

**Reinventing the Securities Disclosure Regime:
Online Questionnaires as Substitutes
For Form-Based Filings**

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Working Paper No. 361
August 2008

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Abstract: We briefly describe a proposed reform of the SEC's disclosure process that would replace the great majority of disclosure forms with an on-line questionnaire-driven disclosure regime subject to mandatory updating according to a schedule defined by the Commission. This approach allows the Commission to elicit all the information currently generated by its forms-based filing system at, we believe, a dramatically lower cost to filers. It would also facilitate rapid, low-cost construction of databases that promote ready comparison of disclosures across registrants and over time. The system promises to eliminate the filing of duplicative information and can automatically focus attention on changes from prior disclosures. It thereby facilitates Commission review while simultaneously calling the market's attention to matters most likely to influence price formation. This new regime would also allow the Commission to achieve the significant potential benefits of a company-based disclosure system without seeking legislative authority, and without running the risk of changes to the liability structure provided under the current offerings-based disclosure regime.

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1. Introduction.

The United States Securities and Exchange Commission has recently announced a project to bring disclosure structure and practices into the 21st Century.¹ We heartily endorse the Commission's initiative, and present this brief note to introduce and summarize our proposal for a dramatic restructuring of the Commission's disclosure regime.

We suggest that the Commission abandon all forms currently used in the Commission's disclosure mechanism. Forms 10-K, 10-Q, 10-D or 8-K would no longer exist, and the great majority of other forms used for company disclosure would also be eliminated.

Disclosure would instead occur in response to an on-line, internet-based questionnaire subject to mandatory updating according to a schedule defined by the Commission.² As explained in greater detail below, and as to be detailed in a more extensively documented article currently in preparation, a disclosure regime driven by an internet-based questionnaire offers substantial efficiencies to registrants, investors, the Commission, and the public alike. It can dramatically reduce filing and registration costs, and can also facilitate rapid, low-cost construction of databases that promote ready comparison of disclosures across registrants and over time. Because the system can be structured automatically to focus attention on changes from prior disclosures - - the very

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¹SEC Press Release 2008-119 (June 24, 2008).

² Our proposals relate only to disclosures outside of the financial statements that accompany or are incorporated into these filings. Those financial statements can be submitted electronically with XBRL tagging that, we believe, is sufficient to generate the efficiencies that we view as lacking in the current form-based filing system. Our proposals also do not address filings that are already highly structured and that are amenable to XBRL tagging, such as listings of mutual fund company portfolio holdings.

sort of information to which the market is most likely to respond - - the system can facilitate Commission review of filings while simultaneously calling the market's attention to matters most likely to influence price formation and eliminating the need to file duplicative information.

This approach allows the Commission to elicit all the information currently generated by the forms-based filing system while reducing compliance costs and generating more useful data for investors. This approach also allows the Commission to achieve the significant potential benefits of a company-based disclosure system without the need to seek legislative authority, and without changes to the liability structure provided under the current offerings-based disclosure regime.

The Commission's forms-based filing system, with its roots in a paper-driven disclosure regime that dates from the 1930's, cannot, we think, be merely retooled in a manner that addresses the realities of a 21st century internet-driven information economy. Radical change is necessary: the sort of change that best comes about only if one totally abandons all vestiges of the world of paper-based filings and fully embraces the reality of an on-line database-driven disclosure regime.

2. The Online Questionnaire: A More Detailed Explanation.

The current forms-based structure calls for filing complete documents that provide all the information required by specific forms according to a schedule defined by Commission rules. The system operates on the assumption that those documents are prepared, studied, and archived on paper. In today's world companies assemble data, including in databases, that capture the salient information. Disclosure documents on paper-based forms are then prepared based on that information. Investors and intermediaries then analyze Commission filings in what is in effect an effort to reconstruct the databases and other information that are the starting point of the disclosure process. The interposition of the paper-based filing of forms, even if executed electronically through EDGAR, thus introduces a wasteful inefficiency in the information flow from filers to investors and to the Commission.

A more efficient process would promote a "direct to database" design that would make it easier and cheaper for registrants to provide the necessary information and for users to analyze the information provided by registrants. An online questionnaire is, we suggest, the most efficient means of achieving this objective.

Although the proposed on-line questionnaire can take many different forms, we presently conceptualize the questionnaire as being composed of a combination of binary (yes/no) responses, pull-down menus, numeric fields, and textual responses. Information corresponding to current 10-K disclosure requirements would be updated annually; information corresponding to current 10-Q disclosure requirements would be updated quarterly; and information corresponding to that now required by Form 8-K would be updated on the occurrence of specified events. Information required by Schedule 14A would be updated as of each proxy solicitation relating to a similar matter put to

shareholder vote.³ (Of course, implementing this new disclosure structure would provide an important opportunity for the Commission and the staff of the Division of Corporation Finance to consider revisions to the substantive disclosure requirements and modify them as appropriate to improve the quality of disclosure.)

Further, once the questionnaire is initially completed, filers would be required to update only those items that have changed since the last reporting period. The need to repeat unchanged information - - a pervasive and wasteful aspect of the current disclosure regime - - is thus eliminated.

Binary Responses. As for the architecture of the questionnaire itself, some disclosure items are easily addressed by simple binary, yes/no responses. For example, has the registrant been subject to any material new litigation during the relevant period? Is a specific director a member of the audit committee, or has a specific director been designated as an “audit committee financial expert”? Does the registrant have a shareholder rights plan, or has it made a change to any pre-existing plan? Have there been any issuances of new securities since the last update? Has the filer repurchased any of its shares during the quarter for which the disclosure is made? A positive response may call for additional disclosures via pull-down menus or full-text disclosures. A negative response may indicate that no further disclosure on this topic is necessary, or may call for additional explanation.

To address the possibility of ambiguity or the possible need for additional information in connection even with simple binary responses, the questionnaire should provide text boxes in which filers can explain why a straightforward yes or no response might not be completely accurate in light of the filer’s particular circumstance.

Pull-Down Menus and Direct Factual Responses. Responses to other questions can be anticipated through pull-down menus or predefined fields in which straightforward factual information can be entered. For example, information describing the jurisdiction of incorporation, SIC classification, and jurisdictions in which the registrant has offices, plants, or facilities, can typically be captured through pre-defined taxonomies. Other responses can be structured as numeric entries in predefined fields. For example, data describing the number of employees are easily entered into a specified field. Similarly, a request to name all executive officers is easily addressed through a text box that allows for a direct factual response, typically with little necessary elaboration.

Again, to address the possibility of ambiguity or the possible need for additional information, the questionnaire can provide a text box in which the filer can explain why

³ The current structure of disclosure under Schedule 13D under the Exchange Act, which requires information regarding 5% beneficial owners, provides an interesting contrast with what would result under our proposal. Currently, amendments to Schedule 13D are only required to set forth information that has changed from that previously provided. However, because of the paper forms-based underlying structure of disclosure, a user of the disclosure must nonetheless obtain the original filing and all amendments to determine the current state of disclosure, even if operating on EDGAR. Under our proposal there would be a single location under which the complete current Schedule 13D information is available, together with the dates on which changed information is provided. The changes themselves would also be identified.

the pull-down menu alternatives, numeric entries, or other factual responses might not accurately describe its particular circumstance.

Free Form Textual Responses. To be sure, many questions will require free form textual responses that can be inserted in a specified location in the questionnaire. For example, a description of the company's business can be identical to disclosures currently provided in response to Item 101 of Regulation S-K, and can be inserted as a response to a question calling for a description of the registrant's business. If the company's business does not change as of the next date on which an update is required, then no additional response is necessary: the system simply carries forward the prior disclosure with an automatically generated notation that there is no change from a prior filing. If a change occurs, then the filer amends its prior disclosures. The system automatically notes the fact that a change has occurred and various software tools can be applied to highlight text that has been dropped from or added to the disclosure. A variant of the Commission's "plain English" requirement can also call for disclosure in a form that minimizes the amount of altered text required in these disclosures, thereby making it even easier to track and understand the changes and updates.

Standardized Disclosures. It is common knowledge that many forms of disclosure are highly standardized. While there is debate over the situations in which standardized forms of disclosure are beneficial, it is, we believe, generally accepted that certain types of disclosure are highly standardized because there is no meaningful, pragmatic alternative. Consider, for example, risk factor disclosure regarding the consequences of a major earthquake in the San Francisco Bay Area for a company headquartered in that region and with its manufacturing facilities there as well. Unless one knows which fault ruptures, the magnitude of the event, whether the event causes liquefaction of soil under San Francisco Airport's runways, whether roads in the vicinity of the registrant's plants collapse, and myriad other factors, it becomes impossible to describe the risk other than to say it could be extreme. Standardized disclosures of seismic risk are therefore to be expected, and can be entirely accurate. A questionnaire driven disclosure regime will make the presence of standardized responses all the more apparent, and will allow the Commission and its staff to focus on situations in which standardized responses are entirely appropriate as distinct from situations in which more tailored discussions are beneficial.

The Optimal Degree of Structure. The optimal degree of structure embedded in the questionnaire is a complex issue that, we believe, will benefit from public debate and discussion. For example, when calling for a description of a shareholder rights plan, the questionnaire could provide for an entirely free-form description that allows the plan to be described in a text box of unlimited length. This structure would essentially capture and replicate the information currently supplied in the forms-based filing system.

Alternatively, the questionnaire could provide for a set of pull down menus that describe the typical characteristics of a shareholder rights plan, such as whether the plan is flip-in and/or flip-over, and the trigger levels embedded in the plan, together with a text

box that allows for description of the extent to which the pull down menus are not be fully accurate, or of additional information not called for in the pull down menus. While our initial view is that more structured response architectures are preferable, we recognize that there is little learning and experience on this subject. Our views are therefore likely to change as filers and users comment on the prospects of a questionnaire-driven disclosure regime, and the details associated with the design of such a regime are developed. We would observe that the greater the structure, the greater the ease with which databases that permit comparisons over time or among large numbers of companies can be facilitated.

Treatment of MD&A. Providing for optimal MD&A disclosure will be a challenging task in designing the new disclosure structure. MD&A at its best relies substantially, if not entirely, on free-form disclosure of management's own views about a company's financial condition and operations, and such MD&A changes from period to period as circumstances change within the company and externally. However, many companies rely significantly on recitations of percentage changes in consistently defined metric describing rather stable lines of business (X increased Y%, A decreased B%).. The latter approach lends itself to greater structure in an online questionnaire format. Our thinking on this complex issue is at a preliminary stage, but we would be inclined to pursue a solution that involved structured quantitative disclosure combined with free-form explanatory and analytical narrative. We note that our proposed approach can be structured so as not to change the content of current MD&A disclosures, and so as to accommodate more textured and nuanced analysis. We also note that the design of the new structure to focus on changes in disclosure would permit identification of companies that continue to use the same MD&A as their condition or performance changes or as the world changes around them.

3. Exhibits

The proposed on-line questionnaire would also centralize all exhibits in a single on-line location. Changes or amendments to already filed materials will be easily recognizable through the application of track change tools. The addition of new exhibits would then also occur in a form that can be easily traced by the Commission and the market.

This feature of online questionnaire-based filing helps solve a problem that plagues the current forms-based disclosure regime. Currently, exhibits are presented as attachments to the forms with which they are initially filed. However, when the exhibits are listed as incorporated by reference (as is often the case in the most recently filed annual report on Form 10-K), any user seeking to find the original text has to search to find the original filing to which the exhibit was attached in order to identify the document itself. This is often a time-consuming process. By providing an automatic direct link to the exhibit itself, without requiring any refiling of the materials that have already been posted as responses to prior questions, the questionnaire approach reduces search costs for users without increasing costs for filers.

4. The Evergreen Analogy

Our proposed on-line questionnaire-driven approach will generate an evergreen incrementally updated disclosure database. We are mindful that updates would have to be clear to the market and not submerged in the modified updated body of disclosure, and therefore emphasize that the system should be engineered so as to allow efficient identification of changed information. Ideally, the databases generated by this online disclosure regime would include audit trails that allow easy identification of the date and content of any modification, thereby allowing users easily to reconstruct any filer's disclosure history as to any disclosure item. It would then, for example, be easy to track the history of changes in any filer's description of its own business, risk factors, or any other disclosure item.

5. Company-Based Disclosure

An on-line questionnaire driven disclosure regime also evolves the Commission's disclosure regime more closely to a company disclosure process without requiring any amendment of the legislative regime and without undercutting the protections of Section 5 of the Securities Act of 1933.

Many observers suggest that company-based disclosure serves the market better than periodic and even current reporting, and better than registration-based reporting. Indeed, secondary market activity for most companies represents many multiples of primary market activity, and there is no primary market equity activity for many of the largest filers except that related to equity-based compensation. Our proposal would be the next step in the evolution to company-based disclosure, and would accomplish that result within the mandate of the Commission's current statutory authority.

At the same time, a pure company registration regime, even if it can be accommodated within the current statutory requirements of the securities laws, could run the risk of undercutting Section 5 of the Securities Act in ways that would be unfortunate. Section 5 operates in a manner that provides not only material disclosure to purchasers in registered offerings (disclosure that our proposal would ensure) but also a specific regime of remedies under the liability provisions of Sections 11 and 12(a)(2). Regardless of the proper contours of the standards of conduct prescribed under those liability provisions, recent court decisions regarding the application of Section 5 to short sales⁴ and the Commission's lack of response to date already raise issues regarding the vitality of the offering-based liability regime of the Securities Act. Our proposal would provide all of the advantages of company registration without putting the Section 5 structure at further risk.

⁴ Unreported opinion in *SEC v. Mangan*, Civ. Action No. 3:06-CV-531 (W.D.N.C. October 24, 2007); *SEC v. Lyon*, 529 F. Supp. 2d 444 (SDNY Jan. 2, 2008); *SEC v. Berlacher*, No. 07-CV-3800 (EDPA Jan. 23, 2008).

6. Filing Mechanics

As for the technical requirements of “filing,” they can be accomplished through a variety of different mechanisms. Current technology allows filers to post response either to their own websites, or to a Commission-designated location on the internet, with a “hash” that authenticates the document as well as the date and time of posting. The act of posting on either of these sites, together with the relevant hash, could then constitute filing. Providing the hash to the Commission, whether the disclosure is posted on a Commission-designated location or only elsewhere, would allow Commission verification of the integrity of the document as of the authenticated date and time.

Alternatively, the Commission could require that responses be forwarded with a hash to the Commission’s location on the internet from which the Commission could readily construct its own internal master database of officially filed materials. The Commission’s own software can then review the filing and respond with a message, containing the Commission’s hash, indicating that the responses have been accepted for filing.

7. XBRL

XBRL and interactive data approaches are well suited to financial statement disclosure and to disclosures that are readily structured as entries responding to a fixed format, such as tabulations of holdings by mutual fund companies, filings on Forms 3, 4 and 5 to provide the reports required pursuant to Section 16(a) of the Exchange Act, or bank call reports. The questionnaire-driven approach is, we submit, superior to XBRL tagging of information for other forms of disclosure.

The tagging and taxonomy requirements under XBRL for the more free-form non-financial disclosure may be formidable in the extreme. In addition, simply adding XBRL tagging to the current form-based architecture continues to require the preparation and filing of repetitive information. This feature of the XBRL approach is not problematic for financial disclosure because those disclosures almost always differ for each financial period. We are also concerned that extending XBRL to non-financial disclosure would add to the cost of the disclosure system, could raise difficult issues regarding the legal liability that might arise in the event of a contested XBRL tag, and would fail to provide for the flexibility inherent in the questionnaire driven approach.

8. Conclusion

Much work remains to be done in order to flesh out the full contours of an internet-based questionnaire-driven disclosure regime. We plan to address some of these issues in a longer article. We also plan to develop a “mock up” of an actual on-line questionnaire. We currently intend to focus on the information elicited in portions of Schedule 14A, poison pill descriptions, and other examples of the disclosure process that might usefully illuminate the potential strengths and weaknesses of a questionnaire-

driven regime. In addition, we plan to develop a mock up of a database with an audit trail that will illustrate the ability to track new disclosures across filers and over time.

The path toward an internet-based questionnaire will not be easy. The experience of the online community in developing open source code and wikis is, we believe, salient though alien to the legal community and to the administrative process. This preliminary description of an on-line questionnaire-driven disclosure regime is intended to provoke among securities lawyers and regulators the sort of open discussion, debate, and commentary that is the norm in the internet community and that can help build a more efficient disclosure regime that reduces costs for filers while improving the quality of information available to investors.