corporations: "Are We There Yet?",* 20 CARDOZO L. REV. 135, 163 (1998).

110. *Id.*

111. NYSE MANUAL § 201.00, *available at* http://www.nyse.com/content/publications/1043269645687.html (last modified Nov. 6, 1999).

technological barriers to real-time information collection and dissemination no longer exist.

In addition growing political support in both Congress and the SEC suggests that the time is ripe for a real-time disclosure system. Although the implementation of Regulation FD as a supplement to periodic disclosure may strike an appropriate balance between the costs and quality of issuer disclosures at the present time, the political and technological environments suggest that disclosure in the United States is moving toward a real-time disclosure system.