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2019

Disclosure's Purpose


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Georgetown Law Journal, Vol. 107, Issue 4, 1045-1069.

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Disclosure's Purpose Hillary A. Sale¹

The United States securities regulatory infrastructure requires disclosure of a wide array of information both by and about covered companies. The basic purpose of the disclosures is to level the playing field – for investors, for issuers, and for the public.² Although the structure is complicated, the premise is fairly simple. Corporate insiders know far more about the entity than those buying securities or those impacted by the sale of securities (a group, as we shall see, that is far larger than simply investors), resulting in an information asymmetry. Thus, requiring disclosures both before the sale of securities and on an ongoing basis can provide information to diminish those asymmetries.³ This is, in fact, the choice of the United States securities regime – to regulate through disclosures, both in the offering context and on an ongoing, periodic basis.⁴

Although investor protection is the disclosure goal often touted, this article develops the purposes of disclosure extending beyond investors to issuers and the public. Indeed, the disclosure system is designed to level the playing field for issuers— addressing confidentiality concerns, for example. In addition, the system helps to promote confidence in the markets, which, in turn, enables growth and innovation by creating access to capital – goals important to issuers. Yet, as importantly, the system also protects the public more broadly. After all,

¹ Professor of Law and Affiliated Faculty, McDonough School of Business, Georgetown University. Thanks to Kelsey Bolin and Colin Pajda for excellent research assistance and to participants at the Institute for Law and Economics Spring 2018 Conference, Washington University School of Law Faculty Workshop Series, and Andrew Tuch, Brian Tamanaha, _____ for helpful comments.

² Hillary A. Sale, *Disappearing Without a Trace: Sections 11 and 12(a)(2) of the 1933 Securities Act*, 75 WASH. L. REV. 429, 482 (2000).

³ Hillary A. Sale & Donald C. Langevoort, *"We Believe": Omnicare, Legal Risk Disclosure and Corporate Governance*, 66 DUKE L.J. 763, 768 (2016).

⁴ Paul G. Mahoney, *Mandatory Disclosure as a Solution to Agency Problems*, 62 U. CHI. L. REV. 1047, 1079 (1995).

the harms of market crashes and other disruptions are not confined to investors and issuers – despite the fact that writing in this space focuses largely on them.

Disclosure’s purpose, then, is to diminish asymmetries and the space for fraud, both for those within the entity and for the public affected by the entity. To achieve these purposes, the system depends on gatekeepers, like corporate directors who are assigned a role in effectively managing the purpose and consequences of disclosure. Doing so requires them take ownership of both the ensuing internal discourse between the entity, its insiders, and its owners, as well as the external discourse with the entity’s public stakeholders and the public more generally.⁵ When directors do so, the resulting discourse and candor helps to ensure the purposes of disclosure are met.

This article examines the purpose and regulation of this discourse, emphasizing the role of the board of directors and its attention to public stakeholders and the public, with a particular focus on omissions. Omissions occur when disclosures fail to include specific required information or when, for example, the disclosed information necessitates additional disclosures to be complete. The article proceeds as follows. Part I explores the purposes of disclosure in corporate discourse and how disclosure requirements are designed to transmit information. As we will see, the securities disclosure regime aims to address a broad range of issues -- from fairness to market competitiveness. Part II develops the omissions theory in the context of the purposes of disclosure, as well as explicating their role in corporate discourse. Part III turns to the board and its responsibilities with respect to the purposes of securities disclosures and corporate discourse, with a particular emphasis on omissions and candor, and deploying some case studies to develop the theories further. Part IV analyzes the relationship between directors, disclosure (and its purpose) and omissions, and publicness, tying the information-forcing-substance theory to director

⁵ Sale & Langevoort, *supra* note 2, at 788.

gatekeeping and explicating how it can result in more thorough disclosure outcomes for investors, issuers, and the public – and thereby, fulfill disclosure's purpose

I. Disclosures, Discourse, and Purpose

The U.S. securities regime has a long and complicated history with mandatory disclosure. The regulations require disclosures both at the issuance of securities and over time, with a periodic system that addresses secondary markets.⁶ The United States' approach to securities regulation focuses on disclosure and is not merits-based.⁷ Instead, the system is designed to press for information through disclosures that will allow outsiders to develop their own view of the merits of the securities.

In this sense, the regime deploys the information-forcing-substance theory. The premise of this theory, about which I and Professor Langevoort (along with others) have written, is that although the choice of the authors of the securities laws was to focus on disclosure, rather than, for example fairness,⁸ various regulatory provisions create incentives for directors to engage in a dialogue with management about the basis for any disclosures, and to do so prior to engaging in discourse with shareholders, stakeholders, and the public.⁹ Thus, the statute drives behavior toward the collection and development of information, producing substantive behavior (discourse with officers and management and potentially, changes in policies and procedures) on the part of

⁶ Mahoney, *supra* note 3, at 1052; *see, e.g.*, Securities Exchange Act of 1934 § 13; 15 U.S.C. § 78m (2015).

⁷ Hillary A. Sale & Robert B. Thompson, *Market Intermediation, Publicness and Securities Class Actions*, 93 WASH. U. L. REV. 478, 538 (2015).

⁸ *Sec. & Exch. Comm'n v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 181-82 (1963).

⁹ Sale & Langevoort, *supra* note 2, at 787.

directors.¹⁰ Additionally, requiring specific truthful disclosures forces those who produce them to both ensure accuracy and develop the underlying systems (like risk management) that allow the insiders to avoid admitting that no such system exists. This, in turn, supports the purposes of the disclosure regime. Thus, securities regulatory goals, disclosure regulation, and substantive choices go hand in hand.

The goal of the regulatory approach is to promote strong and healthy markets, which, in turn, enable growth and innovation.¹¹ To achieve that goal, the regime charges corporate players (for our purposes, directors) with responsibility for both the quality and quantity of disclosures, where quality concerns affirmative required disclosures and quantity concerns any additional disclosures needed to ensure completeness.¹² The latter is the home of the half-truth and omissions doctrines.

One of the core purposes of disclosures is to protect investors. In fact, the modern regulatory scheme has its roots in the Great Depression that followed the 1929 market crash.¹³ Both events— the crash and the Depression— resulted at least in part from a lack of investor trust in the market.¹⁴ Recognizing that no one wants to play in a rigged market and that investors had been harmed by market

¹⁰ *Id.* Cite to other pieces on information-forcing-substance.

¹¹ *Id.* at 525-29.

¹² Sale & Langevoort, *supra* note 2, at 768.

¹³ See H.R. REP. No. 73-85 (1933); Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1578–79 (2013).

¹⁴ See H.R. REP. No. 73-85 (1933).

manipulation,¹⁵ Section 2 of the Securities Act of 1934 stresses that the “national public interest” undergirds the regulatory regime.¹⁶

The investor-protection goal is met on the front end with disclosure requirements that address both required disclosures and omissions.¹⁷ This disclosure regimen is paired with an anti-fraud rule, the enforcement of which plays a key back-end, investor-protection role.¹⁸ When taken together, the result is the requirement that disclosures may not be misleading, either affirmatively or through omissions or half-truths.¹⁹ The basic premise here is that fraud in the marketplace is costly and prohibiting and punishing it promotes market confidence.²⁰ Truthful and appropriately complete disclosures are key to building investor confidence.²¹ Thus, disclosures allow investors to make reasoned decisions confidently, trusting that they have the most accurate information available.²²

¹⁵ Sale & Thompson, *supra* note 6, at 530. In a message from President Roosevelt to the House of Representatives in 1933, the president stated that the Securities Act of 1933 was intended to “give impetus to honest dealing in securities and thereby bring back public confidence.” H.R. Rep. No. 73-12, at 1 (1933). *See also* Sen. Rep No. 73-47, at 1 (1933) (“The purpose of this bill is to protect the investing public and honest business”).

¹⁶ Securities Exchange Act of 1934 § 2; 15 U.S.C. § 78(b) (2010); *see also*, Sale & Thompson, *supra* note 6, at 531.

¹⁷ *See* Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1575 (2013); Sale & Thompson, *supra* note 6, at 527.

¹⁸ *See* Thompson & Langevoort, *supra* note 13, at 1575; Sale & Thompson, *supra* note 6, at 527.

¹⁹ *See, e.g.*, Donald C. Langevoort, *Half-Truths: Protecting Mistaken Inferences by Investors and Others*, 52 STAN. L. REV. 87, 117 (1999) (explaining that both courts and SEC regulators require people to “volunteer any . . . information necessary to make [their statements] not misleading” to avoid liability in fraud-on-the-market cases). *See generally* Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 VA. L. REV. 565 (2006); James D. Cox, Randall S. Thomas, & Dana Kiku, *Public and Private Enforcement of the Securities Laws: Have Things Changed since Enron*, 80 NOTRE DAME L. REV. 893 (2005).

²⁰ *See* *Dura Pharm. Inc. v. Broudo*, 544 U.S. 336, 345 (2005).

²¹ *See* Sale & Thompson, *supra* note 6, at 530–31.

²² *Id.* at 528.

Note that the disclosure regime does not prevent risky products from being sold. Indeed, the regulatory choice was to provide investors with accurate information, not to develop a regime where regulators determined the merits of the securities or entity.²³ As a result, regulators' role — even when reviewing offering documents, for example — is not to determine whether the issuer's proposed business or products are “worthy.” Instead, the regulators review documents for sufficient disclosures, and then potential purchasers choose whether to invest.²⁴ This regulatory choice arguably heightens the importance of sufficient and complete disclosures as well as a concern about omissions.

The “national public interest” referred to in Section 2, however, encompasses not only investors, but also extends to issuers and the general public. Like investors, issuers perform more confidently in a robust and fluid market.²⁵ To that end, disclosure's purpose is to address information asymmetries

²³ J. Robert Jr. Brown, *Corporate Governance, the Securities and Exchange Commission, and the Limits of Disclosure*, 57 CATHOLIC U. L. REV. 45, 53 n.45 (2007). See also H.R. Rep. No. 73-12, at 1 (1933) (“Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit”); Sen. Rep No. 73-47, at 2 (1933) (“care has been taken to prevent the public from being led to believe that the Federal Government under the proposed law passes upon the soundness of any security”).

²⁴ *Id.* For more of Professor Langevoort's work on cognitive psychology, behavioral theory, and corporations, see Donald C. Langevoort, *Reflections on Scierter (and the Securities Fraud Case against Martha Stewart That Never Happened)*, 10 LEWIS & CLARK L. REV. 1 (2006); Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285 (2004); Mitu Gulati, Jeffrey J. Rachlinski, & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773 (2004); Donald C. Langevoort, *The Organizational Psychology of Hyper-Competition: Corporate Irresponsibility and the Lessons of Enron*, 70 GEO. WASH. L. REV. 968 (2002); Donald C. Langevoort, *Commentary: Stakeholder Values, Disclosure, and Materiality*, 48 CATH. U. L. REV. 93 (1998).

²⁵ Daniel C. Roper, Committee on Banking and Security, *Report to the Secretary of Commerce of Committee on Stock Exchange Regulation* (1934) (“There is a relationship between fluctuations in the stock market and unsettlement in business conditions, based on the fact that stock-exchange movements are apt to be regarded by both business men and the general public as an indicator of underlying conditions. A violent fall in the stock market consequently may lead business men to curtail commitments and activities, thereby increasing unemployment, while on the other hand a

beyond those facing investors.²⁶ As Professor Langevoort's works reveal, corporate insiders, like officers and directors, know far more about the entity than investors and the public, but they may lack appropriate incentives to ensure disclosure.²⁷ Addressing information asymmetries thus helps to put different companies on a more equal footing in the market, with the comparable information allowing investors to contrast the entities.²⁸

This aspect of disclosure has at least two roles. First, it helps to level the playing field between issuers by requiring all of them to provide similar information. In this sense the disclosure addresses the confidentiality concerns of issuers, requiring that equivalent information be shared publicly. Here, then, the disclosure regulation helps to address the concerns of corporate issuers that selective disclosure might result in a competitive disadvantage. In that sense, the mandatory regime also addresses fairness concerns, which, along with those related to confidentiality, might otherwise result in inadequate issuer incentives to disclose, a situation which could, in turn, produce in suboptimal disclosure levels. The prohibition on material omissions also plays a key role here, ensuring that some issuers cannot take unfair advantage of their peers by omitting to disclose certain particulars.²⁹

sharp rise in the stock market may lead to expansion of business activity beyond the bounds of sound economics").

²⁶ Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (And Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 114 (1997).

²⁷ *Id.*

²⁸ Sale & Thompson, *supra* note 6, at 528. *See also* House Consideration, Amendment, and Passage of H.R. 9323, *Securities Exchange Bill of 1934*, 78 Cong. 7717 (1934) (Statement of Mr. Ford) ("Now, I think, we have a bill that will protect the public by preventing inequitable and unfair practices and that will in the end prove beneficial to legitimate operators on our stock exchanges. This bill does three things. It protects investors, controls market manipulations that are destructive to values, and tends to curb destructive speculation...[the President] is acting in the interest of honest business and honest investors").

²⁹ Sale & Langevoort, *supra* note 2, at 777.

Second, disclosure provides investors with information to enable them to choose between potential investments which are not otherwise fungible.³⁰ When investors have the information necessary to make informed choices, and when they have confidence in the information, they may broaden their potential purchases to investments that otherwise would have been discounted or entirely foregone.³¹ The information-forcing-substance theory plays a role here as well. Categories of required disclosures mean that an issuer with nothing to report in a particular category will stand out relative to its peers. To avoid that outcome, issuers implement systems so that they are able to produce disclosures like their peers. Thus, the required disclosure/information results in substantive corporate decision-making and action on the part of directors and management. The resulting systems and disclosures about them help to increase capital investment in issuers, including some that might not otherwise have received it. That in turn, contributes to the flow of capital and allocative efficiency, as well as to growth and innovation.

Disclosure is also designed to complement corporate governance systems. Here, the idea is that once an investor buys stocks, it becomes an owner of the entity. Yet, shareholder owners suffer from the classic agency concerns implicated by the distance between owners and operators.³² Of course, the harm from weak or bad governance extends well beyond shareholders to the public more generally. The disclosure regime helps to police this space in at least two

³⁰ Sale & Thompson, *supra* note 6, at 528.

³¹ Nicholas L. Georgakopoulos, *Frauds, Markets, and Fraud-on-the-Market: The Tortured Transition of Justifiable Reliance from Deceit to Securities Fraud*, 49 U. MIAMI L. REV. 671, 696 (1995). *See also* Sen. Rep No. 73-47, at 1 (1933) (stating that the bill's aim is to "protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion ... to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power.")

³² *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 307 (1976); Mahoney, *supra* note 3, at 1048–1050.

ways. In the first instance, mandatory disclosure decreases monitoring costs on the part of shareholders.³³ The result is the facilitation of issuer capital raising and, in theory, the allocation of capital to the best issuers; thus creating substantial benefits for issuers as well.³⁴ Further, as discussed in Part III, the regulatory structure also inserts directors into the disclosure space, demanding that they play a role in diminishing information asymmetries and detecting fraud, which helps to decrease shareholder monitoring costs, facilitate capital raising, and diminish the impacts of publicness.³⁵ In addition, the construct of publicness — explored more fully in Part IV — is important to discourse and disclosure because it connects the interaction of media, analysts, and the public to issuers' disclosure choices.³⁶

As the 2008-2009 financial crisis and the accompanying slow recovery made clear, healthy markets are key to growth.³⁷ Disclosure plays a role here as well. The disclosure theory posits that information promotes robust capital raising and markets.³⁸ In this space, the regulatory structure is generally focused on offering regulations and a wide array of required disclosures. The goal is building and maintaining market confidence because without it, investors will decline to invest or, arguably, demand larger premia before being willing to invest.³⁹ Why? Because when markets become unreliable, investors choose to put their money in the bank or elsewhere, and market liquidity decreases as a result.⁴⁰ This, in turn,

³³ Mahoney, *supra* note 3, at 1051.

³⁴ Sale & Thompson, *supra* note 6, at 529.

³⁵ Sale & Langevoort, *supra* note 2, at 787–88.

³⁶ See *infra* notes 155-175 and accompanying text.

³⁷ Sale & Thompson, *supra* note 6, at 527.

³⁸ See Sale & Thompson, *supra* note 6, at 529.

³⁹ Georgakopoulos, *supra* note 26, at 696; see also Sale & Thompson, *supra* note 6, at 538.

⁴⁰ Georgakopoulos, *supra* note 26, at 696, 707.

produces an additional problem: the cost of capital increases.⁴¹ When that happens, in theory, investment decreases.⁴² Those decreases in investment harm not just issuers, but also stakeholders such as employees, as well as the public more broadly. Thus, disclosure regulation plays a powerful role on the front end: it helps to improve accuracy in price setting. Better pricing helps to allocate capital to appropriate investments which helps to fuel growth, benefiting investors, issuers, stakeholders, and the public.⁴³

Of course, all of these arguments in favor of regulation have detractors and counter-arguments.⁴⁴ Yet, despite calls for changes and overhauls, the system has remained firmly in place – at least in part because market issues and situations involving significant greed and fraud provide regular counterweights to proponents of deregulation.⁴⁵ As we shall see next, omissions continue to play a part in the debate about the power of disclosure.

II. *Discourse, Omissions, and Liability*

⁴¹ See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 300–11 (2007) (discussing evidence on the cost of capital and enforcement).

⁴² See Georgakopoulos, *supra* note 26, at 706.

⁴³ See Sale & Thompson, *supra* note 6, at 527.

⁴⁴ See e.g., Adam C. Prichard, *Self-Regulation and Securities Markets*, 26 REGULATION 32 (2003) (arguing that securities exchanges and competition should play a more significant role); John C. Coffee, Jr., *Systemic Risk after Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies beyond Oversight*, 111 COLUM. L. REV. 795 (2011) (arguing that contingent capital and preferred shareholders can play a role in preventing excessive risk taking and the ensuing regulation that comes with it); Paul G. Mahoney, *Technology, Property Rights in Information, and Securities Regulation*, 75 WASH. U. L.Q. 815 (1997) (arguing that technology, in combination with market intermediaries, can help to alleviate information asymmetries).

⁴⁵ See e.g., Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629, 1655 (2014).

Omissions are key to the integrity of the disclosure regime and, therefore, to the other goals of disclosure.⁴⁶ As noted above, the securities regulatory regime is one premised on information (and the correlating substance) through disclosure and the resulting discourse. There is a thorough and ongoing regulatory structure that requires substantial, affirmative, truthful disclosures both when an issuer offers securities to the public and, in an integrated manner, on an ongoing basis. A cornerstone of this regimen is that disclosures cannot be so carefully calculated or cabined that they mislead by omission.⁴⁷ Omissions are not, of course, affirmative statements or facts; they are, rather, statements with facts or other information missing. Their disclosure is required when material and necessary to make other disclosures truthful or not misleading.⁴⁸ In this sense, the requirement is actually a prohibition against misleading half-truths.

Half-truths and omissions have a daunting history in securities law and litigation, and Professor Langevoort, whose work we celebrate in this volume, has thought and written more about these issues than any other scholar of corporate and securities law.⁴⁹ As Professors Langevoort and Gulati pointed out, the omissions doctrine is confused and limited by courts misunderstanding the difference between duty (whether disclosure is required) and materiality.⁵⁰ This

⁴⁶ See generally Langevoort, *supra* note 15.

⁴⁷ See Securities Act of 1933 § 11; 15 U.S.C. § 77k(a) (1933).

⁴⁸ Securities Act of 1933 § 11; 15 U.S.C. § 77k(a) (1933); Langevoort, *supra* note 15, at 88.

⁴⁹ See Langevoort, *supra* note 15; Mitu Gulati, Jeffrey J. Rachlinski, & Donald C. Langevoort, *Fraud by Hindsight*, 98 NW. U. L. REV. 773 (2004); Donald C. Langevoort, *Lies without Liars: Janus Capital and Conservative Securities Jurisprudence*, 90 WASH. U. L. REV. 933 (2013); Donald C. Langevoort, *Commentary: Stakeholder Values, Disclosure, and Materiality*, 48 CATH. U. L. REV. 93 (1998); Donald C. Langevoort, *Fraud and Deception by Securities Professionals*, 61 TEX. L. REV. 1247 (1983).

⁵⁰ Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose under Rule 10b-5*, 57 VAND. L. REV. 1639 (2004). See also David Mosma & Timothy Olson, *Muddling through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137 (2007).

confusion recently came to a head in a case discussed in Part III and on which the Supreme Court granted certiorari, *Leidos*.⁵¹ The allegations in *Leidos* involved omissions related to the cancellation of the issuer's largest revenue source, contracts with the City of New York, due to fraudulent billing practices. Those issues were not resolved because the parties settled the case just prior to its argument and filed a motion to remove it from the Court's calendar and hold it in abeyance pending lower court approval of the settlement.⁵² Nevertheless, the omissions issues highlighted by the *Leidos* case are unlikely to go away.

Under multiple provisions of the securities laws, private plaintiffs can sue for affirmative misstatements and omissions.⁵³ The first provision that allows for an express cause of action is Section 11(a) of the 1933 Securities Act. It states:

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security ... may[] sue.⁵⁴

As the language of this provision makes clear, there are two potential types of liability. The first clause focuses on what an issuer stated affirmatively, and the second on what the issuer did not say, or omitted.⁵⁵ Section 11 does not require

⁵¹ *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted).

⁵² *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 138 S. Ct. 369 (2017) (motion granted).

⁵³ Securities Act of 1933 §§ 10b, 11, 12(a)(2); 15 U.S.C. §§ 77j(b), 77k(a), 77l(a)(2) (1933); Langevoort, *supra* note 15, at 88.

⁵⁴ Securities Act of 1933 § 11, 15 U.S.C. § 77k(a) (1933).

⁵⁵ *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1323 (2015).

fraud or the intent to deceive.⁵⁶ Rather, except with respect to forward looking statements,⁵⁷ it is a strict liability provision.⁵⁸

This standard of liability is tied directly to the purposes of the disclosures. Section 11 is an enforcement mechanism for the disclosure-based premise of the Securities Act: that issuers provide “full and fair disclosure of information” when engaging in a public offering.⁵⁹ The idea is that when a company is raising money by issuing securities to the public, it is important to diminish the asymmetries and opportunities for fraud. Section 11 imposes liability on those responsible for false or misleading registration statements to all purchasers—regardless of from whom (issuer, underwriter, etc.) they bought. The purpose of the disclosures is to level the playing field for competing issuers and to decrease information asymmetries for investors and for the public. In addition, the regulatory apparatus not only requires an extensive array of specific disclosures, it also contains a requirement for additional information needed to prevent what is disclosed from being misleading.⁶⁰ Thus, embedded in each required disclosure is a prohibition against misleading half-truths.⁶¹

In addition to Section 11, Section 12(a)(2) of the Securities Act provides liability for misstatements and omissions in another offering document, the

⁵⁶ *Id.*

⁵⁷ 15 U.S.C. § 77z-2(c)(1)(B).

⁵⁸ *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381–82 (1983) (citing H.R. Rep. No. 85, 73d Cong., 1st Sess. 9 (1933) (Section 11 creates “correspondingly heavier legal liability” in line with responsibility to the public)). “The section was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering.” *Id.* There are defenses available, including the due diligence defense. 15 U.S.C. § 77k(b)(3).

⁵⁹ *Omnicare*, *supra* note 49, at 1323 (citing *Pinter v. Dahl*, 486 U.S. 622).

⁶⁰ Securities Act of 1933 § 11, 15 U.S.C. § 77(a) (1933).

⁶¹ The scope of this prohibition, of course, is at issue here and has been the focus of considerable scholarly writing including by one of the authors here. *See, e.g.*, Langevoort, *supra* note 15.

prospectus.⁶² Section 12(a)(2) allows purchasers to rescind or assert damages if a seller commits fraud in a prospectus or through an oral statement, and it also requires privity. Its coverage overlaps to some extent with that of Section 11, and like its Section 11 counterpart, this provision does not require reliance. Defendants do, however, have a defense that allows them to prove that they neither knew nor should have known of the untruth or omission.⁶³ Again, the purpose here is also to prevent misleading disclosures in the offering context and thereby protect investors, issuers, and the public.

The final provision at issue in the majority of the private-plaintiff class-action suits is Section 10(b) and the accompanying rule, 10b-5, (Section 10(b) claims) of the Securities Exchange Act. This is the cause of action that applies to fraud claims for any misstatements and omissions on the part of issuers.⁶⁴ As a result, a Section 10(b) claim is not tied to an offering document. Although initially developed as an implied cause of action, and subject to arguments that the courts could “disimply” it, Congress has since legislated around it, developing pleading standards and many other requirements and thus, arguably, firmly establishing its place in the securities litigation arsenal.⁶⁵ Moreover, in doing so, Congress expounded on the connection between the private enforcement role that this cause of action serves and the purposes of disclosure discussed in Part I of this article.

For a Section 10(b) claim, plaintiffs must plead, and if the case goes to trial, prove, multiple elements, including:

⁶² Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2) (1933). Section 12(a)(1) provides liability for any person who sells securities that was required to be registered but was not. 15 U.S.C. § 77l(a)(1) (1933).

⁶³ See e.g., *Casella v. Webb*, 883 F.2d 805, 809 (9th Cir. 1989). As a result, this provision is negligence-like in application. *Dennis v. Gen. Imaging, Inc.*, 918 F.2d 496, 507 (5th Cir. 1990).

⁶⁴ Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1934).

⁶⁵ See *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 37 (2011) (“We have implied a private cause of action from the text and purpose of § 10(b).”).

- 1) A material misrepresentation or omission by the defendant(s);
- 2) Scienter;
- 3) A connection between the misrepresentation or omission and the purchase or sale of a security;
- 4) Reliance upon the misrepresentation (but not an omission);
- 5) Economic loss; and
- 6) Loss causation.⁶⁶

As the above list makes clear, Section 10(b) claims are more complicated than their Section 11 and 12(a)(2) counterparts. In particular, the scienter element is subject to a very strict pleading standard.⁶⁷ As a result, an “inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.”⁶⁸ Most importantly, Section 10(b) allows for issuer liability to investors for misstatements and omissions regardless of whether they occur in an offering document, thus broadening significantly the potential scope of liability.⁶⁹

A key regulatory disclosure provision, Item 303 of Regulation S-K, Management’s Discussion and Analysis, presses for narrative information about the company.⁷⁰ In particular, Item 303 requires information about known trends and uncertainties.⁷¹ The thrust of this requirement, of course, is that issuers

⁶⁶ *Id.*

⁶⁷ See PSLRA §21D(b)(2); 15 U.S.C. § 78u-4(b)(2).

⁶⁸ *Tellabs, Inc. v. Makor Issues & rights, Ltd.*, 551 U.S. 308, 313-14 (2007).

⁶⁹ Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j (1934).

⁷⁰ See *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted). The defendants in the *Leidos* case argued that Item 303 does not create a cause of action. Brief of Petitioner at 14, *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted). Indeed it does not. It is, however, subject to litigation under Sections 11, 12(a)(2) and 10 – assuming that disclosure was required and that a claim meets the elements of the provisions at issue.

⁷¹ 17 C.F.R. § 229.303. Interestingly, however, empirical evidence reveals that as an issuer’s situation deteriorates, so does the quality of its disclosures. The MD&A becomes harder to read.

should share what they know (or have reason to know) about what is coming around the corner.⁷² As Professor Langevoort has so aptly put it, if the company has had three great quarters, but knows that the bottom is about to fall out of its business, a reasonable investor would find that information material to an investment decision.⁷³ In short, although we do not require issuers to disclose everything, disclosures full of gaps are useless to investors and the public. They also undermines the issuer-related purposes of disclosure.

Nevertheless, the half-truths and omissions doctrines have stretched the courts' abilities. In effect, the challenge with omissions is two-sided. The premise for disclosure and liability seems relatively straightforward. If a company is required to make disclosure under the securities laws, as in the case of the MD&A, then that disclosure must be sufficiently complete so as not to be misleading.⁷⁴ Or, put differently, there is no point in requiring certain disclosures if an issuer is free to cabin them, through omissions, in a manner that makes what is disclosed misleading. The same is true for voluntary disclosures.⁷⁵ To do otherwise would undermine the very purposes of a disclosure-based securities regulatory regime. Thus, the disclosure structure, with its emphasis on omissions, is designed to press for complete and accurate information.

Yet, a key challenge with omissions is that there is a temptation by any investor harmed by a purchase to argue that more information was necessary and,

Tone shifts, sentences become more complex, and the obfuscation of the language increases. Donald C. Langevoort, *Disasters and Disclosures*, SCHOLARSHIP @ GEORGETOWN LAW 1, 14-16 (2018), <http://scholarship.law.georgetown.edu/facpub/2024>.

⁷² Langevoort & Gulati, *supra* note 44, at 1652.

⁷³ *Id.* See also David Mosma & Timothy Olson, *Muddling through Counterfactual Materiality and Divergent Disclosure: The Necessary Search for a Duty to Disclose Material Non-Financial Information*, 26 STAN. ENVTL. L.J. 137 (2007).

⁷⁴ Sale & Langevoort, *supra* note 2, at 790.

⁷⁵ See, e.g., *In re Hi-Crush Partners L.P. Sec. Litig.*, 2013 WL 6233561 at *18 (S.D.N.Y. Dec. 2, 2013).

therefore, omissions must have occurred.⁷⁶ As the saying goes, hindsight is twenty-twenty, making it easy to argue about what should have been disclosed when time has passed and the investment looks less promising. The result is pressure to prevent every bit of missing information from becoming an actionable omission.

The line between the two is tricky to draw. The trouble with omissions is that because they are not affirmative statements, they “don’t exist.” As a result, the courts have determined that there is no reliance requirement for an omission on the theory that investors cannot prove reliance on something that was not said. This is particularly important in the context of class actions, where reliance might well be different for every purchaser. Yet, without reliance as an element, the claims are arguably easier to bring, potentially expanding liability dramatically.⁷⁷ As a result, courts have cabined potential claims such that, in order to trigger liability for an omission, the alleged misstatement and the omission must pertain to the same subject matter, and the missing information must render the statement misleading by altering its meaning.⁷⁸

This concern about the expansion of 10b-5 claims has been, and continues to be, a focus of the courts. In their article, Professors Langevoort and Gulati argued that concerns about increases in these claims may well have been at the root of earlier attempts by courts to limit their potential.⁷⁹ Nevertheless, since that time, Congress has stepped in and severely restricted the power of the 10b-5 cause of action—developing strict pleading limitations, heightened state of mind requirements, fee-shifting provisions, lead-plaintiff provisions, and more.⁸⁰ This

⁷⁶ See, e.g., *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 36 (2011).

⁷⁷ *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 152-53 (1972).

⁷⁸ See, e.g., *Kleinman v. Elan Corp.*, 706 F.3d 527, 541 (5th Cir. 2008).

⁷⁹ Langevoort & Gulati, *supra* note 44, at 1683.

⁸⁰ *Id.*

higher standard means that the 10b-5 and fraud cases that are brought are both stronger and more likely to achieve real settlements.⁸¹ Thus, many of the arguments that defendants and others gnawing at the omissions doctrine make about the strike-suit nature of these class actions have arguably been tackled.⁸²

Additionally, omissions are actionable only if material,⁸³ but here the doctrine is subject to confusion. The confusion stems, in part, from the fact that the SEC's standard for materiality in the MD&A is different from (and lower than) the standard for proving materiality under Sections 11, 12, and 10(b).⁸⁴ The resolution, however, is relatively simple. Whether something should have been included in the MD&A should be judged by the SEC's materiality standard. But, whether a private plaintiff can bring a claim for liability should be measured by the appropriate liability provision for the cause of action. Thus, for an omission to result in liability in a private-plaintiff class action, it must meet the requisite materiality standard.⁸⁵ This standard is set forth in *TSC v. Northway*: whether the omitted information "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."⁸⁶ In short, if the market possessed the correct information, a false statement or omission will not be materially misleading.⁸⁷ Further, to the extent that the misstatement in question involves speculative information, as is much of the information contained in Item 303, the test requires balancing the probability of

⁸¹ See Sale & Langevoort, *supra* note 2, at 765.

⁸² Langevoort & Gulati, *supra* note 44, at 1683-84.

⁸³ Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 77k(a) (1934).

⁸⁴ Langevoort & Gulati, *supra* note 44, at 1651. This was one of the challenges in the Leidos case.

⁸⁵ *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976).

⁸⁶ *Id.*

⁸⁷ See, e.g., *In re Convergent Techs. Sec. Litig.*, 948 F.2d 507, 513 (9th Cir. 1991).

the event occurring along with the anticipated magnitude of that event.⁸⁸ Importantly, neither standard involves a bright-line rule or strict percentage approach. In fact, it is well understood that any percentage deemed material could result in fraud up to the line, and that a definition of materiality that is too stringent would result in the wrong incentives and the potential for more fraud.⁸⁹

The courts have been applying these materiality standards for decades, and they are quite straightforward – whether applied to affirmative misstatements or omissions.⁹⁰ Moreover, the standard for both types of misleading information must be the same. Any other approach would lead to a standard that creates liability for an affirmative misstatement but not for silence that creates a misleading outcome.⁹¹ That would be untenable. It would create an incentive to commit fraud through omissions and undermine the investor, issuer, and public interest protection goals of disclosure. It would also diminish the incentives of those charged with ensuring accurate and complete disclosures – the directors. We turn to them and their role in disclosure’s purpose and in discourse next.

III. Directors, Discourse, and Candor

As we have seen, there are many demands on our disclosure regimen and those, in turn, produce demands on the director gatekeepers. Disclosure and candor are interrelated, and directors have a role in both. So far, this article has focused on disclosure and its purpose. We now turn to the connection between disclosure, its purpose, and candor, a fiduciary duty, with a focus on Delaware law.

⁸⁸ *Basic Inc. v. Levinson*, 485 U.S. 224, 238 (1988).

⁸⁹ *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976).

⁹⁰ *See, e.g., Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 45 (2011); *Basic Inc. v. Levinson*, 485 U.S. 224, 226 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 440 (1976).

⁹¹ *Langevoort & Gulati, supra* note 44, at 1680.

Like disclosure, candor is an information-forcing rule, requiring the sharing of information between officers and directors, for example.⁹² Candor also operates in contexts implicating information shared outside of the corporation, like when the corporation asks for a shareholder vote on a merger.⁹³ Here, the Delaware courts generally look to the directors to determine whether proxy disclosures are sufficiently candid.⁹⁴

For the purposes of securities disclosures, candor presses on the informational asymmetries that are internal to the corporation. Thus, the fiduciary duty of candor can play a role in addressing the challenges that directors, who have limited time and access to information, face with respect to their officer counterparts.⁹⁵ The demands of the disclosure regimen press on the substantive choices that officers and boards make as well as providing an opportunity for boards to ask questions and question answers. This is particularly important when companies face, for example, revenue, profit, or other challenges. Indeed, what we know from the evidence is that disclosures tend to be more transparent and complete when times are good.⁹⁶ But, when a company experiences a downturn,

⁹² See Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. CIN. L. REV. 1187 (2003).

⁹³ See *Lynch v. Vickers Energy Corp.*, 383 A.2d 278, 281 (Del. 1977) (holding that directors must provide with complete candor “information such as a reasonable shareholder would consider important in deciding whether to” tender shares).

⁹⁴ *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270, 1277 (Del. 1994).

⁹⁵ Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 316-17 (2004). See generally Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817 (2006-2007); James J. Park, *Rule 10B-5 and the Rise of the Unjust Enrichment Principle*, 60 DUKE L.J. 345 (2010-2011).

⁹⁶ Donald C. Langevoort, *Disasters and Disclosures*, SCHOLARSHIP @ GEORGETOWN LAW 1, 14-16 (2018), <http://scholarship.law.georgetown.edu/facpub/2024>.

disclosure quality suffers. Obfuscation and complex sentences abound. Cageyness increases.⁹⁷

Directors are arguably situated as the gatekeepers of disclosures in order to ensure candor and completeness, which, in turn, supports the purposes of disclosure. Of course, directors must trust officers to provide relevant information but, as this part of the article makes clear, the SEC and the laws and regulations place expectations on directors to mediate the information asymmetry between insiders and outsiders, performing an agency cost role.⁹⁸ Directors perform this role through discourse and developing information and substance.

The securities laws and regulations, along with various orders and statements from the SEC, emphasize that directors must actively engage in reviewing disclosures, thereby adding to the information-forcing-substance nature of the securities provisions.⁹⁹ The information-forcing-substance theory is part of the architecture of the Securities Act of 1933. For example, as noted above, Section 11 of the Securities Act provides a strict-liability, express cause of action for misstatements and omissions in a Registration Statement.¹⁰⁰ The statute specifically includes directors as defendants.¹⁰¹ They do have a due diligence defense available, and it has the impact of making the claim negligence-like (as opposed to strict liability based) in nature.¹⁰²

⁹⁷ Donald C. Langevoort, *Disasters and Disclosures*, SCHOLARSHIP @ GEORGETOWN LAW 1, 14-16 (2018), <http://scholarship.law.georgetown.edu/facpub/2024>.

⁹⁸ Langevoort, *supra* note 22, at 126-27. *See also* Mahoney, *supra* note 3, at 1090-93 (examining efficiency gains of agency information); Press Release, Fed. Reserve Bd., Accountability as Chair of Wells Fargo & Company Board of Directors (Feb. 2, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a4.pdf>.

⁹⁹ Sale & Langevoort, *supra* note 2, at 773.

¹⁰⁰ Securities Act of 1933 § 11, 15 U.S.C § 77(k) (1933).

¹⁰¹ *Id.*

¹⁰² *In re WorldCom, Inc. Sec. Litig.*, 346 F. Supp. 2d 628, 662 (S.D.N.Y. 2004).

These provisions are, in effect, a cornerstone of the information-forcing-substance theory of the federal securities laws. Here, the due-diligence provision creates an incentive for directors to engage in a dialogue with management about the basis for any disclosures, and to do so prior to making the disclosures public and engaging in discourse with shareholders, stakeholders, and the public.¹⁰³ This, in turn, supports the purposes of the disclosure regime.

The statute also provides that directors, as parties named in the registration statement, can avoid liability in two other circumstances arguably designed to force discourse and candor. For example, if a named party resigns and informs the SEC of the materially false or misleading statement before the effective date of the registration statement, she has a statutory defense.¹⁰⁴ The design of this provision arguably urges directors to push back internally and, when unsuccessful, to make a noisy exit – through resignation. Directors who have been duped by officers can also escape liability by informing the SEC and the public of a false or misleading registration statement after the effective date.¹⁰⁵ Here again, the defense is candor-focused, noisy, and, thereby, supports the purposes of disclosure.

There are many other ways in which the regulatory structure has evolved both in an information-forcing manner and where the role of directors is implicated. Regulation S-K, of which the MD&A is a part, is a classic example. As mentioned in Part II of this article, the MD&A requires information about known trends and uncertainties related to liquidity, capital resources, and results of operations.¹⁰⁶ The MD&A's purpose is to provide investors with a narrative that describes the business from management's perspective, indicating where gaps

¹⁰³ Sale & Langevoort, *supra* note 2, at 787.

¹⁰⁴ 15 U.S.C. § 77k(b).

¹⁰⁵ *Id.*

¹⁰⁶ 17 C.F.R. § 229.303(a).

(uncertainties) might exist, including, for example, changes in sales, revenues, or income.¹⁰⁷ These categories are ones about which investors would want information *and* about which directors should know.

The MD&A is included both in offering documents subject to the 1933 Act and in the periodic disclosures required through the 1934 Act.¹⁰⁸ The same is true of many other areas of Regulation S-K, including the risk disclosures required by Item 503.¹⁰⁹ Indeed, arguably, risk overlaps with all of the disclosures in the MD&A. Understanding evolving risks to an issuer's business plan is key to investment and to the directors' oversight role.¹¹⁰

In addition, all of these disclosures are subject to liability.¹¹¹ For offering documents, Section 11 (registration statement) and Section 12(a)(2) (prospectus) apply.¹¹² For other documents, including the periodic disclosures, Section 10(b) applies.¹¹³ As noted above, the materiality standard for all three provisions is the same: the reasonable investor and probability/magnitude for forward-looking information.¹¹⁴ Liability, of course, is key to the information-forcing-substance theory – it is a back-end enforcement mechanism for the disclosure regime and

¹⁰⁷ *S.E.C. v. Conaway*, 698 F. Supp. 2d 771, 818 (E.D. Mich. 2010). For example, Item 303 requires that “[t]o the extent that the financial statements disclose material increases in net sales or revenues, [issuers must] provide a narrative discussion of the extent to which such increases are attributable to increases in prices or to increases in the volume or amount of goods or services being sold or to the introduction of new products or services.”

¹⁰⁸ 17 C.F.R. § 229.303.

¹⁰⁹ 17 C.F.R. § 229.503.

¹¹⁰ See *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). See also Hillary A. Sale, *Fiduciary Law, Good Faith, and Publicness*, in *THE OXFORD HANDBOOK OF FIDUCIARY LAW* (Robert H. Sitkoff, Evan J. Criddle & Paul B. Miller eds., forthcoming).

¹¹¹ Securities Act of 1933 § 11, 15 U.S.C. § 77k (1933).

¹¹² Securities Act of 1933 §§ 11, 12(a)(2), 15 U.S.C. §§ 77k, 77l (a)(2) (1933).

¹¹³ Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b).

¹¹⁴ *TSC Indus., Inc. v. Northway, Inc.*, *supra* note 81, at 448.

its purposes and, arguably, a key mechanism in prompting the discourse necessary to produce good disclosures as well.¹¹⁵

As a result, every disclosure pursuant to Regulation S-K requires that the people involved: (1) ensure that the information exists; (2) confirm it is accurate; (3) determine whether and how to disclose it, including ensuring sufficient disclosure; and (4) disclose the information.¹¹⁶ Embedded in this process is the concept of omissions. Regulation S-K directly addresses omissions with a requirement that any disclosures must include sufficient information so as not to make them misleading.¹¹⁷ Here again, directors, discourse, and candor play a role.

Indeed, directors may not “blindly” rely on documents prepared by officers. Instead, before invoking the due diligence defense, the directors must do a reasonable investigation, have reasonable grounds to believe, and actually believe that the registration statement did not contain material misstatements or omissions.¹¹⁸ Thus, they must be “active good faith monitors” before they can claim due diligence.¹¹⁹ Accomplishing this requires candid discourse between directors and officers and between directors and those preparing the disclosures (experts or otherwise). This is information-forcing-substance in action with one

¹¹⁵ *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318, 1332 (2015). See also Sale & Langevoort, *supra* note 2, at 786; Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629 (2014) (developing information-forcing-substance theory); Hillary A. Sale, & Robert B. Thompson, *Market Intermediation, Publicness, and Securities Class Actions*, 93 WASH. U. L. REV. 487 (2015) (emphasizing the importance of transparency and publicness goals to securities regulation theory); Hillary A. Sale, *Independent Directors as Securities Monitors*, 61 BUS. LAW. 1375, 1380 (2006) (explaining how disclosure requirements create conversation and conscious decisionmaking that result in substantive changes and disclosures).

¹¹⁶ Sale & Langevoort, *supra* note 2, at 787.

¹¹⁷ *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1296 (9th Cir. 1998).

¹¹⁸ Sale & Langevoort, *supra* note 2, at 772.

¹¹⁹ Hillary A. Sale, *Independent Directors as Securities Monitors*, 61 BUS. LAW. 1375, 1394 (2006); *In re WorldCom, Inc. Sec. Litig.*, No. 02 Civ. 3288 DLC, 2005 WL 638268, at *12 (S.D.N.Y. Mar. 21, 2005).

goal being ensuring candor in public disclosures and, thereby, protecting issuers, investors, and the public.

In addition to the statutory provisions that contribute to our understanding of disclosure, candor, and discourse, there are also SEC enforcement actions that implicate directors and their role in ensuring the purposes of disclosure are upheld.¹²⁰ There are several themes running through these matters. For example, directors may not defer too much to insiders.¹²¹ They must meet regularly.¹²² And, if they fail to follow through on requests for information to management, they are also likely to fail to meet their responsibilities under the securities laws.¹²³ Further, directors who know officers are under investigation for criminal charges and fail to share this sort of information with shareholders in a prompt and accurate fashion are failing in their securities monitoring roles.¹²⁴ Similarly, directors in a company with a high burn rate need to know if there are liquidity or credit freeze issues and, in some

¹²⁰ See, e.g., Report of Investigation in the Matter of Stirling Homex Corporation Relating to Activities of the Board of Directors of Stirling Homex Corp., [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,219, (July 16, 1975); Report of Investigation in the Matter of the Cooper Cos., Inc., as It Relates to the Conduct of Cooper's Board of Directors, Exchange Act Release No. 34-35082, 1994 SEC LEXIS 3975, *1 (Dec. 12, 1994); Report of Investigation in the Matter of National Telephone Co., Inc., Relating to Activities of the Outside Directors of National Telephone Co., Inc., Exchange Act Release No. 34-14380, 13 SEC Docket 1393 (Jan. 16, 1978); *In re Rita L. Schwartz*, Exchange Act Release No. 42684, 72 SEC Docket 432 (Apr. 13, 2000).

¹²¹ See Report of Investigation in the Matter of Stirling Homex Corporation Relating to Activities of the Board of Directors of Stirling Homex Corp., [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,219, at 85,459, 85,460-63 (July 16, 1975). These directors would also breach their state law fiduciary duties. *Id.* See also Press Release, Fed. Reserve Bd., Accountability as Chair of Wells Fargo & Company Board of Directors (Feb. 2, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a4.pdf>.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ Report of Investigation in the Matter of the Cooper Cos., Inc., as It Relates to the Conduct of Cooper's Board of Directors, Exchange Act Release No. 34-35082, 1994 SEC LEXIS 3975, at *12, *20 (Dec. 12, 1994) (criticizing directors for omissions in public statements concerning wrongdoing by officers and stating that directors must take "immediate and effective action" to protect shareholders with accurate statements).

circumstances, update information to shareholders.¹²⁵ Those who do not, fail in their duties to shareholders. In short, directors have a “responsibility affirmatively to keep themselves informed of developments within the company and to seek out the nature of corporate disclosures to determine if adequate disclosures are being made.”¹²⁶ This role, which connects directly to the purpose of the disclosures, is heightened when the conduct of management is implicated and, of course, when the issues are key to the company’s survival or its business.¹²⁷

These themes are echoed in more recent SEC enforcement actions as well as in statements by the Department of Justice. For, example, in 2000, the SEC entered a cease and desist order against an outside director of Incomnet, arguing that she knew or should have known that an officer had engaged in fraud and that prior public statements were inaccurate.¹²⁸ The order also emphasized the role of directors in policing fraud, stating that they must “maintain a general familiarity with the corporation’s public disclosures and accounting practices and investigate ‘red flags’ that come to their attention.”¹²⁹ In addition, the SEC criticized the directors for failing to “establish procedures reasonably designed to ensure the accuracy of Incomnet’s public statements.”¹³⁰ In doing so, the SEC reiterated the role that directors must play in ensuring that disclosures are complete and

¹²⁵ Report of Investigation in the Matter of National Telephone Co., Inc., Relating to Activities of the Outside Directors of National Telephone Co., Inc., Exchange Act Release No. 34-14380, 13 SEC Docket 1393, 1396 (Jan. 16, 1978).

¹²⁶ *Id.*

¹²⁷ 17 C.F.R. § 229.303(a)(3)(ii); Langevoort & Gulati, *supra* note 44, at 1648.

¹²⁸ *In re* Rita L. Schwartz, Exchange Act Release No. 42684, 72 SEC Docket 432 (Apr. 13, 2000) (entering cease and desist order against outside director; stating that “directors have a duty . . . to oversee the corporation’s financial reporting process and to ensure the integrity and completeness of public statements made by the corporation”). The standard here is negligence. *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

accurate, as well as the valuable role that directors play in ensuring that the purposes of disclosure are fulfilled. These securities-based roles are directly tied to the directors' fiduciary, good-faith obligations under Delaware law.¹³¹

The SEC also made similar allegations against directors in the *Chancellor Corporation* matter. There, the directors were members of the audit committee when officers fired the company's auditor for refusing to support reporting suspect financial results and information reported by the officers.¹³² According to the SEC complaint, at least one of the directors knew of the underlying audit concerns, but "took no steps" to investigate the issues.¹³³ The SEC accused the directors of "ignoring clear warning signs that financial improprieties were ongoing at the company and ... failing to ensure that the company's public filings were accurate."¹³⁴ Indeed, with respect to one of the director defendants, the SEC asserted that he signed the annual report "without taking any steps to ensure that it did not contain materially misleading statements, ... made no inquiry into the [new auditor's] reasons" for the change in position, and failed to check into several related party arrangements involving the CEO.¹³⁵ There are similar allegations with respect to the company's restatements, with the SEC characterizing the director as "ignoring red flags and never question[ing] whether there was any basis" for the revisions.¹³⁶

At a minimum, a change in auditor should prompt clear and direct questioning and discussion (candid discourse) between directors and

¹³¹ Sale & Langevoort, *supra* note 2, at 773. See also *In re Caremark Int'l Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996); *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

¹³² *Id.*

¹³³ Complaint at 29, *SEC v. Chancellor Corp., et. al.*, 03-CV-10762-PBS (D. Mass. 2003).

¹³⁴ *Id.* at 48.

¹³⁵ *Id.*

¹³⁶ *Id.* at 51-60.

management.¹³⁷ Indeed, in order to help prevent these sorts of shenanigans, management is no longer allowed to serve on the audit committee.¹³⁸ The purpose of that change was to increase the role of independent directors in ensuring accurate and truthful disclosures and to prompt the exact sort of candid discourse missing in this case.¹³⁹ In short, the director's role in the information-forcing regime requires active, candid discourse between directors and corporate insiders. The to so engage undermines the purposes of the disclosure regime.

The issues presented in the *Leidos* case raise similar red flag questions. The claims were about the company's failure to reveal that a key source of revenue tied to its projections was in jeopardy.¹⁴⁰ The amounts at issue were quite significant, and the reason for the contract and revenue issues was that the company had engaged in an overbilling scheme with its key government client. According to the plaintiffs, the company valued the market opportunity that might grow out of its contract with the New York City at over \$2 billion.¹⁴¹ The City's initial budget for the project was only \$63 million; yet within a short period of time, and due to allegedly fraudulent overbilling, the City paid almost \$700 million before catching the improprieties.¹⁴² These improprieties, the plaintiffs' alleged, put at risk the Leidos's government contracting business, "from which it derived

¹³⁷ *Id.* at 89, 100, 120. See also Hillary A. Sale, *Federal Fiduciary Duties for Directors*, UC BERKELEY LAW AND ECONOMICS WORKSHOP 1, 37 (2006).

¹³⁸ Sarbanes-Oxley Act of 2002 § 301, 15 U.S.C. § 78j-1(2002).

¹³⁹ *Id.* See also Jonathan Macey & Hillary A. Sale, *Observations on the Role of Commodification, Independence, and Governance in the Accounting Industry*, 48 VILL. L. REV. 1167 (2003). Arguably, the SEC could take a stronger role here, increasing its enforcement intensity to press disclosure gatekeepers to engage more. Langevoort, *supra* note 62, at 7-8.

¹⁴⁰ Brief of Respondent at 2, *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted).

¹⁴¹ *Id.* at 5-6.

¹⁴² *Id.* at 6.

97% of its revenues.”¹⁴³ Indeed, the company’s annual report specifically noted the importance of its relationships and contracts with government agencies. Shortly after the City became aware of the fraudulent billings, the criminal investigations began, and Leidos began to lose government contracts.¹⁴⁴

According to the plaintiffs, the directors knew about the misconduct, the loss of business opportunities, and the involvement of its employees in the improprieties.¹⁴⁵ Nevertheless, the directors allowed the 10-K to move forward, with their signatures and without disclosures about the problems.¹⁴⁶ Although the arguments have their own complexities, the story is similar to many others of this nature. Item 303 requires disclosure of known trends and uncertainties that are reasonably expected to impact on a company’s sales or income.¹⁴⁷ Yet, despite evidence to the contrary, the 10-K, with the MD&A included, did not provide information about Leidos’s fraudulent overbilling scheme, which was allegedly known to the defendants and connected to a significant portion of its projected revenue growth.¹⁴⁸ The alleged omissions thus implicated the directors’ information-forcing-substance role. This set of allegations also links the disclosure zone to the directors’ state fiduciary duties. Directors focus on strategy, risk, and people. All three of those obligations are tied to the company’s core business, revenues, and profits. What could be more material?

In response the *Leidos* defendants argued that because the issuer had not discussed the issue at all, there was no need to clarify it with additional

¹⁴³ *Id.* at 52.

¹⁴⁴ *Id.* at 53.

¹⁴⁵ *Id.* at 54.

¹⁴⁶ *Id.* at 11-12.

¹⁴⁷ 17 C.F.R. § 229.303(a)(3)(ii).

¹⁴⁸ Brief of Respondent at 11-12, *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted).

information.¹⁴⁹ This, they argued, was a “pure omission,” in contrast to an omission required to make an affirmative disclosure not misleading.¹⁵⁰ This argument is specious at best and has the potential to gut Item 303. The disclosure regimen is clear: if the revenue source was key to the company’s growth, Item 303 requires disclosure and discussion.¹⁵¹ Indeed, the government’s argument was that reasonable investors understand that when issuers discuss results in financial reports, there is an implicit representation that the issuer is providing all of the information that Item 303 requires.¹⁵² In fact, this is arguably the premise for the requirement that additional information be disclosed to ensure that the disclosures are not misleading. It is also consistent with the statutory mandate that issuers comply with regulatory disclosure requirements deemed by the SEC “as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security.”¹⁵³ Here it is helpful to recall that even though the goals of the disclosure regimen are broad, but at bottom, it requires a level playing field for issuers, investors, and the public.

Omissions are at the heart of another significant securities fraud case, as well: *Ramirez v. Exxon*. There, the plaintiffs alleged that Exxon violated 10b-5 by omitting disclosures related to its recoverable oil reserves and climate change.¹⁵⁴ In particular, the plaintiffs alleged that internal documents contradicted the

¹⁴⁹ Brief of Petitioner at 2, *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted).

¹⁵⁰ *Id.* at 22.

¹⁵¹ 17 C.F.R. § 229.303(a)(3)(ii).

¹⁵² Brief for the SEC as Amicus Curiae at *7, *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted).

¹⁵³ Sarbanes-Oxley Act of 2002 § 409, 15 U.S.C § 78m(a) (2002).

¹⁵⁴ *Pedro Ramirez, Jr., Individually and on Behalf of All Others Similarly Situated, Plaintiff, v. Exxon Mobil Corp., Rex W. Tillerson, Andrew P. Swiger and Jeffrey J. Woodbury, Defendants.*, 2016 WL 6594861 (N.D.Tex., Nov. 7, 2016).

disclosures in Exxon's MD&A/S-K. In support, they argued that the issuer's internal reports revealed that climate change would materially impact Exxon's ability fully to extract its hydrocarbon reserves, and, thereby, negatively impact its future business model.¹⁵⁵ The failure to include this information, which was directly linked to the information disclosed, undercuts the designated role of the MD&A "as an early warning device intended to alert investors as to risks, trends, and uncertainties with respect to the [issuer's] ... business that might make it unwise to rely on past performance."¹⁵⁶ In short, as Professor Langevoort points out, when an issuer describes some risks, but omits one for fear that revealing it would damage the company, the result is materially misleading. Why? Because the disclosure of some material risks makes it reasonable for an investor to believe that the disclosure was complete – or that others were not omitted.¹⁵⁷

IV. *Disclosure, Discourse, Directors, and Publicness*

Like *Leidos*, the *Exxon* case reveals both the link between disclosure and publicness, and the role of directors in managing publicness. Recall that in Part I, we focused on the multiple ways in which disclosure facilitates capital raising, issuer parity, investment, and efficient markets. When coupled with enforcement and litigation, the system is designed to increase the odds of a strong and healthy market system -- where fraud is policed and punished and capital is allocated efficiently.¹⁵⁸ Although this system is, of course, important for investors and

¹⁵⁵ *Id.* at *27-30.

¹⁵⁶ Langevoort, *supra* note 62, at 19.

¹⁵⁷ *Id.*

¹⁵⁸ Sale & Thompson, *supra* note 6, at 525-29.

issuers, its reach extends beyond those who actively engage to many others, including employees, stakeholders, and more.¹⁵⁹ This is the zone of publicness.

Publicness is a concept that encompasses the interplay between the inside players in the corporation, directors and officers, and the outsiders, like media and analysts, who cover the company.¹⁶⁰ Those outsiders reframe and recapitulate information about the issuer and, in that sense, they play an important role in the public perception of the company. The decisions that the issuer and its inside actors make can have very significant impacts outside of the entity. After all, corporations are allowed to wield significant economic and political power,¹⁶¹ and as a result are expected to consider the implications of their choices in a larger context than simply the bounds of the entity.¹⁶² Here, publicness is substantive, requiring thought and action on the part of corporate insiders. Moreover, it is about both what is disclosed and what is not. It is also about how those choices impact the issuer, investors, markets, and the public more broadly.

¹⁵⁹ E. Merrick Dodd, *For Whom Are the Corporate Managers Trustees?* 45 HARV. L. REV. 1145 (1932). As stated in the Senate debate regarding the purposes underlying the Securities Act of 1933, the system's "aim is to prevent further exploitation of the public ... through misrepresentation; to place adequate and true information before the investor ... to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities ... to restore the confidence of the prospective investor ... and to aid in providing employment and restoring buying and consuming power." Sen. Rep. No. 73-47, at 1 (1933).

¹⁶⁰ Sale & Thompson, *supra* note 6; Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629 (2014); Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012 (2013); Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137 (2011); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337 (2013).

¹⁶¹ Luigi Zingales, *Towards a Political Theory of the Firm*, UNIV. OF CHI. BOOTH SCHOOL OF BUSINESS NEW WORKING PAPER SERIES NO. 10 (2017).

¹⁶² Larry Fink, "Annual Letter to CEOs: A Sense of Purpose," BLACKROCK (Jan. 12, 2018) <https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter>; Hillary A. Sale, *Social License and Publicness*, WORKING PAPER (2018); Matthew Rosenberg & Gabriel J.X. Dance, *'You Are the Product': Targeted by Cambridge Analytica on Facebook*, THE NEW YORK TIMES (Apr. 8, 2018) (noting that Facebook has struggled to understand and adequately respond to its users' negative backlash to the Cambridge Analytica scandal).

Failing to act with publicness in mind has powerful consequences. In the *Exxon* case, the climate-change omissions resulted in a series of reactions and ongoing rounds of media coverage. For example, shareholders filed claims against the company, officers, and directors for securities law violations.¹⁶³ Stakeholders, like scientists and states, reacted strongly with concerns about the company's failure to disclose its own climate change concerns.¹⁶⁴ The SEC, multiple attorneys general, and various municipalities began to investigate the company over the omissions. Thus, the media attention, a form of publicness, resulted in investigations and further attempts to regulate and control the company's business decisions, additional layers of publicness.¹⁶⁵

Exxon then struck back, countersuing the public officials, arguing that they had engaged in a politically-motivated conspiracy to violate its free speech rights.¹⁶⁶ A federal judge threw this case out, calling Exxon's theory "implausible" and described it as running "roughshod over the adage that the best defense is a good offense."¹⁶⁷ The result is an additional wave of bad publicity that makes the

¹⁶³ Jillian Ambrose, *ExxonMobil Climate Woes Mount as Study Reveals it has 'Misled' the Public*, THE TELEGRAPH, Aug. 23, 2017, <https://www.telegraph.co.uk/business/2017/08/23/exxonmobil-climate-woes-mount-study-reveals-has-misled-public/>.

¹⁶⁴ *Id.*

¹⁶⁵ Bradley Olson & Aruna Viswanatha, *SEC Probes Exxon Over Accounting for Climate Change*, THE WALL STREET JOURNAL, Sept. 20, 2016, <https://www.wsj.com/articles/sec-investigating-exxon-on-valuing-of-assets-accounting-practices-1474393593>.

¹⁶⁶ *Judge Dismisses Exxon Lawsuit Against Climate Change Probe*, THE ASSOCIATED PRESS, Mar. 29, 2018, <https://apnews.com/b89cf926eaf64ccebb314b905dd67b>. Exxon employed a similar tactic against local governments that sued Exxon for damage and adaptation costs resulting from climate change. Exxon has petitioned a Texas court to subpoena the California officials who brought one such lawsuit, alleging that these officials "are defrauding buyers of municipal bonds by not disclosing to lenders the climate risks they have claimed in their lawsuits." Stuart Leavenworth, *These Communities Sued Big Oil Over Climate Change; Then the Backlash Began*, STAR TELEGRAM, Mar. 5, 2018, <http://www.star-telegram.com/news/nation-world/national/article203208189.html>.

¹⁶⁷ *Judge Dismisses Exxon Lawsuit Against Climate Change Probe*, THE ASSOCIATED PRESS, Mar. 29, 2018, <https://apnews.com/b89cf926eaf64ccebb314b905dd67b>.

company look like a bully. In addition, the negative public opinion of the company and its dishonesty arguably worsened.

Moreover, the attorneys general involved in the litigation are now seeking documents from Exxon going as far back as 1976 to determine what the company knew about climate change and greenhouse gas emissions.¹⁶⁸ They also want documents concerning investor communications on climate change as well as communications with groups associated with “climate skepticism.”¹⁶⁹ In some cases, the attorneys general involved are arguing that their states face serious costs to address climate change, and oil companies should help foot the bill.¹⁷⁰ For its part, Exxon has adopted a strong stance in the litigation and is alleging that there are multiple conspiracies against it.¹⁷¹ In short, the climate change omissions and the lawsuit produced a classic publicness cycle.¹⁷²

How did this happen? At least in part, the *Exxon* case, like *Leidos*, may be the result of blind spots as well as a failure of the directors to engage and manage, *ex ante*, with publicness in mind. Indeed, both examples reveal why ensuring complete disclosures matters. Recall that the purpose of these disclosures is to protect investors, issuers, and the public as well as to ensure fair dealing in the

¹⁶⁸ David Hasemyer, *Massachusetts’ Top Court Refuses to Block Exxon Climate Fraud Investigation*, INSIDE CLIMATE NEWS, Apr. 13, 2018, <https://insideclimatenews.org/news/13042018/exxon-climate-change-investigation-massachusetts-supreme-court-ruling-refuses-block-attorney-general-healey>.

¹⁶⁹ *Id.*

¹⁷⁰ Uccilia Wang, *Federal Judge to Decide Fate of New York City Climate Lawsuit*, CLIMATE LIABILITY NEWS, Jun. 13, 2018, <https://www.climateliabilitynews.org/2018/06/13/new-york-city-climate-lawsuit-keenan/>.

¹⁷¹ James Osborne, *Inside Exxon Mobil’s Fight to Stop Climate Change Litigation in its Tracks*, HOUSTON CHRONICLE, Jun. 14, 2018, <https://www.houstonchronicle.com/business/energy/article/Inside-Exxon-Mobil-s-fight-to-stop-climate-12993891.php>.

¹⁷² Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1629, 1655 (2014) (describing publicness cycle).

security.¹⁷³ Omissions undercut the value of the disclosures and thus erode the purposes. Thus, omissions matter to investors, to stakeholders, to markets, to the public, and to other issuers. As the SEC stated, disclosures under 303 are required, and by implication (and by rule), investors (and the market as well as stakeholders) should be able to assume that the required relevant information has been disclosed in an omission-free manner.¹⁷⁴

Directors have a crucial role to play here: developing candid discourse within the corporation before the disclosures and the external discourse occur. As Professor Langevoort's work on behavioral theory in corporations reveals, directors must foster open, truthful relationships with management to combat the structural asymmetry that may increase managers' incentives to suppress negative information about the day-to-day operations of the corporation when communicating with the board.¹⁷⁵ Those choices by management, of course, violate candor requirements and, thereby, undercut the very purposes of disclosure.

The recent litigation over the Wells Fargo cross-sell strategy and resulting scandal provides just such an example of failed discourse, candor, and disclosure. At issue with Wells was its failure to tell shareholders about growing legal and other issues. Like Leidos and Exxon, the plaintiffs in the Wells litigation argued that the company did not disclose sales practice issues in its SEC filings. Yet, the "fake-accounts scandal turned out to be a seminal moment for [the company], tarnishing [its] reputation and upending its management team."¹⁷⁶

¹⁷³ Sarbanes-Oxley Act of 2002 § 409, 15 U.S.C § 78m(a) (2002).

¹⁷⁴ Brief for the SEC as Amicus Curiae at *7, *Leidos, Inc. v. Indiana Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017) (cert. granted).

¹⁷⁵ Langevoort, *supra* note 23, at 146-47 and 158-59.

¹⁷⁶ See <http://money.cnn.com/2018/05/04/news/companies/wells-fargo-securities-fraud-settlement/index.html>.

The role of the directors in this scandal has been the subject of Congressional hearings, SEC questions, private-plaintiffs' litigation, and even consent decrees from the Federal Reserve. At the heart of the scandal was the company's key strategy and growth mechanism – its cross-sell program, which, it turned out, was premised on fraud. The fraud and cultural issues at the company were so widespread, that the regulators have taken the board to task for its failures to challenge managements' assertions. Indeed, according to the Federal Reserve, management reports to the board “generally lacked detail and were not accompanied by concrete action plans and metrics to track plan performance.”¹⁷⁷ The board should have caught this. And, as a result, the Federal Reserve instructed the board to “strengthen ... oversight of the firm and senior management.”¹⁷⁸

Of course this scandal harmed the bank's shareholders. Yet, like in the Leidos and Exxon situations, the harms extend beyond investors to customers/clients and employees. Further, like the 2008-2009 financial crisis, bank scandals have the potential to cause harm to the public as well. For Wells, the result has been billions in settlements and serious limitations on its business. The process of publicness has thus resulted in some powerful forms of substantive publicness, including, for example, limits on the bank's ability to grow its assets and a timetable for it to appoint new directors. It also faces ongoing scrutiny in the form of requirements for it to submit certain plans for regulator approval.¹⁷⁹ The Federal Reserve also required the directors to sign the consent order, making

¹⁷⁷ Press Release, Fed. Reserve Bd., Accountability as Chair of Wells Fargo & Company Board of Directors (Feb. 2, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a4.pdf>.

¹⁷⁸ Press Release, Fed. Reserve Bd., Accountability as Chair of Wells Fargo & Company Board of Directors (Feb. 2, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a4.pdf>.

¹⁷⁹ *Id.*

clear its view of their role.¹⁸⁰ Their failures include a lack of candid discourse within the boardroom and with the officers – a key role of directors that, when successfully executed helps to ensure that the purpose of disclosure is fulfilled, with sufficient attention to publicness.

Conclusion.

The purpose of securities disclosures is to increase the accountability of the issuer and, thereby, to protect issuers, investors, and the public. Indeed, for many of the reasons delineated in Part I, the incentives of issuers to disclose are insufficient due to confidentiality and other concerns. As a result, we mandate a disclosure regimen and insert directors into it to play a key gatekeeper role in ensuring the accuracy of disclosures, including pressure testing for omissions. Here is where discourse and candor come into play. They are part of the information-forcing-substance regime, which is a product of both federal securities laws and state fiduciary duties. When it works, it increases the accountability of management and the directors –to investors, to the markets, and to the public more generally.¹⁸¹ Indeed, as designated securities monitors, the regulatory goal is for directors to take ownership of disclosures by engaging with management and ensuring accuracy.¹⁸² If they do so, they help to fulfill disclosure’s purpose. Yet, to do so effectively, directors must both engage in discourse and understand publicness and its potential impact on the company. They must understand how their role connects to the entity’s boundaries and private status, as well as to its public obligations, publicness, and social license more broadly.¹⁸³ Indeed, developing this understanding and engaging in the

¹⁸⁰ *Id.*

¹⁸¹ Sale & Langevoort, *supra* note 2, at 786-94.

¹⁸² S. REP. NO. 47, 73d Cong., 1st Sess. 1, 4-5 (1933).

¹⁸³ The theory of social license states that businesses and other entities exist with permission from the communities in which they are situated, and from the stakeholders that constitute those

discourse will help to increase securities monitoring. In this sense then, discourse and candor increase regulatory compliance. In short, pressure testing and candor will produce better, more complete, and balanced disclosure outcomes for investors, issuers, and the public – and thus, fulfill disclosure’s purpose.

communities. In that sense, businesses are social, not just economic, institutions and thus are subject to public accountability and public control. For more information, see Hillary A. Sale, *Social License and Publicness* (2017); Robert G. Boutilier & Ian Thomson, *Modelling and Measuring the Social License to Operate: Fruits of a Dialogue Between Theory and Practice* (2011); Geert Demuijnck & Bjorn Fasterling, *The Social License to Operate*, 136 JOURNAL OF BUSINESS ETHICS 675 (2016); Domènec Melé & Jaume Armengou, *Moral Legitimacy in Controversial Projects and Its Relationship with Social License to Operate: A Case Study*, 136 JOURNAL OF BUSINESS ETHICS 729 (2016); Robert G. Boutilier, Leeora Black, & Ian Thomson, *From Metaphor to Management Tool: How the Social License to Operate can Stabilise the Socio-political Environment for Business*, INTERNATIONAL MINE MANAGEMENT 2012 PROCEEDINGS, 227-237 (2012); David Jijelava & Frank Vanclay, *Legitimacy, Credibility, and Trust as the Key Components of a Social License to Operate: An Analysis of BP’s Projects in Georgia*, 140 JOURNAL OF CLEANER PRODUCTION 1077, 1082 (2017).