Disclosure as a Public Policy Instrument in Global Capital Markets[1]

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ABSTRACT

Globally, most jurisdictions use a disclosure-based system instead of a merit-based system in their securities law regimes. Disclosure enhances capital market efficiency through effective dissemination of information that is material to investor decisions, in turn facilitating the raising of capital in a cost-effective and timely manner. This article examines selective aspects of disclosure in securities law across numerous jurisdictions, specifically, how it serves as a public policy instrument in capital markets. It explores whether the current regulatory framework encourages "full, true, and plain" disclosure, concluding that the increasing complexity of products and the rapid growth in electronic-based disclosure offers both upside potential and downside risks to market integrity. The article also considers "materiality" as the standard for disclosure, including the interplay between statutory requirements and deference to business judgment by regulators and the courts.

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I. INTRODUCTION

Disclosure is a critically important public policy instrument in securities law. Globally, most, if not all, jurisdictions use a disclosure-based system instead of a merit-based system. A disclosure-based system allows securities to be issued and traded where regulators and stock exchanges are satisfied that an issuer meets disclosure requirements. Disclosure is aimed at providing timely, accurate, and complete information to the market, so that investors can make informed choices based on relevant information about the issuer's activities. It places responsibility for accurate disclosure in the hands of those with the information, who are seeking a wide market in which to raise capital. Disclosure enhances capital market efficiency because it can ensure effective dissemination of information that is material to investor decisions, in turn facilitating the raising of capital in a cost-effective and timely manner. In such a system, judgments about the "merits" of a particular product or issuer are left to the purchaser.

Information about an issuer is a valuable good that drives market moves, with securities trading based largely on a standard of fair access to information.[2] However, equal access to information is not a guarantee that information is a ubiquitous good that necessarily leads to fairness in the market, as retail investors have different time, resources, and capacities to digest and make use of the information.[3] Yet as a normative starting point, access to information that is full, true, plain, and timely does create the potential for equal use of that information by market participants. Since the premise of securities law is that the market will reward issuers engaged in effective governance, appropriate risk taking, and wealth maximizing activities through the value of shares in the market, consequent credit ratings and other measures, information creates the conditions for those activities to be rewarded.[4]

Implicit in the linking of disclosure with investor protection is the assumption that investors with fair access to information will make rational choices, rational in this context meaning the capacity to use the disclosed information to act in their own best interests in market transactions.[5] However, behavioral economics has

2. SARRA, *supra* note 1, at 19.
3. *Id.*
4. *Id.*
5. *Id.* at 20.

questioned whether disclosure in itself is sufficient to overcome particular human decision-making tendencies that inhibit the ability to be rational in market transactions.[6] Hence, it is unlikely that there is a model that perfectly protects investors. Moreover, investors draw different conclusions about the same data, which is why there are both buyers and sellers of a stock on a given day. The real issue in respect of disclosure is whether the information is of sufficient quality and quantity to allow investors to make informed investment decisions or assess investment advice.

This article examines selective aspects of disclosure in securities law, specifically, how it serves as a public policy instrument in capital markets. It explores whether the current regulatory framework encourages "full, true, and plain" disclosure, concluding that while the full and true aspects have received considerable attention in recent years, the increasing complexity of products creates challenges for achieving plain and accessible disclosure. This article also examines the potential and limits of electronic-based disclosure, suggesting that the market is ahead of the regulatory system in terms of how disclosure is made and that new measures may be required to protect the integrity of web-based disclosures. It also considers "materiality" as the standard for disclosure, including the interplay between statutory requirements and deference to business judgment in determining what information is considered material information such that it must be disclosed.[7] Finally, as a mechanism to deal with some of the issues raised in the article, the final part proposes a new integrated market disclosure document as a means to enhance disclosure as a public policy instrument and create greater uniformity and accessibility to disclosure across multiple jurisdictions.

II. DISCLOSURE AS A PUBLIC POLICY INSTRUMENT

Disclosure is a key policy instrument in three respects: it serves as a transaction cost control device, a regulatory tool, and a governance-signaling device.[8]

As a policy instrument to control transaction costs, disclosure can serve to reduce the cost of access to capital and thus enhance efficiency in capital markets.[9] Standardized and uniform disclosure requirements reduce transaction costs for issuers bringing securities to the market by reducing the costs of contracting for securities, including the cost of contracting contingency claims. These costs include third party costs incurred in the raising of capital, such as fees and the pricing of new capital in the market. Transaction costs, however, can vary given the frequency of rule changes, the amount of codification, and whether a rule change enhances confidence in the market. A particular level of codification can increase certainty and reduce costs; however, over-codification or rapidly changing standards can increase transaction costs as issuers try to understand and meet new requirements or

6. *Id.* For a discussion of this issue, see JOHN R. NOFSINGER, THE PSYCHOLOGY OF INVESTING 8-17 (2005); MARY G. CONDON, ANITA ANAND & JANIS SARRA, SECURITIES LAW IN CANADA: CASES AND COMMENTARY (Emond Montgomery ed., 2005).

7. While another important question for exploration is whether the disclosure paradigm should be the framework used to protect investors, that question is beyond the scope of this article.

8. For a full discussion, see SARRA, *supra* note 1, at 21.

9. *Id.*

market participants seek premiums for investment.[10] Increased codification could result in an attendant increase in costs of disclosure compliance, which in turn means a higher cost of capital. Alternatively, a high level of codification could avoid making disclosure more costly but could create a "tick the box" compliance culture if it drives the system to a level of prescribed disclosure with little thought and time directed to compliance. In contrast, a well-designed, accessible system can facilitate issuer disclosure and investor decision making, resulting in more efficient trading.

Second, disclosure is a policy instrument in that it serves as a measure of compliance with regulatory requirements.[11] In Canada and the United States, as in many jurisdictions, securities regulators assess fitness for market based on whether the issuer meets disclosure requirements. Disclosure is also the regulatory instrument for sanctioning or removing market participants. In addition, it is a tool for the creation of incentives for appropriate capital market participant behavior. For example, those issuers with recognized experience in the market and a history of compliance with securities law requirements have less onerous regulatory conditions imposed on them in bringing a new offering to the market. Hence there is an incentive to comply in order to reduce costs of future offerings. In this sense, disclosure is a regulatory tool to facilitate creating a culture of both pro-active disclosure and of compliance.

Finally, disclosure has a corporate governance role as a signaling device that communicates messages to capital market participants about the issuer's governance effectiveness.[12] It serves as a signaling device for investors in respect of operational efficiency, director oversight, and managerial skills. Increased disclosure of corporate governance under "comply or explain" policies of stock exchanges and securities regulators means that there is increased information about governance practices, contingency processes, insider trading decisions, executive compensation, and board independence measures. It is also a signaling device for corporate directors, as requirements to disclose corporate governance practices force corporate boards to assess and report on upside and downside risks, which facilitates the board's own process of adjusting strategic planning and oversight of corporate officers accordingly.[13]

The quality of disclosure can influence market behavior, as the willingness of investors to expend their capital on a particular economic activity is affected by whether investors have confidence in the disclosures being made. Failure to achieve effective disclosure can reduce market efficiency because the cost of capital is higher and public confidence and willingness to invest are diminished.

In Canada, there have been two normative directions in disclosure policy for capital markets. On the one hand is the clear move by most regulators towards increased codification through national instruments, policies, and local rules, aimed at certainty in quality of information.[14] In this respect, Canada has followed its

10. *Id.*

11. *Id.*

12. SARRA, *supra* note 1, at 22.

13. *Id.*

14. *See, e.g.*, Continuous Disclosure Obligations, National Instrument 51-102 (April 2, 2004), Acceptable Accounting Principles, Auditing Standards and Reporting Currency, National Instrument 52-107 (Jan. 16, 2004), Certification of Disclosure in Issuers' Annual and Interim Filings, Multilateral Instrument 52-109 (Jan. 16, 2004), Audit Committees, Multilateral Instrument 52-110 (Mar. 26, 2000), *available at* http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/rrn_part5_index.jsp.

largest trading partner, the United States, in large measure because of the highly integrated nature of the two countries' capital markets. One concern is whether current codification initiatives are an overreach of regulation of primary offerings. It is estimated that currently twenty-five percent of all securities regulation in Canada is aimed at the primary market, yet this market accounts for only about six percent of all trading.[15]

The other normative direction is a Continuous Market Access (CMA) model, proposed by the British Columbia Securities Commission (BCSC), which is premised on the notion that principles/standards-based regulation, rather than detailed codification, will better promote the goals of investor protection, efficient markets, and public confidence in capital markets. The BCSC model aligns itself with initiatives in the United Kingdom, which the United Kingdom's Financial Services Agency (FSA) calls a hybrid of high-level principles and detailed rules and guidance that focus on best practices more than rules, with the aim of continuing to change the balance "towards a more principles-based and less rules-based approach."[16]

To date, these divergent approaches have created a barrier to implementing a single national securities law regime in Canada, to replace the existing thirteen provincial and territorial securities law systems.[17] Both normative views have benefits and limitations. There is a risk to accessibility for both issuers and investors in terms of understanding the nature of highly-codified obligations. At the same time, if Canadian regulatory requirements do not align to a certain extent with highly codified U.S. disclosure requirements, there could be difficulties with continued access to U.S. markets. There is also a risk of issuers missing market windows, given time delays in bringing an offering to the market where approval of multiple regulators is required. The BCSC conducted a cost-benefit analysis that suggested that the CMA model provides more expeditious and less expensive access to capital without sacrificing investor protection, and that completion of an IPO under CMA would be up to nineteen percent faster and up to fifty one percent cheaper.[18] Offerings after initial IPO could be up to fifty six percent faster and eighty two percent cheaper, depending on size of the issuer.[19] Issuers would get to market faster, reducing the risk of missing market windows.[20] The CMA is aimed at

15. Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change," Canadian Securities Administrators Notice 53-302 (Nov. 3, 2000), 23 OSCB 7383.

16. FINANCIAL SERVICES AUTHORITY, BETTER REGULATION ACTION PLAN: WHAT WE HAVE DONE AND WHAT WE ARE DOING (2005), http://www.fsa.gov.uk/pubs/other/better_regulation.pdf. The FSA writes that it is "committ[ed] to implementing directives in a sensible and proportionate way. [The FSA] must implement the minimum requirements, even if they would fail a cost-benefit analysis from the viewpoint of the UK. [The FSA] will not gold-plate EU requirements [and]...will only add requirements when these are justified in their own right."

17. There have been a considerable number of studies, wise persons committees, and reports on whether Canada should have a national regulatory system or a passport system that recognizes different jurisdictions. For a discussion of these issues, see CONDON, ANAND & SARRA, *supra* note 6; and CANADA STEPS UP, *supra* note 1.

18. CHRISTINA WOLF, BETTER DISCLOSURE, LOWER COSTS: A COST-BENEFIT ANALYSIS OF THE CONTINUOUS MARKET ACCESS SYSTEM 7, 11 (Deregulation Project 2002), http://www.bcsc.bc.ca/uploadedFiles/CBA_Report.pdf.

19. *Id* at 8, 11.

20. *Id.* The study suggested that prospectus costs for issuers listed on the Toronto Stock Exchange (TSX) are directly related to length, each page of additional prospectus disclosure costs an issuer about

benefiting investors by improving disclosure and benefiting issuers by significantly lowering their capital-raising costs.

While there is not yet convergence of these normative approaches, there has been some loosening of the views regarding principles-based versus rules-based approaches to disclosure regulation. For example, in the United States, the SEC has recently recognized the need for at least a partially principles-based approach. To date, regulatory change in the United States has been highly rules driven, particularly in the years after Enron and other corporate failures. Yet the SEC has adopted a partially principles-based approach to its new requirements on executive compensation disclosure, effective December 2006. The new Compensation Discussion and Analysis (CD&A) document aims to provide clear and complete disclosure of senior officers' compensation, using both the SEC requirements that it be in plain language and principles-based requirements to explain all material elements of compensation.[21]

III. FULL, TRUE, AND PLAIN DISCLOSURE

A critical challenge in thinking about disclosure as a public policy instrument is how truly to make information accessible while also ensuring that issuers disclose the level of detail and depth necessary for analysts to make informed decisions. This question implicates three principal parties to the disclosure: the issuer, the investor, and the market intermediaries.[22] For the issuer, disclosure requirements must be sufficiently clear so that the issuer can, with some certainty, meet the requirements without unreasonable transaction costs. For the investor, disclosure must allow for informed decisions. Because retail investors are increasingly involved in the market both through on-line facilities and managed investment funds, the nature of investor interest lies more along a continuum of interests, information, and sophistication, rather than a two-tier dichotomy between retail and institutional investors. Institutional investors also run along that continuum: while they are sophisticated investors, institutional investors have different interests, time horizons, and priorities in their market activity, and thus may have different disclosure needs.[23] For example, institutional investors interested in long-term investments view governance disclosure as important. For investment analysts, retail stock brokers, fund managers, and other intermediaries, there are obligations to responsibly digest, filter, and provide opinions on disclosure. Parts of the market are highly dependent on the ability of these intermediaries to decipher complex disclosures and deliver skilled advice to the market.

Disclosure documents should clearly identify their purpose and provide "full, true, and plain" information in an accessible form. "Full" disclosure requires a level of completeness in material information such that investors can make informed decisions. "True" denotes a level of correctness and honesty. "Plain" includes clear, simple, and readily understood. While plain language may be necessary for unsophisticated retail investors or those investors without the resources to analyze

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$29,000.

21. SEC News Release 2006-123, *SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters* (July 26, 2006), http://www.sec.gov/news/press/2006/2006-123.htm.

22. SARRA, *supra* note 1, at 36.

23. *Id.* at 37.

all disclosure documents, disclosure requirements must nevertheless continue to provide analysts, institutional investors, and other market participants with the level of detail necessary to make informed judgments about investment advice and to provide regulators with the level of transparency necessary for regulatory approval or monitoring.

Although many regulatory systems have focused on the "full and true" aspects of disclosure, only more recently has the "plain" aspect of disclosure received attention. This is partially because of the size, complexity, and variety of securities offerings, as well as the increased codification of requirements. In part, it is because electronic filing or required disclosure of particular information has been added incrementally to the system without sufficient consideration of the overall implications for full, true, and plain disclosure. This creates new problems of access.[24] The FSA in the United Kingdom and the SEC in the United States have both recently stated that plain language will be a priority for their future regulatory requirements in respect of disclosure.[25]

Internationally, there are numerous plain language initiatives aimed at providing meaningful full, true, and plain disclosure. The International Organization of Securities Commissions (IOSCO) has had a series of initiatives towards plain language disclosure, which are referred to by regulators of numerous jurisdictions to inform their initiatives. For example, the European Union's *Prospectus Directive* requires that information disclosed in prospectus documents be presented in an easily understandable and comprehensible form.[26] The summary to the prospectus is limited to 2,500 words that convey in a brief manner and in non-technical language the "essential characteristics and risks associated with the issuer, any guarantor and the securities."[27] While the required plain language summary statement is an important initiative, the European Union has determined that the summary must contain a warning that it should be read as an introduction to the prospectus, and a summary sheet to a prospectus will not attract liability unless it is misleading, inaccurate, or inconsistent when read together with other parts of the prospectus.[28] That raises the question of whether the liability line has been drawn in the appropriate place for such summaries. The EU *Prospectus Directive* does impose certainty across the European Economic Area (EEA) in that regulators cannot opt out of the liability protections afforded to issuers completing the summary, which fosters the efficient market goal of securities regulation.[29]

24. *Id.* at 39.

25. Financial Services Authority, *Getting Investment Disclosure Right (2005)*,, http://www.fsa.gov.uk/pubs/other/disclosure_factsheet.pdf; Christopher Cox, Chairman, U.S. Sec. and Exch. Comm'n., Videotaped Remarks to the San Jose, CA XBRL Conference (Jan. 18, 2006) (transcript available at http://www.sec.gov/news/speech/spch011806cc.htm).

26. *Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the Prospectus to be Published when Securities are Offered to the Public or Admitted to Trading and Amending Directive 2001/34/EC, 2003* O.J. (L 345) art. 5(1)[hereinafter EU *Prospectus Directive*]; *Commission Regulation (EC) No. 809/2004*, 2004 O.J. (L 149) para. 30. The EU *Prospectus Directive* has as its purpose the harmonization of requirements for creation and distribution of prospectuses when securities are to be offered to the public or an issuer admitted to trading on a regulated market.

27. EU *Prospectus Directive, supra* note 26, pmbl. § 21, art. 5(2).

28. *Id.* art. 5(2). There is no requirement to provide a summary where the securities relate to non-equity securities having a denomination of EUR 50.000, except when requested by a member state.

29. Once a prospectus is approved in one EEA country, it can be used to issue in any other EEA country. In the EU, a significant recent development for primary market disclosure is the move in 2005

Many jurisdictions lack integration between primary and secondary market disclosure requirements. Consequently, information overlap, duplication, and fragmentation create issues of clarity and accessibility. In Canada, for example, primary market disclosure is contained in the prospectus and the Annual Information Form (AIF). For specialized offerings, such as the prompt offering prospectus, the information is disclosed in the prospectus, the AIF, the financial statements, and any material change reports.[30] In secondary market disclosure, information is disclosed in financial statements, AIFs, Management Discussion and Analysis (MD&A), proxy circulars, and material change reports. The different statutory disclosure requirements between primary and secondary market disclosure means that information is often inaccessible to retail investors because it is located in different places during different periods of the issuer's distribution and continuous disclosure life cycles. The upsurge in the quantity of information in recent years often means that the information is publicly disclosed through multiple sources, and it is difficult for investors, particularly some retail investors, to acquire a full and accurate picture of the issuer's activities and business risks. It can also be difficult to assess how material or significant the disclosure is. Although the periodic disclosure documents such as financial statements, AIFs, and MD&As are required to give a full picture, in the interim periods, material change and other reporting can be located in a myriad of places, and can give mixed messages to investors about the risk and return decisions faced by an issuer.[31]

There are signs of a move toward more integrated disclosure in Canada. In 2006, the change to short form prospectus requirements illustrated the move toward recognizing a continuous disclosure record, whether for the primary or secondary market. Short form prospectuses were historically only available to issuers with considerable market experience or sizable capitalization, which allowed those issuers to bring an offering to market quickly and with less cost. The new national instrument regulating short form prospectus offerings has eliminated many seasoning and minimum market capitalization requirements, thus expanding eligibility criteria for accessing short form offerings to include most Canadian listed issuers.[32] These changes facilitate access to capital markets by permitting issuers to rely increasingly on their continuous disclosure record. Broader qualification requirements enable more issuers to take advantage of the short form prospectus system. With 3,800 issuers listed on the TSX and TSX Venture Exchange,[33] the new requirements will allow several thousand more issuers to use short form prospectuses, and thus give many small and mid-cap issuers access to a national market on a more expeditious and cost-effective basis.

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from a recognition system to a full passport system for prospectus offerings throughout the European Economic Area (EEA), which is comprised of all EU member states plus Norway, Iceland and Liechtenstein. *Id.* art. 1(1).

30. CONDON, ANAND, & SARRA, *supra* note 6.

31. SARRA, *supra* note 1, at 47.

32. SHORT FORM PROSPECTUS DISTRIBUTIONS, NATIONAL INSTRUMENT 44-101, ONTARIO SEC. COMM'N, *available at* http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part4/rule_20061222_41-101_gen-pro-requirements.pdf; CONTINUOUS DISCLOSURE OBLIGATIONS, NATIONAL INSTRUMENT 51-102, ONTARIO SEC. COMM'N., *available at* http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part5/rule_20031219_51-102_con-dis.pdf.

33. WISE PERSONS' COMMITTEE TO REVIEW THE STRUCTURE OF SECURITIES REGULATION IN CANADA, IT'S TIME 5 (Ottawa Dept. of Finance, 2003), http://www.wise-averties.ca/reports/WPC%20Final.pdf.

In the United States, recent changes are aimed at enhancing timely delivery of information to investors while controlling costs to market. The Securities Offering Reform Rules, effective December 2005, created a new class of "well-known seasoned issuers" (WKSIs) comprised of issuers that are widely followed in the marketplace.[34] WKSIs can use a new "automatic shelf registration" process, which allows them to register unspecified amounts of specified types or classes of securities on immediately effective registration statements, without allocating between primary and secondary offerings, and can exclude more information from the base prospectus. WKSIs eliminate the delivery requirement for final prospectuses, liberalizing issuer communications so that more information goes to the market earlier in the process.[35] The shelf registration rules for WKSIs allow more flexibility and faster issuing. As in Canada, the United States is now distinguishing between those issuers well known to the market and those that are new, in terms of the extent of additional disclosures required to bring a new issue to the market. While these developments in Canada and the United States are important for time to market, they do not address potential fragmentation of information and the question of access to full, true and plain disclosure.

Investor education is another aspect of the disclosure system because it can enhance investor knowledge and provide skills to assess disclosures. While education does not remedy an individual's capacity to digest and apply information, it can serve to reduce disparities in processing information and reduce the incidence of completely uninformed decision making. Education can provide investors with a greater appreciation of their own limits (time, resources and information) with respect to investment decisions without the assistance of knowledgeable advisors. Realistically, the vast majority of investors do not make investments themselves; instead, they retain retail stock brokers, mutual fund managers, or others to provide them with advice or to direct their investment portfolio. Although technically individual retail investors make the actual decision to buy, sell, or hold, in reality the analyst is often the *de facto* investment decision-maker. In the United Kingdom, there has been a requirement since June 2005 that analysts give investors two 'keyfacts' documents at the start of the advice process, in order to provide retail investors "...with clear and understandable information about the products and services offer[ed], and the cost of advice...", as well as information about "...all options that are available in the market, not just what [the firm] offers."[36] These requirements acknowledge the limitations of disclosure in terms of how retail investors may rely on the advice of intermediaries in the marketplace, and places some obligation on advisors to disclose the scope and limits of their own services within the market for disclosure and investment advice.

In summary, the objective of full, true, and plain disclosure is hindered by fragmentation of information, the complexity of products now offered in the market, a lack of integration between primary and secondary market disclosure

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34. Securities Offering Reform, SEC Release No. 33-8591 (19 July 2005) 70 FR 44722; Rules 415, 424, 430B, Registration Procedures for United States public offerings.

35. *Id.* Rule 163.

36. *Getting Investment Disclosure Right*, *supra* note 25. These documents are: *Keyfacts About Our Services* – also known as the initial disclosure document or IDD; and *Keyfacts About The Cost Of Our Services* – also known as the menu (or fees and commission statement) or a combined initial disclosure (CIDD) document instead of an IDD.

requirements, the incremental and often unplanned nature of new disclosure requirements added to pre-existing rules, and the filtering that occurs as information changes hands before the investment decision is made.

IV. ELECTRONIC DISCLOSURE AS A KEY ASPECT OF ENHANCED DISCLOSURE REGIMES

Methods of disclosure communication have radically changed. Whereas historically, the paper prospectus was the principal protection device, paper generally has been replaced by electronic and web-based communication. The exponential increase in the use of web-based platforms and other technology has quite literally revolutionized access to information. In Canada, for example, investors can access information about issuers through the System for Electronic Document Analysis and Retrieval (SEDAR), the System for Electronic Disclosure by Insiders (SEDI), stock exchange listings, company web-sites, electronically posted information about legal actions that the issuer is involved in, and a host of other portals through which information is now disseminated.[37]

However, the material information contained in these systems is not always easily accessible. Disclosures are posted in multiple places on the website and it takes a certain amount of time, talent, and tenacity to find all material information.[38] Some investors may believe that they are making decisions based on full and complete information, but they may have missed an important material change report buried within the site. Liberal access to web-based information has thus created a new tension in the disclosure debate. On one side of this debate, electronic and web-based disclosures are enhancing the ability of issuers to make full, timely, and material disclosure to a broader range of market participants. This protects investors because both primary and secondary market disclosures are more accessible. Timely disclosure increases market efficiency because it allows the market to respond to earnings statements or material changes rapidly, and alerts all market participants to developments that may influence their investment decisions. While in some countries there may be concern regarding access to web-based disclosure, this concern is less likely to be a justification for maintaining the current paper-based system because those engaged in securities markets are increasingly likely to have access to web-based information.

On the other side of the debate, there is a risk that accessible but extensive information will reduce true access to information for investors, particularly with the use of hyper-links and different web-platforms that can obscure access to information for investors. Hyper-links can perform an important disclosure role in directing the investor to the appropriate place in the disclosure documents, where an issue is more fully discussed. The more sophisticated and exciting the delivery, for example, shifting back and forth from formal disclosure documents to video-footage of recent resource discoveries, however, the greater the risk of missing important information. Hyper-links can also take the investor to related web-sites where other parties are responsible for the disclosure content. In such cases, it is not always clear

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37. *System for Electronic Document Analysis and Retrieval (SEDAR)*, National Instrument 13-101, Ontario Sec. Comm'n, http://ftp.sfsc.gov.sk.ca/scripts/ssc/files/nat-inst/13-101niamendedasof-mar30-04.pdf; Canadian Securities Administrators SEDI Home Page, http://www.csa-acvm.ca/html_CSA/sedi.html.

38. SARRA, *supra* note 1, at 44.

that the investor is leaving a web-site for which the issuer assumes responsibility and exiting to another site not within the issuer's control in terms of accuracy and completeness of information. The issue of transparency needs to be addressed in thinking about the move to a primarily web-based disclosure regime. The choice of where to locate all disclosure information is a critical one that may affect the market. If a "one-click full access" system was the responsibility of individual issuers, the costs could become quite onerous in terms of IT support. Yet more than 90% of Toronto Stock Exchange (TSX) listed companies already maintain web-based disclosure, suggesting that the market has determined this is a timely way to ensure disclosure to the market.

Web-based communication also allows investment dealers and other intermediaries to access information and to digest, analyze, and disseminate that information to their client base in a timely manner. Historically, the market was structured so that these participants were able to access disclosures more readily than retail investors and hence differential access created a market demand for their services. Increased direct access may diminish that traditional market. At the same time, there is a growing demand for investment advice as the range and diversity of products increases. Hence, better discipline in respect of web-based disclosure should enhance market choices overall. Electronic disclosure may also create greater incentives for analysts and other market participants to maintain or enhance the quality of their advice, as retail investors will have the option of accessing the market directly.[39]

A number of web-based, electronic, or technology-based initiatives have enhanced access to disclosure in recent years. Electronic road shows are increasingly available, allowing investors from remote locations to access information meetings and ask questions about securities being brought to the market. In China, such electronic road shows are now mandatory with any new offering. Another example is the growing practice of advance notice of earnings announcements, with the electronic capacity to be on-line for the announcement or to hear the announcement on a deferred basis but first-hand. Electronic disclosure is now part of the market, and regulators should use these advances to promote enhanced quality and timeliness of issuer disclosure. Creating access to analyst calls, where the issuer discusses particular issues with analysts, is also a positive development in disclosure access. While most retail investors do not have the time or resources to follow analyst calls, the participation of intermediaries and those investors able to participate is likely to help ensure that inappropriate or unfairly advantageous disclosure does not occur.

Many jurisdictions are moving to an "access equals delivery" system such as the delivery of WKSI disclosure in the United States. Notwithstanding that there may be a lingering concern that some investors do not have consistent access to web-based disclosure, the system could shift to a default-based system where investors receive notice that documents have been posted with the appropriate web-links and an option to receive paper-based disclosure. Web-based communications platforms can allow for the reduction of information asymmetries and can enhance timely, extensive disclosure that is accessible to everyone seeking to participate in the market.

39. *Id.* at 46.

If web-based disclosure access is to equal delivery of information for purposes of meeting market disclosure requirements, it is important to build in a high degree of investor protection, including measures that guard against information tampering. It is also important that regulators are able to monitor disclosure, given its function as a regulatory tool. The design of a system that allows certainty in tracking, especially disclosure as ephemeral as electronic information, will require some care. Attention will also have to be paid to how securities holders can establish delivery or non-delivery of information where they seek remedies for breach of disclosure requirements. While statutory deemed reliance provisions will alleviate some of this concern, it may become a practical challenge in establishing the timing of issuer disclosure on a particular matter.[40] Requiring all continuous disclosure to be housed in one location, perhaps the issuer's web-page, would, address the fragmentation problems discussed earlier.

One question is whether there should be a market for centralizing data for investors. While this might provide an accessible service for investors, there is also the public policy issue of preservation, storage, and retrieval of that data in case of compliance or civil liability issues. Even without the use of centralized data services, investors may face difficulty in pursuing civil liability claims based on electronic documents that they did not download at the point in time for which they later seek to impugn the disclosure conduct. Without paper-based copies, the system design will need to ensure timely and cost-effective access to that point-in-time disclosure or there will be enormous transaction costs associated with litigating access to "disclosure of the point-in-time disclosure."

Similarly, while some technology would allow for particular investors to customize document disclosure, one needs to be concerned about disclosure that, in customizing data for investors, alters the first-hand disclosure by issuers. The second-hand reporting may diminish the ability of investors to hold issuers accountable for disclosure information on which they based their investment decisions. While issuers in such circumstances should be protected, there may need to be a liability regime that holds the service customizing data responsible for the integrity of the disclosures. Adoption of new technological strategies must take account of these concerns. The issue is what use of technology will enhance disclosure and promote the objectives of securities legislation. The responsive capacity exists; it needs to be implemented in a manner that allows issuers cost-effective disclosure delivery while protecting investors of all kinds along the continuum of sophistication and interest.

Another issue is whether there should be a private market for electronic disclosure that operates above the publicly regulated structure. For example, in Canada, CDS INC., which operates SEDAR on behalf of the Canadian securities regulatory authorities, offers a new service on its own web-site called SEDAR-SCRIBE, a service that gives subscribers immediate disclosure of SEDAR filings 12-24 hours before they are posted for the general public.[41] Arguably, this could create a two-tiered electronic disclosure system with more timely disclosure for those market participants that can afford to pay. If disclosure is a good that we want to be

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40. Technological developments can reduce the cost of delivery for issuers. However, it is unlikely to be an overall cost savings, as moving to a fully integrated web-based or electronic disclosure system requires full-time ongoing IT and IP support to ensure that continuous disclosure is accurate and timely.

41. SEDAR-SCRIBE: CDS Innovations Inc. Filing Information Home Page, http://www.cdsinnovations.ca/cdsinnovationshome.nsf/Pages/-EN-Filinginformation?Open.

uniformly accessible as a public policy matter, then the appropriateness of such services may have to be examined.[42]

In the European Union, issuers are to ensure that where a prospectus is published in electronic form, safety measures are to be used to maintain the integrity of the information, and to avoid manipulation or modification from unauthorized persons.[43] The prospectus must be easily accessible when entering the web-site: it must not contain hyper-links, with the exception of links to the electronic addresses where information incorporated by reference is available, and the investor must be able to download and print the prospectus.[44] The prohibition on most hyper-links is an interesting regulatory choice, particularly when other jurisdictions are exploring allowing the use of hyper-links to amplify disclosure information. While the EU has made a fulsome shift towards electronic disclosure, it still provides investors with a basic right to return to paper-based delivery free of charge.[45]

In the United States, the SEC is promoting a new electronic platform called eXtensible Business Reporting Language (XBRL), developed by an international consortium of 400 major companies and government agencies. About 30 U.S. filers with US$1 trillion in capital are currently using XBRL on a pilot basis.[46] XBRL is also being tested in Europe, Canada and other jurisdictions. XBRL attaches standardized electronic tags to elements of information on financial statements. The tagged data can then be pulled out of the comprehensive electronic disclosures, allowing investors to draw out the information they are interested in examining on a selective basis. It also allows software programs to calculate ratios and perform other analyses without having to re-input financial data, providing enhanced access to information for analysts and other financial intermediaries. The express objective of XBRL is to "level the playing field for tens of millions of average investors."[47]

The drive behind the initiative is the SEC's conclusion that the solution to accessible disclosure for retail investors is not to eliminate detailed information and replace it with summaries, but rather to allow each investor to order up his or her own custom information instantly to one page, removing the necessity of culling through data where originally entered. If the platform is as accessible as the SEC believes, this could revolutionize electronic disclosure. In September 2006, the SEC announced that it will expend $54 million to makes its disclosure system, EDGAR, interactive using the XBRL computer language.[48] Currently, the EDGAR public disclosure system houses 700,000 new disclosure documents per year, and the project is aimed at allowing investors and advisors to search information more efficiently and effectively.[49]

42. For a discussion of this issue, see SARRA, *supra* note 1, at 47.

43. EU *Prospectus Directive*, *supra* note 26.

44. *Id.* art. 14(7).

45. *Id.* para. 31, art. 14(7).

46. Christopher Cox, Videotaped Remarks to the San Jose, CA XBRL Conference, *supra* note 24.

47. Christopher Cox, Chairman, U.S. Sec. and Exch. Comm'n., Opening Remarks to the Practicing Law Institute's SEC Speaks Series (Mar. 3, 2006) (transcript available at http://www.sec.gov/news/speech/spch030306cc.htm).

48. SEC News Release 2006-158, *SEC to Rebuild Public Disclosure System to Make it 'Interactive'* (Nov. 29, 2006), http://www.sec.gov/news/press/2006/2006-123.htm.

49. *Id.*

The sheer volume of disclosures makes it apparent that electronic disclosure does not necessarily guarantee full and true disclosure. The SEC has recognized this in its new initiatives. In China, regulators have moved quite aggressively into use of technology in market disclosure. Financial statements, interim announcements and other relevant documentation of companies are required to be entirely disclosed on the websites of the stock exchanges.[50] While the use of internet-based disclosure has resulted in a significant expansion of the amount of disclosure, the technological advances have also amplified the risks in the market. China faces new challenges of data quality, reliability and the potential abuse of the internet to disseminate misleading information, provide false advice, defraud investors and manipulate the market. Its regulators are currently engaged in a process to improve the integrity of electronic disclosures.

V. MATERIALITY

Material fact, material change, and material information - these terms denote the scope and timing of information that is to be brought to the market. Not all information of an issuer should be disclosed to the market because it would create an inordinate burden on issuers if they were required to report continually their activities and financial condition, and would flood the market with excessive and transient information. Hence, regulators throughout the world have adopted the approach that it is material information that must be disclosed. Investors are to be given information that can inform their decisions to buy, sell, or hold. In some jurisdictions, "material" is defined as what a reasonable investor would consider important to his or her investment decision, referred to as the reasonable investor test. In other jurisdictions, it is information that is likely to affect the value of the securities, referred to as the market-impact test. In reality, there is overlap between these tests: what is considered material because it has the potential of affecting the value of securities will always be information that a reasonable investor would want. There are issues, however, in determining materiality, particularly as some jurisdictions make distinctions between material facts and material changes in terms of disclosure requirements. Corporate officers determine materiality, yet there can be an uncomfortable fit between statutory standards of materiality and whether deference should be given to corporate officers in their determination that particular information is not material.

The EU *Prospectus Directive* specifies that the prospectus is to contain all information that is necessary to enable investors "to make an informed assessment of the assets and liabilities, financial position... and prospects of issuers..." based on a materiality standard.[51] There is optional disclosure of financial forecasts, but such forecasts must be presented in a consistent and comparable manner that is not to be confused with disclosure of known trends or other factual data with material impact on the issuer's prospects.[52] Supplements to the prospectus are required for "every significant new factor, material mistake or inaccuracy relating to the information

50. China Securities Regulatory Commission, *Collection of Laws and Regulations of Securities and Futures of the People's Republic of China* (2002), http://www.csrc.gov.cn.

51. European Union *Prospectus Directive, supra* note 26 art. 5(1) (stating the information is to be according to the particular nature of the issuer and of the securities offered to the public or admitted to trading on a regulated market.).

52. *Id.* para. 8.

included in the prospectus that is capable of affecting the assessment of the securities," if it arises between the time the prospectus is approved and the final closing of the offer to the public.[53] No distinction is made between material fact and material change in the disclosure obligations.

In Canada, a distinction continues to be made between material fact and change in securities statutes. A major contested point in Canada is whether the current distinction between material fact and material change ought to be eliminated. Material fact is defined as "a fact that would reasonably be expected to have a significant effect on the market price or value of the securities".[54] Material change is defined as "a change [or decision to change] in the business, operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the issuer."[55] Once a prospectus is given a receipt by securities regulators, there is no obligation to update material facts during the offering period, whereas there is an obligation to disclose material changes.[56] Hence the delineation between material fact and material change becomes significant. The Ontario Court of Appeal in Kerr v. Danier Leather recently held that a prospectus is only required to provide full, plain and true disclosure of all material facts as of the date of the prospectus, not the date of closing.[57] This is a less rigorous standard than under the European Union's *Prospectus Directive*. The judgment in Kerr v. Danier Leather indicates that investors' expectations of accuracy in prospectus disclosure may be incongruent with the statutory provisions. Canadian judgments suggest that there is still not a clear or shared understanding by regulators, market participants, and the courts regarding the difference between material fact and material change. The Supreme Court of Canada has granted leave to appeal in the Kerr v. Danier Leather case and the matter is pending as this article goes to press.[58]

Here, the law lags behind market developments. Issuers listed on the Toronto Stock Exchange (TSX) are required to disclose to a material information standard.[59] For these issuers, the material fact/change distinction only becomes significant if there is a claim of failure to meet statutory requirements or a civil liability claim. At that point, the issuer may try to categorize changes as material facts if not disclosed, in order to avoid liability. This after-the-fact apportioning of materiality to "disclosure boxes" seems an inappropriate way to determine statutory compliance. For many issuers, the difficulty is whether and at what point the information is material, not whether it is a fact or a change. The relatively new National Policy 51-201 *Disclosure Standards* recommends a material information standard, but to date, Canadian statutes have not been amended to align. The proposed Continuous Market Access model, aimed at creating consistency in reporting material information, would eliminate the distinction between material fact and material

53. *Id.* art. 16(1).

54. *Ontario Securities Act*, R.S.O. 1990, ch. S5, as amended, §1(1). For the Québec provisions, see *Québec Securities Act*, R.S.Q. ch. V-1.1 §§ 25, 68, 73.

55. *Ontario Securities Act*, §1(1).

56. Kerr v. Danier Leather Inc., [2005] O.J. No. 5388 (Ont. C.A.), leave to appeal to the Supreme Court of Canada granted, Kerr v. Danier Leather Inc. [2006] SCCA No. 56 (Can.).

57. *Id.*

58. *Id.*

59. Toronto Stock Exchange, Policy Statement on Timely Disclosure and Related Guidelines, http://www.tsx.com/en/pdf/PolicyStatementOnTimelyDisclosureNotes.pdf.

change and require continuous up-to-date disclosure of all material information about issuers, whether or not issuers raise capital in a given year.

To satisfy the United States' materiality standard in disclosure obligations, there must be a substantial likelihood that a fact "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[60] This is a common law, not statutory, test of materiality. Hence in terms of material disclosure, Canada has a market impact test and the United States and the European Union have a reasonable investor test.

Other countries have attached disclosure requirements to a materiality standard. In Japan, continuous disclosure obligations include disclosure of financial and other information that will significantly affect investors' decisions, and announcements of business results and material corporate information to public investors.[61] Each issuer must designate a "Corporate Information Handling Officer" to enhance timely disclosure.[62] There is a general obligation to disclose in a manner that is "swift, accurate and fair." Issuers are also required to have a system in place capable of supporting continuous, timely, and adequate legally required periodical disclosures.[63] The Tokyo Stock Exchange (TSE) requires listed companies to disclose immediately to the public "any information that might be expected to materially affect the prices of its stocks," including financial results, capital changes, occurrence of a material fact such as a major change to shareholders, legal action or decision.[64] However, one of the most serious challenges for secondary market disclosure in Japan is the lack of enforcement mechanisms, and Japan also has no mechanism for private enforcement through class-action lawsuits.[65]

As China moves into global capital markets, it has increasingly codified materiality disclosure requirements in an effort to remedy earlier failures to capture market confidence and to demonstrate to international investors that a rapidly emerging capital market can still provide a degree of certainty and completeness in its disclosure regime. The *Collection of Laws and Regulations of Securities and Futures of the People's Republic of China*, compiled by the China Securities Regulatory Commission (CSRC) in 2002, is comprised of 71 regulations and regulatory documents.[66] However, codification of materiality may not address longstanding cultural norms that do not value disclosure and hence may not comply with regulatory requirements. While this topic is beyond the scope of this discussion, it does point out that imposition of materiality standards is only one part of the equation, and there must be both a culture of compliance and enforcement mechanisms for disclosure to be effective as a public policy instrument.

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60. For a discussion, see CONDON, ANAND, & SARRA, *supra* note 6, at 269-270.

61. *See generally* TOKYO STOCK EXCHANGE, RULES ON TIMELY DISCLOSURE OF CORPORATE INFORMATION BY ISSUER OF LISTED SECURITY AND THE LIKE (2002), http://www.tse.or.jp/english/guide/regulations/data/securitylisting.pdf.

62. TOKYO STOCK EXCHANGE, SUPPLEMENTARY RULES TO SECURITY LISTING REGULATIONS, Dec. 10, 2003, at Part III, Disclosure Requirements after Listing.

63. Tokyo Stock Exchange Application Checklist, http://www.tse.or.jp/english at 49.

64. Tokyo Stock Exchange Organization, http://www.tse.or.jp/english/about/organization.html.

65. Although recently there are more accessible corporate law remedies through new provisions that facilitate derivative actions in Japan.

66. *Collection of Laws and Regulations of Securities and Futures of the People's Republic of China*, *supra* note 50.

In the European Union, secondary market disclosure initiatives have been aimed at creating uniformity of secondary market disclosure, but have also been developed to respond to the United States' *Sarbanes-Oxley Act* materiality requirements.[67] The objective of the European Commission *Directive on the Harmonization of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market* (*Transparency Directive*) is "to ensure investor confidence through equivalent transparency in disclosure throughout the [European] Community."[68] The *Transparency Directive* specifies that "the disclosure of accurate, comprehensive and timely information about securities issues builds sustained investor confidence and allows an informed assessment of issuers' business performance and assets."[69]

In the United States, there have been extensive revisions to secondary market disclosure with the Sarbanes-Oxley Act (SOX) and subsequent regulatory amendments.[70] Sarbanes-Oxley was enacted to mandate a number of reforms to enhance corporate responsibility and financial disclosure, and to combat corporate and accounting fraud. SEC rules since 2002 have included, but are not limited to, 1) certification of disclosure by the issuer's executive and financial officers,[71] 2) new disclosures regarding audit committee financial experts,[72] 3) requirements regarding disclosure of off-balance sheet arrangements in MD&A and aggregate contractual obligations;[73] and 4) electronic filing and web-site posting of requirements for insider transactions.[74] One question is whether, as a result of SOX requirements, issuers have been disclosing many more minor announcements that do not materially impact financial statements, in order to reduce liability risk.

Given the need to defer to decisions by corporate officers as to what information is material such that it must be disclosed, U.S. regulators have imposed assurance requirements on corporate officers, which has the effect of deferring to corporate officers the decision about what information is considered material for disclosure. The Sarbanes-Oxley Act section 404 directs the SEC to adopt rules requiring issuers to include in their annual reports "a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting" and assess the effectiveness of those internal controls.[75] The company's auditors are to attest to and report on this management assessment.[76] The objective of the provisions is to enhance confidence in financial reporting

67. *Opinion of the European Economic and Social Committee on the 'Proposal for a Directive of the European Parliament and of the Council on the Harmonization of Transparency Requirements with Regard to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market and Amending Directive 2001/34/EC,* O.J. (C 80/128), para. 1.2.

68. *Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2-4 on the Harmonization of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market and amending directive 2001/34/EC,* O.J. (L 390), para. 41.

69. *Id.* pmbl, para. 1. The directive is aimed at greater harmonization of periodic and ongoing information requirements throughout the Community.

70. Sarbanes-Oxley Act, 15 U.S.C. § 7241 s. 302(a) (2002). For an example, see the 2002 revised *Uniform Securities Act*, aimed at further harmonization of federal and state securities law.

71. Sarbanes-Oxley Act, § 7241 s. 302(a).

72. *Id.* §§7241 ss. 302, 7265 s. 407.

73. *Id.* § 7261 s. 401(a).

74. Securities Exchange Act of 1934, 15 U.S.C.A. 15 U.S.C. § 78p s. 16(a) (2002).

75. Sarbanes-Oxley Act, 15 USC §7262.

76. *Id.*

because internal controls over that reporting would be effective and timely.[77] The original compliance date for SOX section 404 has been delayed several times.[78] In part, the delay has resulted from compliance costs being much greater than anticipated. The SEC cites a study that found that "second year total costs of reporting, after initial development of controls reporting, for public companies with a market capitalization of $75-700 million was on average $900,000."[79]

Smaller companies have had difficulty in working towards compliance with SOX section 404 rules, specifically because of a lack of guidance in the requirements in terms of application to smaller companies; a compliance model that discourages use of business judgment, and a disproportionate cost burden that some scholars have suggested could pose significant risks to economic growth in United States capital markets.[80] The SEC Advisory Committee on Smaller Public Companies has recommended adopting a disclosure system that integrates disclosure rules that apply to WKSIs, but based on capitalization.[81] It also suggests that management representations as to the effectiveness of internal controls should be sufficient for micro and small cap issuers, without external audit involvement.[82] The premise is that micro cap and small cap companies account for 78.5% of all U.S. public companies, but represent only 6% of total market capitalization, and that the offering requirements, as well as SOX section 404 requirements, create a disproportionate compliance burden on smaller issuers.[83]

More recently, however, the SEC has announced its intention to proceed with deadlines for SOX section 404 compliance, offering new interpretive guidance aimed at enabling public companies of all sizes to focus on risk and materiality in evaluating their disclosure processes and controls, while reducing unnecessary compliance costs for smaller companies. It also merits note that some market participants, such as private equity funds, hold smaller issuers to the higher SOX section 404 requirements, even where they have not yet been required to comply under U.S. securities law, as this serves as a governance check on their activities.

Another example of evolving transparency norms is Australia, which has embarked on a series of regulatory changes aimed at enhancing disclosure. The Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act (CLERP 9) focuses on transparent and open communication to create equal access to material information, continuous disclosure, financial reporting, audit reform, and auditor independence and enforcement.[84] CLERP 9 is aimed at "new, clear, concise and effective disclosure obligations" in the issuing of

77. SEC Release No. 33-8238, (June 5, 2003) 68 FR 36636; SEC Release No. 34-49884 (June 17, 2004) 69 FR 35083.

78. SEC Release No. 33-8545 (Sept. 22, 2005) 70 FR 11528.

79. SEC Release Nos. 33-8666, 34-53385, Exposure Draft of the Final Report of the SEC Advisory Committee on Smaller Public Companies (Mar. 3, 2006) at 29.

80. William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of 'Going Private'*, available at http://ssrn.com/abstract=672761; Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L. J. 1521 (2005).

81. Exposure Draft of the Final Report of the SEC Advisory Committee on Smaller Public Companies, *supra* note 79, at 15.

82. *Id.* at 40-41, 44.

83. *Id.* at 5, 25-50.

84. Corporate Law Economic Reform program (Audit Reform and Corporate Disclosure) Act, (July 2004), amending the *Corporations Act, 2001*, enacted July 2004, http://www.asic.gov.au.

securities, which includes a new remedy in the form of an infringement notice for breaches of continuous disclosure obligations.[85]

There are different normative views as to whether a full rules-based system creates a climate of compliance or generates a "tick-the-box view" of compliance without market participants really acquiring a sense of responsibility for their disclosures.[86] One point of divergence is whether principles/standards-based, less-codified requirements can better foster a climate of compliance and integrity once the issuer is known to the market and regulators, and whether the principles/standards-based approach instills a concern for market participants based on an enshrined sense of responsibility. One view is that less codification raises the level of uncertainty for issuers in terms of the standards they must meet; for investors in determining the availability of a remedy for particular conduct; and for regulators in allocating resources for compliance and enforcement initiatives. A different view is that less certainty can mean that issuers and their principal officers must consciously make disclosure decisions on the basis of standards and their best judgment on materiality and investor protection.

Given the high level of court deference to securities regulators and the fact that the courts themselves are not experts, a further question is whether less codification would really just relegate rule-making in many jurisdictions to securities administrators, as uncertain standards are enforced at the first instance by regulators and lack of codification could leave securities regulators as the de facto law-makers. While there may be some risk of that outcome, one notes that securities regulators are already rule-makers at first instance, and that a principles/standards-based approach may shift that slightly by encouraging issuers to cultivate best disclosure practices. The principles/standards-based approach to disclosure does not eliminate rules; instead, it reduces the degree of specificity in some instances so that issuers can develop disclosure practices based on their size, sector, and governance structure.

VI. INTERPLAY BETWEEN BUSINESS JUDGMENT AND DISCLOSURE OBLIGATIONS

Issuers are required to disclose material information as a condition of access to capital markets. Determining what information is considered material is, however, a judgment that is to be made by corporate officers. Hence, statutory standards of materiality are complied with judgments regarding what aspects of the issuer's activities or financial condition are material. The interplay between statutory standards and corporate decisions as to when and what to disclose is a key issue in an effective disclosure regime.

In considering the relationship between disclosure requirements and the business judgment rule, it is important to distinguish between the notion of deference to business judgment and the so-called "business judgment rule" as it has

85. AUSTRL. SEC. & INV. COMM'N, CONTINUOUS DISCLOSURE OBLIGATIONS: INFRINGEMENT NOTICES 3 (2004), http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/infringement_notice_guidelines.pdf/$file/infringement_notice_guidelines.pdf; AUSTRL. SEC. & INV. COMM'N, CORPORATE LAW ECONOMIC REFORM PROGRAM 4 (2004), http://www.treasury.gov.au/documents/264/PDF/clerp.pdf.

86. Compare, e.g., the approaches of the United States and United Kingdom to compliance.

been articulated in United States caselaw. In the United States, the business judgment rule is a rule of "judicial non-review" of business decisions, creating a rebuttable presumption that directors are meeting their duty of care, and that in performing their duties, are honest, well-meaning, and their decisions are informed and rational. The business judgment rule limits judicial review of directors' business decisions in order to limit the amount of interference in business affairs by the judiciary.[87] Hence, the rule shields directors from personal liability and shields the decisions of corporate boards from judicial review.

In Canada, there has been long-standing court deference to business judgments. More recently, the Supreme Court of Canada recognized a "business judgment rule" in Canadian corporate law. Unlike the U.S. rule, Canada's approach is aimed at providing a defence to duly diligent directors from allegations that they have failed to meet their statutory and common law obligations to act in the best interests of the corporation.[88] There must first be evidence that corporate officers have been duly diligent. Such deference, however, is complicated where there are statutory standards that corporate officers are to meet. The Ontario Court of Appeal in Kerr v. Danier Leather held that the business judgment rule applies to director decisions with respect to primary market disclosure obligations.[89] It held that reasonableness is the centerpiece of the business judgment rule, involving a range of reasonableness.[90] There are important differences between the United States' and Canadian tests and thus a key issue is how business judgment is treated when measured against statutory disclosure requirements in securities laws.[91]

Clearly, there are business judgments involved in an issuer determining what is considered material information. Given that directors and officers have the greatest knowledge and understanding of their business, operations, and capital, they are the most likely to be able to determine accurately what is or is not material information. Disclosure decisions can involve difficult business judgments, and in distinguishing between material fact and material change reporting in Canadian securities law, the determination of where particular information fits within those differing obligations is arguably a matter of business judgment. However, such business judgment bumps up against clear statutory disclosure requirements. Where the law specifies a particular disclosure, there is no business judgment to be made: the issuer must comply with the law. It is where judgment is called for that market participants may need some guidance of the scope of any deference that may be granted.

The judgment issue is complicated when there are determinations about when to disclose material facts, such as early merger discussions, transactions under negotiation, or consideration of moving into new markets or different product lines. Disclosure too early may be highly premature and have a negative effect on a proposed transaction or direction that the issuer is considering taking. It may also cause investors to make decisions prior to the particular matter having actually crystallized, which in turn could harm investors' interests and create uncertainty in the market.[92] While the issuer can make confidential disclosure to the regulator in

87. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984); Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

88. Peoples Dep't. Stores Inc. v. Wise, [2004] 3 S.C.R. 461 (Can.).

89. Kerr, *supra* note 57.

90. *Id.*

91. Hopefully this will be a question that the Supreme Court of Canada clarifies on appeal.

92. *See* Re YBM Magnex Int'l Inc., [2003] 26 O.S.C.B. 5285, para. 29 (Ont. Sec. Comm'n.).

many jurisdictions, this does not prevent the disclosure from entering the market, it only delays the release. Where early discussions regarding transactions or mergers do not crystallize but are disclosed on a delayed basis, this could send misinformation to the market. Another view is that early disclosure does not send misinformation, particularly if the disclosure is accurately couched in language that reflects the degree of uncertainty. It is the information being presented as more certain than it actually is that creates misinformation. If this problem were addressed, early disclosure could have an explanatory and mitigating effect on market disruption.

However, if deference to business judgments is too high, it will create incentives for issuers not to disclose and then seek the protection of the business judgment rule to justify business decisions not to disclose material changes. In turn, this may prevent material information from being disclosed in a timely manner and would create barriers for investors in establishing claims of breach of statutory disclosure requirements.

As a result, some express statutory language addressing this issue may be warranted, as business judgment is an area that is likely to generate different judicial approaches to the deference question across jurisdictions. This differing approach may result in increased uncertainty for all market participants. The objective of the disclosure requirement is to ensure that the issuer deals with disclosure of good news and bad news with equal urgency. Deference to business judgment should apply only to judgments that are made on a reasonable basis after a duly diligent process. Given current information asymmetries, it may be necessary to place an onus on the issuer's officers to establish their due diligence, as has occurred in the context of takeover bid cases. Any deference given as a judicial interpretation tool or device should be carefully limited so as not to detract from both the express disclosure requirements in securities law and the goals of investor protection, market efficiency, and public confidence in capital markets.

VII. DEVELOPMENT AN ELECTRONIC INTEGRATED MARKET DISCLOSURE DOCUMENT

Any initiatives to modernize disclosure as a public policy instrument should build in mechanisms that test the effectiveness of whether outcomes of proposed rule changes are clear and likely. One Canadian securities regulator has observed that rules should also be tested for their neutrality in order to not favor particular types of market participants, for their flexibility in order to require market participants to exercise judgment and place responsibility on officers to establish and apply adequate systems and controls to meet regulatory requirements, for scope so that rules should prescribe only what is necessary to achieve the intended outcome, and for clarity so that the rules are accessible, understandable, and able to be applied practically.[93]

One option to address many of the issues raised in this article is to locate disclosure in one "living" electronic integrated market disclosure document (IMDD) that investors can access at any point in the life cycle of the issuer, whether it is

93. British Columbia Securities Commission Home Page, http://www.bcsc.ca.

making an offer of securities to the market or meeting its continuous disclosure obligations.[94] The integrated market disclosure document (IMDD) could combine financial statements, MD&As, AIFs, and proxy circulars into one document. These financial and other disclosures are called by different names in different jurisdictions, but they increasingly align in the nature of their disclosure requirements globally and thus could be integrated into a living IMDD.

Such an integrated disclosure document could contain four parts. The first part of a new IMDD could be an executive summary of no more than four to five pages, with a substantive and informative summary of material information regarding the issuer conveying in brief, non-technical language the essential characteristics and risks associated with the issuer and the securities. Modeled after the European Union summary document, it would provide specific references to relevant materials in the remainder of the document. The executive summary would not provide "full disclosure," as that is what the remainder of the document would provide; however, it would be fulsome because it would flag the material information. This part would be required to meet the threshold of reporting material information in a way that investors could both rely on the information and seek remedies where the issuer failed to flag it. It could caution that investors are to make any investment decisions based on the IMDD as a whole, and that no civil liability will attach to any person solely on the basis of the summary, unless it is misleading, inaccurate, or inconsistent when read together with other parts of the IMDD.

The second part of the proposed IMDD would contain the financial statements, as well as information that is currently disclosed in the AIF, providing extensive and substantive financial and operational disclosure. While an effort would be made towards plain language disclosure, this part would provide the level of detail necessary for analysts and other market participants to make an informed assessment of the issuer, and provide an integrated snapshot of the issuer's capital, business, and operations.

The third part of the IMDD would contain MD&A-type descriptions by senior officers, but would directly reference previous parts to eliminate duplicative information, with a specified standard on which to measure the quality of disclosure. The new Compensation Disclosure and Analysis (CD&A) required in the United States (effective in 2006) could also form part of this section.[95] It may also be timely to require disclosures in this part for corporate social and environmental responsibility measures, as part of the corporate governance disclosures. Corporate social responsibility disclosures are increasingly prevalent in EU member states and other countries. Canada's requirements in this respect are minimal at best, although a number of issuers, particularly in the resource sector, are routinely disclosing environmental sustainability measures. This corporate social and environmental responsibility disclosure could be pegged to a standard developed by private actors, such as the "comply or explain" standard pegged to the principles of the Global Compact, or it could merely impose a general requirement to disclose practices in respect of the issuer's social and environmental responsibility practices.

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94. I first proposed this idea as part of the background research report for the Task Force to Modernize Securities Law in Canada, see SARRA, *supra* note 1, at 11-12.

95. SEC News Release, SEC votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters, http://www.sec.gov/news/press/2006/2006-123.htm.

The final part of the IMDD would comprise Future Oriented Financial Information (FOFI), separated because of the particular nature of forecast disclosure. While FOFI would be optional, as it is under many current systems, it too would have clear standards, whether based on a reasonableness standard or reasonable investigation standard.

Subsequent material change reporting would then be integrated directly into the IMDD as one document, flagging the date of the change in disclosure. Press releases and the revised IMDD with the material change incorporated would clearly signal to market participants at the front of the document the nature of the change and location in the document. The IMDD as a whole would be the living disclosure document, and would include electronic "tags" specifying when the particular material change or information disclosure was integrated into the document.

This notion of a dynamic current and accessible document is possible given technological developments. Instead of investors having to access numerous documents, plus trying to ascertain whether there have been material change reports, all information publicly available to the market would be contained in one document at all times, including a "last updated" reference. This model would place the emphasis on disclosure to meet the principal goals of informing and protecting investors, while generating efficiencies in capital markets. The transaction costs of converting to a single document would eventually be offset by the streamlined nature of the disclosure.

The IMDD could be held to a standard of disclosure of all material information, thus aligning many jurisdictions. The uniformity in requirements would promote harmonization of standards and certainty for issuers. A less rigorous option is that the IMDD would hold the issuer to a standard of disclosure of material information at the time the IMDD is first presented to the market, with material changes integrated on an ongoing basis, and then requiring a semi-annual update to include all material information, with the summary clearly specifying the last update period. Micro and small cap issuers could be required to undertake the update annually if there are concerns about the costs of semi-annual compliance for these issuers.

The proposed IMDD does meet a number of the indicia of effective rule changes. It would be flexible, in terms of issuers creating an IMDD that allows the issuer to meet a standard of disclosure. It would eliminate duplication in primary and secondary market disclosures. It would provide all market participants with single portal access to current material information about the issuer. It could be designed with stock exchanges so that issuers are required to meet only one set of disclosure standards.

VIII. CONCLUSION

This article raises a number of issues in respect of disclosure, particularly with the growth of global capital markets. Disclosure is the public policy instrument of choice for most countries for the protection of investors and the efficiency of capital markets. However, with the rapid changes in the number and types of securities offerings, the exponential growth in web-based paperless disclosure, and the international nature of securities trading, there needs to be further exploration of

how regulatory structures can adjust to ensure that disclosure requirements continue to foster fair and efficient capital markets.

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