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Stop the Insanity!

Making Public Disclosure More Effective

By **Robert B. Lamm**

A few years ago, when I served as in-house counsel to a major corporation, I asked a representative of one of our largest shareholders how much time she devoted to reviewing our proxy statement — a document that had occupied a significant portion of my time and on which I had lavished considerable care and attention. "Oh," she said, "your company represents one of our largest investments, so I spend about 20 minutes on it." I was shocked, but she was not done. "Of course, when it goes to our proxy committee for a voting decision, I'd say five or 10 minutes max." Shock turned to dismay; how could all that deathless prose be dismissed in so cavalier a manner?

I'm sure that those responsible for proxy statements at companies throughout the U.S. have had similar rude awakenings. We try to make our disclosures accurate and complete; we often go beyond minimally compliant disclosure to give our owners and the investing public a "feel" for our companies' businesses, how we operate, how our boards and their committees function, and how we compensate our management team. But the facts are that our disclosures are voluminous and getting more so every year (many companies' proxy statements are at or close to 100 pages, and some 10-Ks are in excess of 200 pages) that most investors don't have the time to read, much less digest, these documents and that those who do often find them overwhelming.

In an Oct. 15, 2013 speech, Securities and Exchange Commission (SEC) Chair Mary Jo White stated that "ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information to ferret out the information that is most relevant." *See* The Path Forward on Disclosure." She could just as easily have added that because of the difficulties involved, many investors don't even try to wade through the information. Retail investors may well give up entirely, but some institutional investors — including some major investors — farm out the task of reviewing these disclosures and,

indeed, voting the investors' shares, to proxy advisory firms, such as Institutional Shareholder Services and Glass Lewis & Co.

Disclosure Reform

There has got to be a better way; in fact, there is. Specifically, all of us who strive for better disclosure — and that includes not just securities lawyers, but also our regulators, our companies' investors, and the proxy advisory firms mentioned above — need to engage in a comprehensive effort to make our disclosures more effective. This effort will certainly entail doing away with some antiquated substantive and structural requirements, but it also will entail additional disclosure in appropriate circumstances and using technology to make our disclosures readily available, even if they are not included in our disclosure documents themselves.

Of course, disclosure reform — whatever the name given it — is not a new concept. The SEC has endorsed it on any number of occasions and has successfully revamped parts of the disclosure system, such as the overhaul of the offering process under the Securities Act of 1933 that took place several years ago. In fact, when Meredith Cross took over as Director of the SEC's Division of Corporation Finance in 2009, she stated that disclosure reform was one of her goals. However, other things got in the way, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the Jumpstart Our Business Startups Act, or JOBS Act, in 2012, both of which required the SEC to engage in massive rule-making that rendered it impossible to address disclosure reform. In fact, in mid-2013, after leaving the SEC, Ms. Cross stated that it was unlikely that the SEC would be able to engage in serious disclosure reform because it does not constitute a crisis.

If Ms. Cross is right, then it is incumbent upon the private sector to take the lead on disclosure effectiveness. The Society of Corporate Secretaries and Governance Professionals is one of the organizations that is taking the lead, but the phrase "it takes a village" certainly applies to the task. We will need to engage many constituencies if the effort is to be successful — regulators, self-regulatory organizations (including the stock exchanges, the Financial Accounting Standards Board, and others), retail and institutional investors of all types (including public and union pension funds), boards of directors and managements, and even proxy advisory services.

The Task at Hand

How to even begin to launch a project of such magnitude? The Society

has begun by forming a working group and dividing it into two task forces. One will address the Form 10-K and other periodic reports under the Exchange Act. The other will consider proxy statements. These two types of disclosures are directed toward different constituencies and have different goals, so it seems appropriate to address them separately despite many common elements.

Each task force will consider the two principal components of disclosure — content and presentation/delivery. As for content, assuring that each type of document contains the right disclosures — and excludes disclosures of immaterial information — is critical. However, the manner in which information is presented and delivered is increasingly important in the age of the Internet. After all, why should a disclosure document have to contain all information about a topic when much of the information remains substantially the same over time and can be accessed on the Internet instead of having to be repeated in every filing — and thereby making it harder to find key information in that filing?

For example, the typical proxy statement contains extensive information about committees of the board, including their composition and responsibilities. Much of this information is provided by repeating the terms of each committee's charter, including the independence of its members, its right to retain outside advisors, and so on. But is it necessary to lift sections of a committee's charter when discussing it in the proxy statement? Wouldn't it be more helpful to shareholders to refer to the charter, as posted on the website, and to instead use the proxy statement to explain what each committee has actually done in the prior year? Calls for this type of disclosure — what a committee has actually done versus a dry recitation of its responsibilities — is being called for not only by investors, but also by directors, who spend a great deal of time executing those responsibilities.

We will also need to consider how we can help readers find information on various topics. Investors tell us that they cannot easily locate information on particular topics, which are found in different places in different companies' filings and that tables of contents and even search tools are not always up to the task. Some have suggested that use of a standard format should be mandated for all companies, but it is not clear that this is a practicable approach.

The Obstacles

As noted above, it will be critical to get many constituencies to contribute to and buy into any new disclosure regime. However, that is

far from the only obstacle that the disclosure effectiveness project will need to overcome. Some of the others are as follows:

1. Any effort to overhaul the 10-K and 10-Q will need to address the long-standing practice of having the financial statements stand alone — *i.e.* , the financial statements cannot disclose information by means of cross-references to or incorporation by reference of information in the narrative portion of the filing. This practice generates considerable repetition in and adds many pages to our 10-Ks and 10-Qs. At this juncture, it is unclear whether the Financial Accounting Standards Board, among others, will be able to "get comfortable" with this notion.

2. Even in proxy statements, where there is no legal or accounting reason for the same or similar information to appear in several places, information is often given two or three times. For example, companies have made increasing use of proxy summaries or executive summaries; these tools are helpful, but they generate repetition in already lengthy filings. (Anecdotally, when companies add information not expressly required but desirable to add "color," advisers are suggesting that the extra information be placed in a summary, rather than in the body of the document, with the odd result that the summary may become longer than what it purports to summarize.)

3. The SEC staff has approached the use of the Internet and, more recently, social media conservatively. There is also considerable concern among members of the securities bar about the use of live hyperlinks in proxy materials and other Exchange Act filings, and counsel often recommends against their use out of concern that extraneous information will be swept into the filings and will generate liability. These concerns have some legitimacy, but this bias will need to change if basic and seldom-changing information can be removed from specific filings and instead posted on a company's website. (As a personal matter, the author has never understood why it is acceptable to have inappropriate language on a website, so long as it is not referred to or incorporated in a Securities or Exchange Act filing.)

4. There is also a strong historical bias that more disclosure is better, which has proven not to be the case. We will need to overcome that bias and satisfy the various constituencies that in at least some cases less is more. One example in this regard is a fairly standard comment made by the SEC staff when it says "disclose supplementally and include in future filings. … " While supplemental information may be of interest to the SEC staff and some shareholders, there should not be an assumption that such information should be included in future

filings.

5. As suggested in Chair White's speech as referenced above, our legislators and investors need to restrain themselves when it comes to using our disclosure documents to advance social causes — or political agendas — and we need to figure out a better way of providing such information to those investors who desire it. While disclosures on conflict minerals, political contributions, sustainability and other matters may be of interest, and in fact strongly demanded by some investors, it is not clear why every item of such information needs to be included in our Securities Act and/or Exchange Act filings, particularly given the liability that can attach to those filings. At the same time, we need to develop appropriate, voluntary standards for such disclosure so that all companies are on a level playing field.

Conclusion

Underlying all of these items is a critical question that all constituencies need to answer — specifically, what is the real purpose of each and every disclosure in our proxy statements and periodic Exchange Act filings? Do we need to provide disclosure of matters that a limited number of investors — or indeed, a significant group of investors — believe is relevant? Is it enough that some investors might be interested in a particular disclosure? Or should we take the position that only disclosures that are material to investors generally, whether relating to investment or voting decisions, should be included?

Should we try to communicate what our companies, and their boards and management, are all about, or should our disclosure documents be little more than prophylactics against shareholder litigation? The answer to these questions could determine whether the goal of effective disclosure is feasible, or if our 10-Ks, 10-Qs and proxy statements end up becoming the legalistic equivalent of coffee table books that no one other than lawyers (representing companies and plaintiffs, respectively) ever reads.

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