

**INTEGRATION OF THE SECURITIES ACT AND THE EXCHANGE ACT:
A CASE STUDY OF REGULATION IN THE DIVISION OF CORPORATION
FINANCE OF THE UNITED STATES SECURITIES AND EXCHANGE
COMMISSION**

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I. Introduction: two statutes in tension

The Securities Act of 1933 (Securities Act) [1] and the Securities Exchange Act of 1934 (Exchange Act) [2] are familiar to many lawyers. The Securities Act requires disclosure in a registration statement of several different items of information when securities are sold to the public [3]. The Exchange Act requires companies of a certain size, or companies that have previously sold securities to the public, to prepare and file with the Commission annual (Form 10-K), quarterly (Form 10-Q), and special (Form 8-K) reports [4]. Not so familiar perhaps is the tension between the two Acts due to differences in timing of required disclosures, resulting in duplicative reporting by companies in registration statements and periodic reports. Such duplication obviously increases the costs incurred by reporting companies. By the late 1970s the volume and acceleration of economic activity and the increasing level of overlapping mandated disclosure made the task of resolving the tension a top priority. A resolution has been attempted through a program called "integration", *i.e.* a program designed to take advantage of and rely upon periodic information furnished by a company under the Exchange Act when that company is required by the Securities Act to make disclosure in a registration statement when selling securities to the public. Integration is accomplished by incorporating by reference information from relevant periodic reports into the registration statements.

In the Securities and Exchange Commission, the Division of Corporation Finance has the principal responsibility for developing, implementing, and admin-

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istering the disclosure requirements of the two Acts. The number of filings submitted to the Division under the Acts has grown dramatically. In 1980, over 7,000 registration statements and amendments to registration statements were filed under the Securities Act, while over 8,000 Forms 10-K, 21,000 Forms 10-Q, and 6,000 Forms 8-K were filed under the Exchange Act. The likelihood of overlapping disclosure is quite high, as these numbers indicate. The Division's regulatory goal has become one of developing a rational set of rules that assures that the two statutes, together, result in full material disclosure to investors without wasting companies' funds on duplicative or unneeded disclosure.

In 1980 the Division culminated its effort to integrate the two Acts by revising the structure and content of periodic reporting under the Exchange Act and proposing new registration forms under the Securities Act which would result in uniformity of disclosure under both Acts and which would take advantage of the mandated disclosure in the new periodic forms. Implementation, testing, and refinement will take hard work and some years, but, through the Commission's action, the basic conceptual work and the adoption of the policy and operational strategy have been accomplished. The pace and volume of economic activity made the work simultaneously urgent and harder. In fact, the Division's work in 1980 has been likened "to changing the wheels on a locomotive while it was in motion — and increasing in speed" [5].

This article, while a legal note, is also in part a case study of how a regulatory agency adjusts its perspective in administering forty-seven-year-old statutes in rapidly changing financial markets. The article discusses the rationale for the regulatory course of action, and offers some preliminary assessments for the practitioner of securities law.

2. Integration as a regulatory strategy

The core of the federal securities laws in the United States is mandated disclosure to the investing public of material economic information about a company.

The Securities Act of 1933 was designed to prevent fraud when securities are sold to the public in interstate commerce. It requires full disclosure of all material information about the seller's business, principally through a registration statement and prospectus. The focus of the Securities Act disclosure is the condition of the company at the time the offering to the public occurs. The Securities Exchange Act of 1934 was enacted to regulate the securities exchanges and broker-dealers, but, very importantly, the Exchange Act, when passed, also contemplated that issuers the securities of which were listed on national exchanges should regularly report publicly on company developments. Therefore,

[w]hile both statutes were designed to provide disclosure to investors and the market place, the framework of the Securities Act was transaction oriented, *i.e.*, the focus was upon the public offering of securities by any company. The framework of the Exchange Act was status oriented, *i.e.*, the focus was upon issuers with a class of securities listed and traded on an exchange [6].

For a long time, the Acts operated independently; information was furnished to purchasers of securities because of the provisions of the Securities Act irrespective of whether that information was already available in the market and reflected, as a result of periodic reporting, in the market value of the security offered. Underwriters, issuers, and various professionals labored to prepare a lengthy prospectus each time securities were sold, and the Commission staff reviewed each prospectus intently. As a result, there was often duplicative reporting which resulted in unnecessary expense. In 1966, Milton Cohen noted that the disclosure frameworks under the Acts would have been quite different, perhaps more congruent, if they

had been enacted in opposite order, or had been enacted as a single, integrated statute – that is, if the starting point had been a statutory scheme of continuous disclosures covering issuers of actively traded securities and the question of special disclosure in connection with public offerings had then been faced in this setting [7].

This observation and other developments led to a concept called “integration”, which stressed integrating the disclosure required of the same companies by both Acts.

The Commission has been moving fitfully to implement integration since then. The history of the Commission’s efforts has been set forth in great detail in its recent release proposing revision of the most widely used forms by which securities are registered for sale to the public [8]. Suffice it to say that integration rests in part on the premise of equivalency between transactional (Securities Act) and periodic (Exchange Act) reporting. If a “subject matter is material information (other than a description of the transaction itself) then it will be material both in the distribution of securities and to the trading markets” [9].

But there is also another component of integration separate from the premise of equivalency. The Securities Act contemplates delivery of the disclosure package (the prospectus) to the purchaser. The Exchange Act contemplates delivery of the disclosure package (Form 10-K, Form 10-Q, or Form 8-K) to the Commission, to be made in turn available to the market. It is not enough to decide what basic package of information is material to investment decisions and therefore to be disclosed under both statutes. One must also decide “[u]nder what circumstances and in what form should such material information be disseminated and made available by companies making public offerings to the various participants in the capital market system” [10]. Under the Exchange Act, information is regularly furnished to the market place through periodic reports. As the Commission noted with respect to widely followed companies:

This information is evaluated by professional analysts and other sophisticated users, is available to the financial press and is obtainable by any other person who seeks it for free or at nominal cost. To the extent that the market accordingly acts efficiently, and this information is adequately reflected in the price of a registrant’s outstanding securities, there seems little need to reiterate this information in a prospectus in the context of a distribution [11].

Thus, integration involves making disclosures under both Acts uniform to the maximum extent possible and deciding under what circumstances previously filed information should also be delivered to new purchasers of securities.

Generally, the approach of the Commission before 1980 was gradually to make periodic reports filed under the Exchange Act equivalent in disclosure content to prospectuses [12], and to allow certain widely followed companies to incorporate by reference that information from their periodic reports into their prospectus when making public offerings. Incorporation by reference avoids the necessity to restate in the prospectus the incorporated information which is still current, while at the same time satisfying the requirements of the Securities Act as to what information must technically be in the prospectus itself. The result is Form S-16, a short, readable prospectus containing information about the distribution and new information about the company not previously disclosed; the basic package of disclosure information is not delivered to new purchasers.

The benefits of this approach, however, have only been made available by the Commission to large companies, which (i) have common stock outstanding held by non-affiliates with a market value of at least \$ 50 million, (ii) have earnings of at least \$250,000 for three of the past four years, including the most recent year, and (iii) have not either failed to pay any dividend or sinking fund requirements on preferred stock or defaulted on a material indebtedness during the past three years. The number of companies eligible is substantially less than onehalf of the more than 8,000 companies obligated under the Exchange Act to file periodic reports [13]. As a result, the majority of reporting companies, which often are small, currently duplicate Exchange Act information in a prospectus when selling securities to the public and in their annual report to shareholders which must be furnished when proxies are solicited for election of directors. Moreover, the financial statement requirements and the disclosure requirements were not uniform in the various registration forms and reports, and the lack of uniformity increased the costs of preparation. For example, under the Securities Act an issuer utilizing Form S-1 would have had to include one balance sheet and three years of income statements; if using Form S-7, it would have had to include one balance sheet and five years of income statements; and if using Form S-8, it would have had to include two balance sheets and two years of income statements. Furthermore, under the Exchange Act, an issuer might have had to file a Form 10 requiring one balance sheet and three years of income statements and then, at the end of its fiscal year, file a Form 10-K with two balance sheets and two years of income statements. In addition, the financial statements in the annual report to shareholders were required to be prepared in accordance with generally accepted accounting principles (GAAP); these principles differ in many respects from the Regulation S-X applicable to all financial statements filed with the Commission.

3. Implementation steps in 1980

In 1980 the Commission took decisive steps. It adopted uniform financial statement requirements and uniform disclosure requirements, and introduced a concept of multiple delivery of documents to reduce overlap and duplication. Although other problems remain to be resolved, for example defining the role of the quarterly report (Form 10-Q) in light of integration [14], the problem of timely disclosure of material corporate events [15], and the role of underwriters in verifying information incorporated by reference, the decisions taken in 1980 mark a significant turning point in achieving integration.

3.1. *Initiatives to advance integration*

The several steps taken in September 1980 introduced substantial uniformity in financial information required under both Acts and will extend the benefits of integration to all companies which have been reporting regularly under the Exchange Act for at least three years, regardless of size. First, the Commission adopted the following proposals (hereinafter referred to as Adopted Proposals): (i) amendments to Form 10-K, Rule 14a-3, and Regulation S-K [16] to facilitate integration of the two reporting systems; (ii) amendments to Regulation S-X (the Commission's regulation applicable to all financial statements filed under the various securities acts) [17] to establish uniform financial statement instructions for the major forms and reports required to be filed under both Acts; (iii) amendments to Regulation S-X to eliminate, to the extent possible, the differences between the requirements of Regulation S-X and GAAP [18]; and (iv) a new simplified form, Form S-15, available for the registration of securities issued in certain types of business combination transactions; Form S-15 provides for delivery of existing documents together with a short prospectus describing the offering [19]. Significantly, an Exchange Act filing, the Form 10-K, rather than a registration statement under the Securities Act, was the critical first step in the Adopted Proposals. The focus on Form 10-K, and the changes in staff review discussed *infra*, demonstrate that the focus both in first implementing integration and in its subsequent operation is on periodic reports under the Exchange Act, and not on registration statements. This represents a departure from the past practice of placing primary emphasis on Securities Act filings.

3.2. *Coupling the two statutes via the "Uniform Disclosure Package"*

The key to expanding the benefits of integration to all companies reporting for more than three years is the development of a basic, uniform disclosure package ("Uniform Disclosure Package"). Such a Uniform Disclosure Package was formulated in the Adopted Proposals.

Briefly, it consists of the following requirements.

(1) Consolidated audited financial statements comprised of balance sheets for the end of the most recent two fiscal years, and income statements and statements of changes in financial position for the most recent three fiscal years, all prepared in compliance with Regulation S-X (as amended substantially in the Adopted Proposals to eliminate to the extent possible deviations from GAAP).

(2) Selected financial data for the last five years to highlight significant trends in continuing operations. Subject to appropriate variation, the following items are expected to be in the summary of selected financial data: (i) net sales or operating revenues; (ii) income (loss) from continuing operations; (iii) income (loss) from continuing operations per common share; (iv) total assets; (v) long-term obligations and redeemable preferred stock; and (vi) cash dividends declared per common share [20].

(3) A meaningful discussion and analysis by management of the issuer's financial condition and results of operations, focusing in particular on liquidity, capital resources, and results of operations; favorable trends in the business; and the impact of inflation on the company.

(4) Certain information about the trading market for the company's stock [21].

This Uniform Disclosure Package must now be included in (i) the annual report to shareholders which accompanies each proxy and information statement or consent relating to the election of directors of publicly held companies; (ii) Form 10-K, as new Part II; and (iii) all registration forms under the Securities Act and the Exchange Act. Thus, the Uniform Disclosure Package is the interchangeable part of integration, the information which is the basis for continuous disclosure under the Exchange Act and episodic disclosure under the Securities Act. The Uniform Disclosure Package is supplemented in the Form 10-K by information called for by Parts I, III, and IV. Part I requires a detailed description of business, properties, and legal proceedings, some of which is duplicative of information included in an annual report to shareholders by reason of the requirement of Rule 14a-3(b) (5) to provide a "brief description of the business done by the issuer and its subsidiaries during the most recent fiscal year . . .". Part III provides certain information about officers and directors which must be incorporated from a company's proxy statement if it is filed within 120 days after the end of the issuer's fiscal year. Part IV requires the filing of certain exhibits and financial schedules to supplement the consolidated financial statements that are part of the Uniform Disclosure Package. Thus, the Uniform Disclosure Package, as supplemented by the other parts of Form 10-K, provides a total disclosure package of information available from the Commission to anyone who wants it [22].

3.3. Rationalizing the system of registration forms used under the Securities Act

Given the Uniform Disclosure Package, the questions now facing the staff of the Commission are:

(i) when must the Uniform Disclosure Package in Form 10-K or annual report

to shareholders actually be delivered to new purchasers of securities;

(ii) how often must it be updated, and what is the appropriate way to update it if change is necessary; and

(iii) what responsibility should underwriters have in the disclosure process if the Uniform Disclosure Package is incorporated into the prospectus from reports which the underwriters did not review before filing?

With respect to the first question, the Commission proposed in 1980 a new registration framework under the Securities Act which would build on the streamlining of the periodic reports accomplished by the Adopted Proposals. In this regard, there is a growing belief that for many companies the market quickly absorbs all information about a company from a variety of sources (only one of which is the Commission's mandated disclosure), which information is then reflected in the market price of the company's stock. Thus, when new securities are offered, all that needs to be furnished is information about the offering and material information about the company not previously disclosed. Purchasers can, if they wish, review information previously filed with the Commission [23].

In recognition of the validity of this proposition, the proposed registration framework (consisting of Forms A, B, and C) suggests that companies be divided into three categories. The category to which a company belongs would "determine the extent to which previously disseminated information would also be required in the prospectus or otherwise delivered to potential investors" [24]. Because of its prior impact on the market and to ensure its accuracy, information not actually included in the prospectus would nevertheless be incorporated by reference. The result of incorporation is of course that issuers, underwriters, and directors are as responsible for the information as they would be if the information were printed in the prospectus. However, incorporation by reference will permit registrants, particularly those eligible to use Form A, to streamline their registration statements. Thus, incorporation by reference is the mechanism by which integration of the two Acts is effected.

3.3.1. *Form A*

Form A is based upon Form S-16 with some variations. If eligible to use Form A, a company would disclose in its prospectus only (i) summary information about the company (that is, a brief description of the business, the selected financial data which is part of the Uniform Disclosure Package, and tabular presentation of dilution of the book value per share suffered by existing shareholders as a result of the offering); (ii) unreported material events; (iii) proposed use of proceeds from the offering; (iv) plan of distribution of the securities being offered; and (v) a description of the capital stock or debt being registered. Information from the most recently filed periodic reports filed would be incorporated by reference. Thus, the prospectus usually would be no more than ten to twelve pages and could be prepared quickly. Reducing the amount of time necessary to prepare the registration statement is critical in view of the volatility of our markets. Form A is proposed be available to companies (i) having an annual net income after taxes but before extra-

ordinary items of at least \$ 250,000 for three of the past four fiscal years, including the most recent one; (ii) having outstanding securities held by non-affiliates, the market value of which is \$ 50,000,000 or more; and (iii) that have not during the past 36 calendar months (a) failed to pay any dividend or sinking fund installment on preferred stock or (b) defaulted on any installment on material indebtedness for borrowed money, or on any rental on a material long-term lease. Companies using the Form may make primary debt or equity offerings to the public through firm commitment or best efforts underwritings [25]. Like all other companies, these companies would also be able to use the rule for delayed offerings (“shelf registrations”), proposed Rule 462A, which was recently published for comment [26].

As discussed above, eligibility to use Form A depends upon whether the eligible company is sufficiently followed in the marketplace by financial analysts and others such that repetitive disclosure is not necessary. It is not easy, however, to establish what the appropriate parameters are. On the one hand, the proposed Federal Securities Code of the American Law Institute, which would both codify and combine the Securities Act and the Exchange Act, takes an approach which, in the author’s judgment, is too simplistic; it suggests that all companies reporting for at least a year are presumptively followed and therefore should qualify [27]. On the other hand, the current requirements of Form S-16 were developed as a result of a limited survey of financial analysts conducted by the Advisory Committee on Corporate Disclosure some four years ago. These requirements focus only on the float, not on the trading volume in a security, the number of market makers with respect to the security or the number of round lot holders, all of which are also indicators of which stocks are widely followed. Moreover, because of the contraction of the brokerage community and therefore also of the number of financial analysts actively following the market — a result in part of the Commission having abolished fixed commission — the staff may be wary about recommending to the Commission substantially liberalized eligibility for use of Form A. In fact, the staff may recommend either raising the requirements with respect to net income, as well as perhaps adoption of a minimum assets test, or developing market criteria in addition to float.

3.3.2. Form B

Form B is based, to some extent, on existing Form S-7 and Form S-15 [28]. If eligible, a company would disclose in its prospectus the same information as would be included in a Form A prospectus. In addition, a company could either deliver with the prospectus its most recent annual report to shareholders (containing the Uniform Disclosure Package) or alternatively restate it in reasonable detail at least to the same extent as would be required in the preparation of an annual report by Rule 14a-3 [29]. Form B would be available for all companies (i) that do not qualify to use Form A; (ii) that have been reporting under the Exchange Act for at least three years; (iii) that have earnings after taxes but before extraordinary items for two of the last three fiscal years, including the most recent fiscal year; (iv) that have not

during the past 36 months defaulted on those obligations which would disqualify the issuer from using Form A; and (v) that do not have certain financial characteristics. The financial characteristics proposed for comment are: (i) decline in income from continuing operations of more than 50 percent for the past fiscal year as compared to the prior fiscal year; (ii) any material uncertainty concerning the issuer's financial position or results of operations which is or will be accompanied by a "subject to" opinion by the company's independent accountant; or (iii) the downgrading of a bond rating during the previous twelve months. Any type of offering could be made on the Form either directly by the issuer or through underwriters. Of course, companies otherwise eligible to use Form A could also choose to use Form B if they wanted more extensive information delivered to prospective purchasers.

Proposed Form B is the most important and innovative in the package. It would be available to a substantial majority of reporting companies that are not now eligible to use Form S-16. Since the market is presumed not to be efficient with respect to companies eligible to use Form B, the purchaser must receive more information than that called for by Form A. However, since the Uniform Disclosure Package has been developed, the company may either deliver a copy of its annual report to shareholders containing the Package, or if that would be too costly, simply restate or reproduce it. The approach taken in Form S-15, multiple delivery of documents, would thus be available for the first time on a wide scale for a variety of offerings.

Why was not the 10-K, which also contains the Uniform Package in Part II, selected to be delivered with the prospectus if multiple delivery of documents is contemplated? There are several reasons. First, its format is designed so that, for ease of reference and for sake of comparability, each item calling for a response is identified and information in response to each such item is in the same place for all companies. This result diminishes readability substantially. Second, the purpose of the Form 10-K, as revised in September, is to provide information which supplements the Uniform Disclosure Package. This supplemental information is geared to a different, more financially sophisticated audience, and, in order to control costs imposed upon issuers, is restricted to availability upon request. Information from the 10-K is, however, incorporated by reference into the prospectus because it is thought that the market has relied upon it in pricing the issuer's stock.

Eligibility to use Form B is proposed to be dependent upon the absence of certain financial characteristics on the theory that since Form B contemplates a substantial relaxation of the prospectus disclosure requirements, it should initially be open only to financially sound companies to see if the experiment will work. However, there has been strong criticism of the approach, suggesting that while such characteristics should perhaps require additional supplemental disclosure in Form B, the benefits of the Form should not be entirely denied to companies that have been reporting for at least three years. Moreover, there is some concern that the Commission may, through eligibility rules for registration forms, be branding certain

companies as financially troubled when there is no uniform agreement as to when a company is, in fact, experiencing, or can be expected to experience, financial difficulties.

3.3.3. Form C

Form C would be available for any type of offering by any company that is not eligible to use Form B or that has been reporting for less than three years. In either circumstance the disclosure required is the total disclosure package, restated from the 10-K in the prospectus in a format designed to make it more readable. Here, however, reporting companies may incorporate by reference information about a company's management from their proxy statements, the same way that such information is furnished in the Form 10-K.

3.4. Initiatives concerning timely disclosure

Integration as a system is premised upon the proposition that the market operates efficiently with respect to information about a company. To some extent such a market relies upon timely annual and quarterly reporting to keep it informed. However, there are major events which must be reported to the market promptly, before the date the periodic report is otherwise due, so that previous reports will not become stale. At present, however, except for the requirements imposed by certain stock exchanges and the National Association of Securities Dealers (NASD) discussed below, there are no definitive requirements for timely disclosures of material corporate events and the necessity for establishing such requirements deserves serious consideration. Absent such requirements, such information may be disclosed selectively, creating trading advantages.

The absence of such a definitive body of law was recently highlighted in the case of *State Teachers Retirement Board v. Fluor Corp.* [30] ("*Fluor*").

That case involved claims of fraudulent conduct under Section 10(b) [31] of the Exchange Act, as implemented by Rule 10b-5 [32], arising out of the Fluor Corporation's delay, for a period of ten days, of an announcement of the fact that it had been awarded a one billion dollar contract by the South African government. The requirement for the embargo on publicity had been placed in the contract by the South African government to allow it time to make the necessary financial arrangements with France. During the ten-day period rumors began circulating in the marketplace concerning a major development affecting Fluor, trading in Fluor's securities increased substantially, and their price rose rapidly, precipitating action by the New York Stock Exchange to suspend trading pending the announcement of the contract award. The plaintiff purported to represent the class of sellers who sold their stock during the hiatus between the award of the contract and its subsequent announcement. The District Court granted summary judgment for the defendants.

The District Court noted that there have been two traditional bases for a cause

of action under Rule 10b-5 for failure to disclose. The first such basis is present only when a corporate insider desires to trade while possessing non-public material information about the company [33] and has been described as an alternative duty rather than an absolute one: the insider must either disclose the corporate event, such as the mineral strike in *SEC v. Texas Gulf Sulphur Co.* [34], and then trade, or abstain from trading entirely. The other traditional basis is present when there has been a prior misstatement of a material fact by a corporation to its shareholders which was not corrected, thereby harming those shareholders selling on the basis of the misstatement [35]. The Court then pointed out that "[a] few courts, including the Second Circuit, have indicated that a duty to disclose may exist even in the absence of insider trading or misleading disclosure, but the issue has not been squarely presented" [36].

The Court then proceeded to examine whether a duty to disclose does, in fact, exist, stating:

Even in the absence of insider trading or prior inaccurate disclosures, this court believes a violation of Rule 10b-5(c) may arise from a failure to disclose where, as here, the rumors are rampant, the price of stock is shooting upward and the defendants are in possession of all the material facts but refrain from disclosing them. In such cases, liability could be imposed only upon a showing that the failure to disclose was motivated by defendants' intent to deceive investors for his own gain, since a *wrongful purpose* [emphasis added] is required to establish liability in a private action under Rule 10b-5 [37].

Furthermore, in discussing its "wrongful purpose" scienter requirement, which the District Court believed is necessary in a "timing of disclosure" case, it at least implied that a delay based on valid business purposes is an aspect of the scienter requirement — that is, if there were a valid purpose for delay, there would be no wrongful purpose which the plaintiff could show [38].

There seems to be general agreement that, prior to *Fluor*, no court had been squarely presented with the issue of the Rule 10b-5 duty to disclose absent insider trading or prior misleading disclosure [39], although there have been statements that any duty to disclose under Section 10(b) and Rule 10b-5 may be limited when necessary to preserve corporate business interests [40] or when the information is not yet "ripe" [41].

And, of course, the New York and American Stock Exchanges and the NASD all have clear requirements concerning timely disclosures [42]. The New York Stock Exchange *Company Manual*, which "codifi[es] [the] . . . policies, requirements, procedures, and practices of the Exchange relating to listed companies and their securities . . ." [43], sets forth the following disclosure obligations:

Timely and Adequate Disclosure of Corporate News

A corporation whose securities are listed on the New York Stock Exchange Inc. is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for those securities. This is one of the most important and fundamental purposes of the listing agreement which each corporation enters into with the Exchange. . . .

A corporation should also act promptly to dispel unfounded rumors which result in unusual market activity or price variations [44].

In its releases the Commission has recognized a broad duty to disclose and has encouraged a policy of prompt disclosure of material information even beyond those specific reporting requirements set forth in the Exchange Act. The seminal release (although not the earliest) in this area was Securities Act Release No. 33-5092 of October 15, 1970, aptly entitled "Timely Disclosure of Material Corporate Developments". The relevant language of that release, which has been repeated in a number of subsequent releases, is as follows:

Notwithstanding the fact that a company complies with such reporting requirements [Exchange Act requirements], it still has an obligation to make full and prompt announcements of material facts regarding the company's financial condition . . .

Not only must material facts affecting the company's operations be reported; they must also be reported promptly. Corporate releases which disclose personnel changes, the receipt of new contracts, orders and other favorable developments but do not even suggest existing adverse corporate developments do not serve the public needs and may violate the anti-fraud provisions of the Securities Exchange Act of 1934, and in the case of a registered investment company or other issuer making a continuous offering of its shares may also violate the Securities Act of 1933 if the prospectus is not appropriately updated.

The policy of prompt corporate disclosure of material business events is embodied in the rules and directives of the major exchanges. It should be noted that unless adequate and accurate information is available, a company may not be able to purchase its own securities or make acquisitions using its securities, and its insiders may not be able to trade its securities without running a serious risk of violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

To date, however, the Commission has never expressly stated in a release that a corporation would be liable under the anti-fraud provisions or any other provisions of the securities laws *solely* for the *failure to disclose* such material information, and has never passed a rule mandating such disclosure under the Exchange Act. Other than the minimal Form 8-K and 10-Q provisions neither the Exchange Act nor the Securities Act (nor the rules promulgated thereunder) contain express requirements for prompt disclosure of significant corporate events. The closest that any of the Commission Rules come to such a provision is the rather oblique reference contained in the virtually identical provisions of Exchange Act Rule 12b-20 and Securities Act Rule 408 which state:

In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

As currently constituted, the Form 8-K, the form on which disclosure of a significant corporate event generally would be made, asks for disclosure of only five

categories of events in addition to containing one general, or “open”, item. The five categories are: (1) changes in control of registrant; (2) acquisition or disposition of assets; (3) bankruptcy or receivership; (4) changes in registrant’s certifying accountant; and (5) resignations of registrant’s directors. The general, or “open” item, entitled “Other Materially Important Events”, does not require any disclosure but leaves the option with the registrant [45].

Thus, to the extent the Commission is increasing its reliance on the periodic flow of information under the Exchange Act, it must address with redoubled concern the question of timely disclosure. But the question itself raises difficult questions, especially under what circumstances and for what purposes a company can delay disclosure. The Commission could rely upon the foregoing rules of the stock exchanges, but there is a serious question as to whether a plaintiff could sue and recover if those rules are violated [46].

3.5. Responsibility of underwriters

Section 11 of the Securities Act provides that every underwriter shall be liable for any material misstatement or omission in a prospectus unless it can show that it

had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading [47].

This clearly contemplates that the issuer and the underwriter would prepare a document containing the information required by Schedule A, and because the underwriter was responsible for its accuracy it would verify it through a reasonable investigation. Integration, however, results in the information required in the prospectus being incorporated from a periodic report prepared by the issuer without necessarily the involvement of the underwriter. However, the underwriter has responsibility for that information as if it were set forth verbatim in the prospectus, and if the underwriter is uncomfortable with the level and quality of disclosure it is faced with a dilemma: insistence on improvement may suggest the prior filing was deficient thereby inviting litigation; failure to make the change, however, may increase the risk of liability.

If a regular relationship with the issuer existed, of course, the underwriter could involve itself in the preparation of the Form 10-K, in anticipation of an expected filing. However, issuers today appear to be relying less on traditional underwriters’ relationships, and are asking for competitive bids on offerings. As a result, it is becoming less likely that an underwriter will have participated in the preparation of the incorporated documents. Moreover, by reason of incorporation, the preparation time for registration statements has been sharply reduced, thus requiring underwriters to do substantially all of their scrutiny before the preparation even begins. Yet because preparation time is so short for the new registration statements and

because issuers perceive the markets as increasingly volatile, there is pressure to complete offerings, from initial discussion to final closing, in very short time periods, further curtailing the time underwriters may spend scrutinizing the documents. Thus, through liability provisions, underwriters may insure the accuracy of the disclosure but, according to the Securities Industry Association (SIA) and others, they will have virtually no role in verifying its accuracy as contemplated by Section 11. Market forces and competitive pressures are such that steps which have increased the speed with which offerings may be made are not likely to be cut back. The SIA and others therefore have urged the Commission to acknowledge the changed position in which integration has placed them, and to adopt a rule to the effect that in deciding whether an underwriter satisfied its due diligence obligation with respect to a misstatement in a document incorporated by reference, a court should take into account whether it was responsible for preparation and filing of the document. The first such recommendation was that of the Advisory Committee on Corporate Disclosure. In 1977 the committee recommended that the Commission adopt the following rule when the registration statement includes material incorporated by reference:

In determining what constitutes reasonable investigation or care and reasonable ground for belief under the Securities Act of 1933, of information incorporated by reference into a registration statement or prospectus, the standard of reasonableness is that required by a prudent man under the circumstances, including (1) the type of registrant, (2) the type of particular person, (3) the office held when the person is an officer, (4) the presence or absence of another relationship to the registrant when the person is a director or proposed director, (5) reasonable reliance on officers, employees, and others whose duties should have given them knowledge of the particular facts (in the light of the functions and responsibilities of the particular person with respect to the registrant and the filing), (6) the type of underwriting arrangement, the role of the particular person as an underwriter, and the accessibility to information with respect to the registrant when the person is an underwriter, (7) the type of security, and (8) whether or not, with respect to information or a document incorporated by reference, the particular person had any responsibility for the information or document at the time of the filing from which it was incorporated [48].

The Advisory Committee urged the Commission to adopt such a rule "in order to encourage the use of the short form registration statements, and taking into account the practical problems confronting underwriters and others while balancing the need for appropriate liability standards" [49]. The Commission did not adopt such a rule when it implemented rules broadening the use of Form S-16. It did indicate, however, that it would ask the staff to study the issue.

In response, the SIA asked the Commission to adopt a rule it proposed and pending the adoption of the rule to suspend the effectiveness of the proposal to extend the Form S-16 to primary offerings. Its proposed rule was as follows:

In determining whether an underwriter has made a reasonable investigation, exercised care or had a reasonable ground for belief under the Act with respect to a registration on Form S-16 relevant circumstances include (1) the type of registrant, (2) the type of security, (3) the type

of underwriting arrangement, the role of the underwriter and the accessibility to information with respect to the registrant, and (4) with respect to information or a document incorporated by reference, the fact (if such is the case) that the underwriter had no responsibility with respect to the information or document at the time of filing from which it was incorporated [50].

In May 1978 the Commission rejected the rulemaking petition and declined to delay the effective date of Form S-16. It did state, however, that, in its judgment, a court in determining liability would consider all facts and circumstances (including incorporation by reference) surrounding the underwriter's participation in the offering. Thereafter, the SIA submitted the following modified proposal:

Examination by Underwriters of Registration Statements on Form S-16.

In connection with a registration statement on Form S-16 and related prospectus, an underwriter shall be deemed to have conducted a reasonable investigation and to have reasonable ground for belief for purposes of Section 11, and to have exercised reasonable care . . . if the underwriter (1) has read the registration statement, including all exhibits and documents incorporated therein by reference, (2) has discussed the registration statement with responsible representatives of the registrant, and of any persons named therein as an expert, and (3) after such reading and discussion, does not know of any untrue statement of a material fact in such registration statement or any omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading. Nothing in this Rule shall alter or affect in any way the responsibility or potential liability under any other provision of the Federal securities laws of any underwriter of securities included in a registration statement on Form S-16 [51].

The approach is similar to the approach taken in the proposed Federal Securities Code of the American Law Institute, which provides, among other things, that a defendant is liable for misrepresentations and material omissions contained in registration and offering statements unless "the defendant, after reasonable investigation, reasonably believed . . . that any fact or document incorporated by reference did not contain a misrepresentation at that time", and that the applicable standard of reasonableness "is that required of a prudent man under the circumstances in the conduct of his own affairs", and lists as a relevant factor in making this determination "whether, with respect to a fact or document incorporated by reference, the particular defendant had any responsibility for the fact or document at the time of the filing from which it was incorporated"[52].

The Division recognizes the changes in underwriter practices which result from integration, and which may result if a company registers under proposed Rule 462A securities it anticipates selling through unidentified underwriters in the following two-year period. As one response, the Division has inquired as to whether there should be some minimum time between filing and effectiveness of a short form registration statement to provide adequate time to complete due diligence [53]. Moreover, it recently acknowledged underwriters' concerns about incorporation by reference:

Comments at the time Form S-16 was amended to allow primary offering use prompted the Commission to propose certain amendments to Form S-16 which it hoped would alleviate

somewhat the concerns of underwriters over potential Section 11 liability for issuers' Exchange Act filings which they had not helped prepare, but which are incorporated by reference into Securities Act registration statements. Specifically, the Commission proposed amendments to Form S-16 which would: (1) deem the effective date of documents incorporated by reference into registration statements on that Form to be the date of the document's initial filing with the Commission; (2) deem a statement in a document incorporated by reference into the registration statement on that Form not to be part of the registration statement if the statement has been modified or superseded in the registration statement or in subsequently filed documents which are incorporated by reference into a registration statement on that Form; and (3) provide that the making of a modifying or superseding statement shall not be deemed an admission that the modified or superseded statement constituted a violation of the federal securities laws. These proposed amendments were in response to the concern that, because Section 11 imposes liability for statements misleading or untrue when the registration statement becomes effective, liability could be asserted based on Exchange Act documents accurate when filed but subsequently outdated. In addition, they dealt with what underwriters feared would be a reluctance by issuers to accept recommendations to change disclosure in Exchange Act filings because the issuers would not want to admit a deficiency in the original filing.

The Commission believes that further consideration of the proposed amendments to Form S-16 is warranted in connection with the proposed Securities Act disclosure system. Therefore, the Commission has included these proposals as provisions in the relevant incorporation by reference items [Item 8 of Form A, Item 9 of Forms B and C] in all three proposed forms. Although the original proposals to Form S-16 are being withdrawn, the Commission believes that additional public comment in the context of this release is necessary to assist it in determining whether the proposals represent a reasonable and prudent approach to the liability problems relating to incorporated documents [54].

However, it is not clear whether the Commission, absent the revisions of the Code, should act at this time to define what constitutes due diligence. To the extent that the short form may be used only by companies with respect to which the market is purportedly efficient, underwriters and other market participants already have adequate information about the issuer. Moreover, the speed of preparation by the issuer and the time needed by the underwriters are really separate issues, and the latter is not affected by the former. On the other hand, the market cannot necessarily distinguish between true and false information, and the role of verification is important, as recognized by the Commission when it imposed the requirement that Form 10-K be signed by a majority of the Board of Directors. Thus, the Commission may have to investigate whether integration, or competitive pressures, are causing the problem.

4. Division operations as Exchange Act reports become the backbone of disclosure

All of the initiatives and proposed registration forms discussed above, to a greater or lesser extent, rest upon periodic reporting. With this expanded emphasis on integration, the Division of Corporation Finance must change its approach to how it reviews the over 60,000 disclosure documents filed with it each year under the Securities Act and the Exchange Act.

4.1. Workload and constraints on staff size

In the past, the Division's review operations have been committed primarily toward reviewing registration statements filed under the Securities Act. Each registration statement was intensely reviewed and it was expected that the quality of disclosure resulting from the review process would carry over and improve the quality of the Form 10-K and the proxy statement, so that, taken together, they would be equivalent to the prospectus.

However, this approach ignored the fact that most companies reporting by reason of the provisions of the Exchange Act do not necessarily finance each year, yet the market trades back and forth in great volume based in part upon the presumed accuracy of periodic information which has not been reviewed by the staff. Moreover, as reporting under the Securities Act and Exchange Act is integrated, resulting in a slimmer prospectus to avoid overlap with periodic reporting, careful disclosure oversight of periodic reports has to be assured, an oversight that should not necessarily be triggered solely by a Securities Act filing. However, this creates a great dilemma for the staff because there are far more periodic reports filed than registration statements. In 1980, for example, 3,299 registration statements were filed, of which 601 were initial public offerings by previously private companies. This represented a substantial increase from 1979, when 2,560 registration statements were filed, of which 480 were initial public offerings. But even with the increase, the number in 1980 is much less than the over 8,000 Forms 10-K filed in 1980.

As previously mentioned, the staff could choose to review only those Forms 10-K of companies which file registration statements for public offerings at the time they are filed. Such an approach, however, would be no different from the old one (except that two documents, not one, would be involved). Registration of securities would be the only time for disclosure oversight, even though the value of the securities registered would usually be an extremely small percentage of the market value of the securities traded during the course of the year. It has been estimated that in 1979 the dollar value of equity securities traded in United States secondary markets was about \$345 billion, and the same figure for corporate debt securities would be far greater. In contrast, the dollar value of equity and debt sold in underwritten public offerings in 1979 was about \$36 billion. Thus, if we are to increase reliance on periodic reporting to expand the benefits of integration and yet oversee the result, we must take time away from review of registration statements in order to review periodic reports, whether or not a company is financing. Yet, as the staff tries to do this, its problems are compounded, for the number of registration statements itself is dramatically increasing while the resources of the Division have diminished seriously. For example, in 1962 the Division received 18,000 filings under both Acts which were reviewed by a professional staff of 142 financial analysts, accountants, and attorneys. The figure rose to 55,000 in fiscal 1980 but the review staff has declined to 100. The review staff constitutes 80% of the Divi-

sion's personnel. And, although the staff is talented, it is becoming younger, and the turnover rate is increasing because of the growing inability of the Commission to provide salaries that are competitive with the private sector.

4.2. Selective review

The Division does not have now, and does not expect to have in the foreseeable future, adequate staff to review all major filings under the Securities Act and the Exchange Act. Thus, its recent major initiative has been to switch to a system of selective review. A filing will either be reviewed or not; there will be no intermediate stages. Moreover, selective review will be applied to filings under both Acts, because it is imperative that the staff provide disclosure oversight over periodic reports filed under the Exchange Act if integration is to function successfully. Disclosure under the Securities Act has tended to be more comprehensive and of a higher quality, primarily because of the liabilities attaching to it by reason of Section 11 of the Securities Act as well as the involvement of professionals such as underwriters, accountants, and counsel. To the extent these professionals are not so involved in the preparation of periodic reports, one runs the risk of lower quality. For this reason, in part, the Commission recently required that the Form 10-K filed annually be signed by not only the chief executive and financial officer but also by a majority of the Board of Directors [55]. Also, the staff will have to increase its surveillance under the selective review program.

Even under selective review, however, all of some classes of filings must be reviewed. Thus, any filing with respect to (i) an initial public offering by a private company; (ii) a transaction between affiliates resulting in one company ceasing to be a reporting company (so-called "going private" or Rule 13e-3 transactions); (iii) initial registration statements on Form 10 or Form 20-F under the Exchange Act with respect to a class of equity securities; (iv) tender offers [56]; and (v) proxy contests [57], will be reviewed. All other classes of filings will be subject to a sampling, with the filings being selected based in part upon criteria applied at the beginning of each fiscal quarter. Such criteria will have to take into account that filings do not come in at the same rate throughout the year. For example, the bulk of Forms 10-K and proxy statements are filed during February, March, and April because of the numerous companies with fiscal years ending on December 31. The volume of registration statements depends more and more upon the nature of the market, which is becoming increasingly volatile. Because affirmative staff action must ordinarily be taken with respect to a Securities Act filing [58], a company will be notified promptly as to whether or not the filing will be reviewed. If no review is scheduled, the participants in the offering will be alerted to the fact that they are solely responsible for the accuracy of disclosure. The company will ordinarily be allowed to proceed with its offering at the time it selects. No such notification will be provided, however, with respect to periodic reports. If there is a review, and questions are raised, a letter of comment will be sent to the issuer.

A shift in emphasis to Exchange Act filings to firm up the underpinnings of integration will also result in a change of emphasis in the way in which the review must be conducted. Under the Securities Act, staff review is provided while the document is in preliminary form. After such review, the effective date of the registration statement is usually accelerated under Section 8(a) of the Securities Act. Thus, the issuer is quite willing usually to make changes suggested by the staff, so that the effective date will be accelerated and the offering can begin; the staff can focus on improving the quality of the disclosure and not deliberate extensively as to whether each individual suggested comment deals with a material item. However, save for the case of proxy voting materials, Exchange Act documents are filed in final form. There is no opportunity for preliminary review and comment by the staff. As a result, issuers are far more reluctant to make changes because any amendment might imply that the initial filing was defective, which is especially troublesome if such initial filing were incorporated by reference into a prospectus [59]. This problem of course is exacerbated to the extent that the required disclosure appears in the annual report to shareholders and is incorporated into Form 10-K [60].

Thus, the staff will have to be more imaginative and conservative in its review. With respect to comments which would improve disclosure, but are not necessarily significant, it will be suggested that the subsequent filings incorporate responses to comments, what the staff refers to as "future comments". Truly material misstatements will have to be corrected if discovered; however, the staff must satisfy itself that the omission or misstatement is such that amendment is necessary.

This approach is not, of course, a perfect response. There is, no doubt, an increased risk of undetected and undeterred fraud. However, it is the only realistic response in light of prevailing attitudes that the role and size of the government workforce be reduced.

4.3. Stewardship of staff resources

The Division has taken several steps to allow it to reallocate resources to the review of periodic reports. First, it has tried to improve the professionalism of the staff. Up until 1980, companies were assigned randomly, at the time of their initial public offerings, to one of 15 branches. Thus, a branch might have several hundred companies in disparate industry groupings. It was, because of the variety involved, therefore difficult regularly to develop much expertise about any given industry, notwithstanding that branch personnel might know a particular company fairly well. To enable the branches to become more expert in industries and their problems, it was decided to group reporting companies by 35 industry groups based upon issuer SIC codes assigned by the Department of Commerce and, after consolidating the branches into units of optimum size, to allocate the 35 industry groups among ten branches. In addition, the Division began programs to invite financial analysts and other specialists in to advise the branches about current industry trends and problems.

Second, a new office was created: the Office of Operating Procedures and Review. The primary function of this office is (i) to establish selective review procedures to be applied on a consistent basis by branch personnel; (ii) to develop training material for new employees; (iii) to conduct training sessions on new disclosure rules or developments; and (iv) to review, after the fact, branch operations to see that reviews were in fact conducted adequately in accordance with Division policy.

Third, the Division has tried to eliminate the review of routine filings and to develop new procedures designed to save the valuable time of the staff. As an example of the attempt to eliminate review of routine filings, it was decided that filings on Form S-8, the registration form used when securities of a company are offered to its employees pursuant to a variety of employee benefit plans, did not pose significant disclosure issues, in part because the plans had become standardized and in part because it could be presumed that most employees were able to evaluate the disclosures and risks with respect to their employer. Thus, initial filings registering securities to be offered under the plans now become effective automatically 20 days after filing as provided in Section 8(a) of the Securities Act, and any post-effective amendments necessary to update the prospectus become effective immediately upon filing [61]. Since there were some 3,000 of these filings during fiscal 1980, staff time saved was substantial. In addition, new time-saving procedures include the recently initiated endorsement procedure for no-action letters. For years, the Division has communicated its views to the public on certain sections of the Securities Act through what are known as "no-action" letters. In a letter to the staff an entity will describe a proposed course of action and will solicit the staff's view as to whether, if such action were taken, the Division would deem it a violation of law and therefore recommend that the Division of Enforcement take appropriate remedial action. If the staff is of the view that the proposed course of action would be lawful, it would indicate that it would not recommend any such action by the Enforcement Division. In the past, the staff has, in responding to each letter, tried to condense and restate the salient facts from the requesting letter before indicating its views. Such an approach, however, consumed many hours of professional staff and clerical time; in fiscal 1980 over 1,500 letters were responded to by the Division's Office of the Chief Counsel. Thus, a new procedure was developed based upon a similar approach recently implemented by the Division of Investment Management. The staff's response will be typed and then affixed to the letter requesting its views, that is to say, the staff will respond by endorsement. Such an approach is not as preferable as the former practice because it makes it far more difficult to highlight which facts or circumstances the staff of the Division believes are particularly important to its decision. However, the prior approach was a luxury the staff can no longer offer to the public.

5. An assessment of the regulatory status

At a time so soon after the taking of these major decisions, for a writer so intimately involved with their development to make an attempt at full assessment would be premature and perhaps impossible. But certain implications of the solution of statutory integration seem to be fairly evident and ought to be singled out for thought and comment.

5.1. *Implications for the bar*

The plain consequence of the Division's course is that the practicing lawyer will have to be somewhat more self-reliant in advising on federal securities matters. This is to be expected in a government environment in which manpower resources will be scarcer generally, and in which the Commission has moved specifically to selecting only some filed documents for review.

However, this alteration is one of degree; the close dialogue between Commission staff and the bar has been a strength of federal securities regulation. Actually, with nearly 50 years of experience with the disclosure philosophy embodied in the Securities Act and Exchange Act, a trend emphasizing self-reliance is to be expected. A practical and imminent result will be emphasis within the Disclosure Operations staff of the Division upon rejecting wholly inadequate submissions (through use of a "bedbug" letter, which will refuse to process the filing), on the theory that the Commission cannot afford resources to serve, in effect, as a company's counsel in the work of assembling an adequate presentation of disclosure [62].

A second practical effect will be the need for counsel to undertake generally far more careful planning than was typical in the 1960s and 1970s with regard to a timetable for preparing a document for filing. This will be important under the Exchange Act because Exchange Act reports have a heightened role in the disclosure system now, and can be incorporated by reference into Securities Act filings. Under the Securities Act, planning and timing can prevent "bedbugs". Also, timing will have to allow for the company's being selected for review — a review that is facilitated where there are no late or omitted Exchange Act filings and, where applicable, there are previous well-prepared Exchange Act filings which have been incorporated by reference.

Most importantly, the need of client companies to be able to move as quickly as possible to market with new offerings and the fiscal constraints on manpower in the Commission staff create a need for a continued and active dialogue between the bar and the staff on innovations and new procedures for submitting disclosure. One potential example in this regard is broadened use of data and word processing technology. Possible areas for exploration could be computer-readability of parts of some submissions [63] or, conceivably, direct electronic transmission of filings data.

5.2. Implications for the researcher in regulatory law

Certain fundamental aspects of the SEC's history specifically apply to this "case study" on integration. They should be indicated before more technical assessments are made. First, the rapport between staff and bar has long facilitated change in the rule structure under the securities acts when needed. One principal reason for this rapport is that the bar itself has a major role in implementing the disclosure provisions of the Acts, since access to civil remedies by private litigants has fostered much self-help by private parties and their attorneys [64].

Also important is the fact that the disclosure regime enjoys popular support. As pointed out by Lloyd Cutler, former Counsel to the President, few citizens dissent from the view that honest, material disclosure is a good thing [65]. This popular acceptance is not so prevalent in the case of direct economic regulation. With popular acceptance there is, to some extent, a relatively high consensus among company management, investors, bar, and staff achieving a worthwhile objective — fair disclosure in the sense of reporting material facts.

A corollary of the fact of this consensus, and of the use of private civil remedies, is that the Commission and Division staffs are not large. The Commission is a small agency, numbering barely 2,000 employees in a government where departments can number in the tens or hundreds of thousands of employees. And growth has been slight. In 1940 the staff was 1,670. In 1980 there are triple the number of reporting companies and ten times the daily stock trading volume, but the number of the Commission employees has hardly grown [66]. This small size permits the Division to coordinate easily within itself, to reach decisions relatively quickly, and to keep a high proportion of very able staff.

All of these attributes can be said to flow, in general, from the fundamental policy of confining federal interdiction in the flow of securities to disclosure (except with regard to stock exchanges and certain financial intermediaries).

The rapid pace of change in information technology makes it hard to keep up with the new possibilities for analysis and data use, and there is also steady pressure for getting the most out of currently available information technology.

These are all complex matters, and their successful resolution draws as heavily upon the traditional management disciplines as upon the traditional legal disciplines. One thing does seem clear: schooling in either set of disciplines can do only so much; the key is experience. This suggests a need for assuring that when possible young professionals be brought into the Division at levels where they can develop managerial as well as legal skills. This effort has been a priority within the Division.

A central problem in the Division's day-to-day regulatory work has been keeping up with changes in the financial world and making prompt adjustments in disclosure rules that are warranted by the changes. How does a professional staff organize itself so as to (a) anticipate and respond to a relatively rapidly changing environment (the financial industry) and (b) keep up a steady, high quality pace of production, in terms of review of filings and writing and testing of new rules? This prob-

lem has been an explicit target of analysis in the Division, and the current organization and workflow for implementing integration have been tailored with the problem in mind. How do we judge results? Should changes in the organization be made?

Perhaps the most vexing question from the point of view of regulatory research has been the task of keeping the staff that is implementing integration sensitized to developments in the court decisions and actions of other government agencies which materially affect the reporting companies. This refers to the disclosures on these subjects that are contained within filings processed by the Division. It is a much easier task to monitor at a general level in the Federal Register and the court reporters for developments in administrative law that affect the Division. It takes high quality manhours to cross-correlate the filings within and among industries in order to detect important court and agency developments as they specifically affect industry. In the Division, the financial analysis staff is focusing on this work.

6. Conclusion

In the next two years integration will be substantially implemented, thereby accomplishing a revolution with respect to the relationship between the Securities Act and Exchange Act. Just as dramatically, the methods of operation to be followed by the Division will have been changed, as the Commission adapts to the volatile market of the 1980s.

Notes

[1] 15 U.S.C. § 77a–77aa (1976 and Supp. III 1979).

[2] 15 U.S.C. §§ 78a–78kk (1976 and Supp. III 1979).

[3] The items are specified in Schedule A, an integral part of the Act. The Schedule lists 32 specified disclosures, including, *e.g.*, the names of directors and principal executives, the specific purposes of the funds to be raised by the registered securities, and detailed financial statements.

[4] Form 10-K must contain certified financial statements, description of the business and activities of the issuer, and other information, including a listing of directors, senior executives, and management remuneration; Form 10-Q contains unaudited quarterly financial statements and management's analysis of material changes in certain financial categories (no report is required in the fourth quarter, since the annual report on Form 10-K is due); Form 8-K requires reports of material changes to be made in certain situations (such as changes in control, bankruptcy, and change in accountants), and gives management discretion to make timely disclosure of other information which management deems of material importance to security holders.

[5] Address by Harold M. Williams, Chairman of the Securities and Exchange Commission, Commission Awards Ceremony, December 18, 1980.

[6] Securities and Exchange Commission, Proposed Comprehensive Revision to System for Registration of Securities Offerings, Securities Act Rel. No. 33–6235, Sept. 2, 1980, *contained in* 45 Federal Register 63693, at 63694, Sept. 25, 1980 [hereinafter cited to Federal Register, as ABC Release].

[7] Cohen, "Truth in Securities" Revisited, 79 Harv. L. Rev. 1340, 1341 (1966).

[8] ABC Release, *supra* note 6, 45 Federal Register at 63694–98.

[9] *Id.* at 63694.

[10] *Id.*

[11] *Id.*

[12] This is particularly true with regard to the Form 10-K annual report, which has steadily been the subject of commentary and analysis as a vehicle for additional disclosure requirements. *See generally*, House Comm. on Interstate and Foreign Commerce, 95th Cong., 1st Sess., Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission 425–28, 470–96 (Comm. Print 1977); Securities and Exchange Commission, Disclosure to Investors: A Reappraisal of Administrative Policies under the '33 and '34 Securities Acts (1969) 328–56, App. X-1 (the "Wheat Report").

[13] *See* Sections 12(g), 13(a) and 13(b)(1), and 15(d) of the Exchange Act. In general, these sections require that a company that files a registration statement which becomes effective under the Securities Act of 1933 or a company which has \$ 1,000,000 of assets and any class of non-exempt equity securities held by more than 500 persons, prepare and file periodic reports with the Commission. The number of firms eligible to use the new integrated approach to filings under the two Acts has been hard to determine exactly because of difficulties in collecting and cross-correlating all the eligibility data, for example as to debt service.

[14] Securities and Exchange Commission, Proposed Revision of Form 10-Q, Quarterly Report, Securities Act Rel. No. 33–6236, Sept. 2, 1980, *contained in* 45 Federal Register at 63724, Sept. 25, 1980. As explained therein, under the proposal the structure of Form

10-Q would be essentially the same as the present form . . . the interim financial information and management's discussion and analysis . . . would not be deemed filed for purposes of [Exchange Act] Section 18 . . . [but] Part II of the form is proposed to be amended to eliminate certain items which may provide duplicative disclosure

[15] *See, e.g.*, State Teachers Retirement Board v. Fluor Corp., [1979–80] CCH Fed. Sec. L. Rep. ¶ 97,340 (S.D.N.Y. 1980), *appeal pending*, No. 80–7592 (2d. Cir.). The Division staff

is evaluating the circumstances typified in cases of current reporting obligations in order to see if further Commission guidance is necessary.

[16] Securities and Exchange Commission, Amendments to Annual Report Form, Related Forms, Rules, Regulations, and Guides; Integration of Securities Act Disclosure Systems, Securities Act Rel. No. 33-6231, Sept. 2, 1980, *contained in* 45 Federal Register at 63630, Sept. 25, 1980 [hereinafter cited to Federal Register, as 10-K Release].

[17] Securities and Exchange Commission, Uniform Instructions as to Financial Statements - Regulation S-X, Securities Act Rel. No. 33-6234, Sept. 2, 1980, *contained in* 45 Federal Register at 63682, Sept. 25, 1980.

[18] *Id.*

[19] Securities and Exchange Commission, Business Combination Transactions - New Short Form for Registration and Related Rule Amendments, Securities Act Rel. No. 33-6232, Sept. 2, 1980, *contained in* 45 Federal Register 63647, Sept. 25, 1980.

[20] Also with respect to financial data, the Commission is considering a proposal to amend Regulation S-K to provide revised and standardized requirements for presenting the ratio of earnings to combined fixed charges and preferred dividends and, if required, the ratio of earnings to fixed charges. *See* Securities Act Rel. No. 33-6196, March 7, 1980.

[21] New Item Nine of Form 10-K calls for the information required in Item Nine of Regulation S-K: identification of the principal market or markets where the registrant's common stock is traded; approximate number of common shareholders; frequency, amount, and restrictions on present or future ability to pay dividends; statement as to whether the current dividend policy will be continued. 10-K Release, *supra* note 16 at 63640, 63643.

[22] As conceived, the Form 10-K feeds detailed information into the market generally through the fact of its public filing and availability at the Commission. Thus, even as to companies that are not widely followed, the investor can in theory rely upon the detailed data of the filed Form 10-K to have been absorbed by other market participants and to be reflected in the security's price. On this view the investor would be satisfied to receive only the minimum disclosure package as contained in the company's annual report to shareholders. If the shareholder wishes to see the detailed data in complete form, though, he can always request the Form 10-K. 10-K Release, *supra* note 16, at 63631.

[23] *Id.* and ABC Release, *supra* note 6, at 63693-701.

[24] ABC Release, *supra* note 6, at 63698.

[25] Also, as proposed, the "form may be used for the registration of securities of a majority-owned subsidiary which are fully guaranteed as to principal and interest by its parent", notwithstanding the failure of the subsidiary to meet the conditions for use if the parent meets the conditions for use of Form A. The parent then acts as guarantor and co-issuer. *Id.* at 63709. In general, requirements as to aggregate market value of the voting stock held by non-affiliates do not apply to secondary offerings of securities which are listed on a national securities exchange or quoted on the automated quotation system of a national securities association or to offerings of certain closed end management investment companies. *Id.* at 63710.

[26] Proposed Rule 462A provides that companies eligible to use Form A would not have to file post-effective amendments containing material information if such information is included in the company's periodic reports filed under Section 12 or Section 15(d) and is incorporated by reference in the shelf registration. However, a post-effective amendment would still be required if the information actually included in the prospectus and delivered to investors was materially misleading. Proposed Revision of Regulation S-K and Guides for the Preparation and Filing of Registration Statements and Reports, Securities Act Rel. No. 33-6276, Dec. 23, 1980, *contained in* 46 Federal Register 78 at 88, Jan. 2, 1981.

[27] The American Law Institute, *Federal Securities Code Proposed Official Draft*, xxxii, Sections 299.16, 512(c); 1978 [hereinafter cited as ALI Code].

[28] When adopted in 1967, Form S-7 "was envisioned as a simplified form for registration

of securities to be offered for cash by companies subject to the reporting requirements of the Exchange Act and having long records of earnings and stability of management and business". ABC Release, *supra* note 6, at 63696. Simplifications included omission of such Form S-1 items as parents of registrant, description of property, and pending legal proceedings. Eligibility for use of Form S-7 has been successively broadened, including use for exchange offers. Currently, the general requirements are that the issuer have (1) a class of securities registered under Section 12 of the Exchange Act or be required to file reports under Section 15(d); (2) filed all reports for three years, and timely filed in the last year; (3) no defaults on any debt or sinking fund installment on preferred stock; and (4) earnings of at least \$ 250,000 for three of the last four years.

[29] ABC Release, *supra* note 6, at 63706.

[30] [1979–1980] CCH Fed. Sec. L. Rep. ¶ 97,340 (S.D.N.Y. March 28, 1980) *appeal pending*, No. 80–7592 (2d Cir.).

[31] 15 U.S.C. § 78j(b) (1976).

[32] 17 C.F.R. § 240.10b-5 (1980).

[33] *Fridrich v. Bradford*, 542 F.2d 307, 318 (6th Cir. 1976), *cert. denied*, 429 U.S. 1053 (1977).

[34] *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969).

[35] *Id.* at 862.

[36] *State Teachers Retirement Board v. Fluor Corp.*, *supra* note 30, at 97,252.

[37] *Id.*

[38] *Id.* at 97,253.

[39] There are suggestions that such a duty exists. See *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*, 474 F.2d. 514, 521 (10th Cir.) (en banc) (per curiam), *cert. denied*, 414 U.S. 874 (1973).

[40] In *SEC v. Texas Gulf Sulphur Co.*, *supra* note 34, at 850 n. 12, the court stated:

The timing of disclosure is a matter for the business judgment of the corporate officers entrusted with the management of the corporation within the affirmative disclosure requirements promulgated by the exchanges and by the SEC. Here, a valuable corporate purpose [securing options on the mineral laden properties] was served by delaying the publication of the [mineral] discovery.

[41] In *Financial Industrial Fund, Inc. v. McDonnell Douglas Corp.*, *supra* note 39, at 519, the Second Circuit stated:

information about which the issues revolve must be "available and ripe for publication" before there commences a duty to disclose. To be ripe under this requirement, the contents must be verified sufficiently to permit the officers and directors to have full confidence in their accuracy.

[42] So do other exchanges, such as the Boston Stock Exchange. See *Boston Stock Exchange, Rules of the Board of Governors, Supplement to Chapter XXVII, Informing the Public, Timely Disclosure*, CCH BSE Guide ¶ 2265 at 2258; the *Midwest Stock Exchange, Midwest Stock Exchange Rules, Policy on Informing the Public, Article XXVIII, Rule 7, Interpretation .01*, CCH MSE Guide ¶ 1898 at 2133. The by-laws of the NASD provide in Art. XVI, § 3, Schedule D, part II, paragraph B.3b for suspension or termination of a security's listing on NASDAQ if: "there shall have been a failure by the issuer promptly to disclose to the public through the press any material information which may affect the value of its securities or influence investors' decisions [..]. CCH NASD Manual ¶ 1653A at 1140.

[43] *Introduction*, Company Manual, New York Stock Exchange, Inc., at 1138.

[44] *Id.* §A2 at A-18.

[45] As presently constituted, Form 10-Q, the quarterly report, requires registrants to disclose, but only on a quarterly basis, a number of "current events": (1) legal proceedings; (2) changes in securities; (3) changes in security for registered securities; (4) defaults upon senior securities; (5) increase in amount outstanding of securities of indebtedness; (6) decrease in amount outstanding of securities or indebtedness; and (7) submission of matters to a vote of security holders. Form 10-Q also contains an "Other Materially Important Events" item, as in Form 8-K. It should be noted that in the proposed revision to Form 10-Q, *supra* note 14, three items in the existing Form 10-Q are proposed to be deleted: changes in security for registered securities; increase in amount outstanding of securities or indebtedness; and decrease in amount outstanding of securities or indebtedness.

[46] It appears from recent case law that the issue of whether a private right of action can be implied from exchange rules is still an open question, at least in the Second Circuit. *See Van Alen v. Dominick & Dominick, Inc.*, 560 F.2d 547, 552 (2d Cir. 1977). *See also Bolt v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38, at 43 n. 6; *Wellman v. Dickinson*, 475 F. Supp. 783, 835 (S.D.N.Y. 1979).

[47] 15 U.S.C. § 77k(b)(3) (1976).

[48] Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission 421 (1977).

[49] *Id.* at 454.

[50] Rulemaking petition of the Securities Industry Association, dated May 25, 1978.

[51] Letter from Securities Industry Association to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, dated June 26, 1978.

[52] ALI Code, *supra* note 27, § § 1704(g), (f).

[53] ABC Release, *supra* note 6, at 63700.

[54] ABC Release, *supra* n. 6, at 63698.

[55] 10-K Release, *supra* note 16, at 63694. The new instruction is that

at least one complete copy of the report filed with the Commission and one such copy filed with each exchange shall be manually signed. Copies not manually signed shall contain printed signatures . . . The report shall be signed by the registrant, and on behalf of the registrant by its principal executive officer or officers, its principal financial officer, its controller or principal accounting officer, and by at least the majority of the board of directors or persons performing similar functions.

Id. at 63638, General Instruction D to Form 10-K.

[56] The Division of Corporation Finance has an Office of Tender Offers to receive and manage the processing of these especially urgent and sensitive filings.

[57] The Division reviewed 38 proxy contests in 1980 and 37 in 1979.

[58] *See* Section 8(a) of the Securities Act. After filing, an issuer may elect either to wait the statutory 20-day period, upon which time the registration becomes effective and the securities may be offered, or the issuer may ask the Commission to accelerate effectiveness, within the 20-day period, a request which requires an act of review of the filing by the Commission staff. As a practical matter, most issuers cannot utilize the 20-day lapse alternative since that alternative requires fixing the offering price 20 days ahead of sale, exposing the issuer (or underwriter) to intervening changes in the financial markets without ability to adjust the price.

[59] However, allegedly defective filings might in any event subject the issuer of securities to claims under Section 10(b) of the Exchange Act. *Robbins v. Banner Industries, Inc.* [1967-69] CCH Fed. Sec. L. Rep. ¶ 92,309 (S.D.N.Y. 1968). To date, no reported case finds such liability under Section 18. Understandably, there is a reluctance among issuers to amend an Exchange Act filing.

[60] Of course, large companies print their annual report to shareholders in great quantities. General Motors, for example, prints over 2,000,000 copies.

[61] Securities Act Rel. No. 6202, April 2, 1980, [1979–80] CCH Fed. Sec. L. Rep. ¶ 82,486. The major revision was to permit updating to be done by periodic reports made under the Exchange Act.

[62] The etymology of the term “bedbug” in this context is not clear; insight from readers on the origin of the term is welcome.

[63] See Section 23(b)(4)(I) of the Exchange Act, requiring reports by the Commission to Congress on progress made by the Commission toward requiring institutional investor reports under Section 13(f) “to be filed and such information to be made available to the public in machine language”. See generally Subcomm. on Securities, Senate Comm. on Banking, Housing and Urban Affairs, Hearings on the Institutional Full Disclosure Act, 93rd Cong., 2d Sess. 51, 57–59, 112–13 (Comm. Print 1974) and Note, *The Institutional Investor Disclosure Act: An Analysis of the Consumer Benefits*, 83 Yale L. J. 1271, 1285–89 (1974) (reproduced in the same hearings at 115, 129–133).

[64] See e.g., *J.I. Case Company v. Borak*, 377 U.S. 426 (1964).

[65] Lloyd N. Cutler, Counsel to the President, Remarks at the Securities and Exchange Commission Awards Ceremony, November 21, 1979.

[66] Securities and Exchange Commission, Annual Report 1940 (at 102, 189, 276) and 1979 (at 65, 108, 114).

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