PERIODIC REPORTING IN A CONTINUOUS WORLD: THE CORRELATING EVOLUTION OF TECHNOLOGY AND FINANCIAL REPORTING

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ABSTRACT

The evolution of technology has drastically altered what it means to be a reporting company in the eyes of the Securities and Exchange Commission. Technological development has also played a large role in the shifting trend from periodic reporting to continuous reporting, as is particularly apparent in the evolution of the Form 8-K. It is true that the increasingly technological world of continuous reporting does not come without disadvantages. This issue brief, however, argues that despite the increased risks and challenges of continuous reporting, its net effect on disclosure, and the investing community generally, is positive. With that benefit in mind, this paper further suggests four new amendments to the Form 8-K.

INTRODUCTION

The Securities and Exchange Commission (SEC) is one of the most successful federal regulatory agencies in our country's history.[1] One reason for the SEC's continued success has been its ability to adapt to changing circumstances, such as the evolution of technology.[2] From the adoption of an electronic disclosure system around the dawn of the Information Age to real-time reporting to the current shift toward interactive data in disclosure filings, the SEC has made valiant attempts to stay in line with an ever-evolving technological world. Modern smartphones and similar technological advancements have created a thirst for constant information that periodic reporting simply cannot satiate. Over the last decade, the SEC has steadily been moving from periodic to continuous reporting. This trend is largely due to the fact that

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1 *See, e.g.*, *Press Releases*, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/news/pressreleases (last visited Feb. 22, 2015) (listing activities of the SEC).

2 *See generally Report to the Congress: The Impact of Recent Technological Advances on the Securities Markets*, U.S. SEC. & EXCHANGE COMMISSION (Nov. 26, 1997), http://www.sec.gov/news/studies/techrp97.htm.

technology has made the prospect of continuous reporting feasible for both reporting companies and investors. This trend is particularly evident in the evolution of the Form 8-K.

The benefits of such continuous reporting are, *inter alia*, that it gives investors the ability to take advantage of important business moves as they occur, and subsequently use periodic reports to interpret the effects of those earlier-disclosed events. Critics, however, worry about compliance costs, continuous disclosure's effect on competitive advantage, and so-called "information overload." In this issue brief, I will briefly discuss the regulatory framework of the SEC, followed by a discussion of the disclosure requirements reporting companies face today. Then, I will discuss how the evolution of the Form 8-K illustrates a trend from periodic towards continuous reporting. Finally, I will weigh some of the advantages and disadvantages of continuous reporting. Ultimately, this issue brief concludes that the shift to continuous reporting will bring a net benefit to disclosure and the investing community, and suggests four new amendments to the Form 8-K to further that benefit.

I. THE REGULATORY FRAMEWORK

The market collapse in 1929 and the ensuing Great Depression led Congress to enact comprehensive reform now referred to as the federal securities laws.[3] Though various factors have been attributed to causing the crash, Congress perceived a lack of information as the critical problem facing investors that ultimately led to the market collapse.[4] In an attempt to remedy this problem, two principal reforms were enacted.

The first major reform was the Securities Act of 1933 (the "Securities Act"), which sought to provide full and fair disclosure for investors by mandating registration statements for the offering and sale of securities.[5] The second reform was the Securities Exchange Act of 1934 (the "Exchange Act"), which instead focused on existing markets and their participants.

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[3] JAMES D. COX, SECURITIES REGULATION: CASES AND MATERIALS (7th ed. 2013).

[4] *But see* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385, 408 (1990) ("Conventional wisdom holds that the Exchange Act was passed in response to the 1929 crash. This view is correct at least in the sense that stock exchange legislation was inevitable once the public blamed the stock market crash for the Depression.").

[5] COX, *supra* note 3, at 5.

Companies subject to the Exchange Act must comply with several reporting and disclosure requirements. Prior to 1982, the separate disclosure regimes applicable to the Securities Act and the Exchange Act often resulted in overlapping and duplicative requirements.[6] After spending many years analyzing the disclosure rules under both the Securities Act and the Exchange Act, the SEC created an "integrated disclosure system" in 1982.[7] The goal was to "revise or eliminate overlapping or unnecessary disclosure and dissemination requirements wherever possible, thereby reducing burdens on registrants while at the same time ensuring that security holders, investors, and the marketplace will be provided with meaningful non-duplicative information upon which to base investment decisions."[8]

Disclosure requirements are broken into two categories: financial and non-financial. For the most part, the required disclosures for each are found in Regulation S-X and Regulation S-K, respectively. Additionally, to promote the goal of fair disclosure, Regulation FD was adopted in order to combat what the SEC viewed as unfair selective disclosure.

II. THE REPORTING REQUIREMENTS

A company becomes subject to the reporting requirements of the Exchange Act when any of the following occurs:

1. The company has a security listed on a national securities exchange (e.g., NYSE, NASDAQ);[9]
2. The company on the last day of its fiscal year has 2000 or more security holders,[10] has assets over \$10 million, and is engaged in interstate commerce;[11] or
3. The company has a registered public offering of securities (though this requirement ends after one

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[6] STAFF, SEC. & EXCH. COMM'N, REPORT ON REVIEW OF DISCLOSURE REQUIREMENTS IN REGULATIONS S-K, at 10 (Dec. 1, 2013), *available at* 2013 WL 7117005.
[7] Adoption of Integrated Disclosure System, SEC Release No. 33-6383, 47 Fed. Reg. 11, 380 (Mar. 3, 1982).
[8] *Id.*
[9] Securities Exchange Act of 1934, Pub. L. No. 73-291, § 12(a), 48 Stat. 881, 892 (codified as amended at 15 U.S.C. § 78*l*(a) (2012)).
[10] Or over 500 security holders, in the case of unaccredited investors. 15 U.S.C. § 78*l*(g)(1)(A).
[11] *Id.* § 78*l*(g).

year, provided that the record holders are fewer than 300).[12]

Disclosure can be required periodically (at certain predetermined times a year) or episodically (in the case of a significant event occurring, such as an initial public offering).[13] This section will discuss examples of periodic reports, the evolution of how companies file these reports, and how that technological evolution is moving regulation towards continuous reporting.

A. Periodic Reporting

The Exchange Act requires reporting companies to file a Form 10-K annually, a Form 10-Q quarterly, and a Form 8-K generally within four business days after the occurrence of certain events.[14] Form 8-K will primarily be discussed in Section III.

1. The Form 10-K

At the end of each fiscal year, a reporting company must file pertinent information about itself in a Form 10-K. This form must include audited financial statements pursuant to Item 301 of Regulation S-K,[15] management's discussion and analysis of the financial condition and results of operation pursuant to Item 303 of Regulation S-K,[16] disclosures of legal proceedings pursuant to Item 103 of Regulation S-K,[17] information on executive compensation pursuant to Item 402 and Item 407 of Regulation S-K,[18] and disclosure of certain relationships and transactions involving director independence pursuant to Item 404 and Item 407 of Regulation S-K.[19] By analyzing a company's Form 10-K, investors can get an inside-look at the firm's financial performance for a given fiscal year and use that information in deciding their investment position on that company.

2. The Form 10-Q

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[12] *Id.* § 78o(d).
[13] COX, *supra* note 3, at 10.
[14] *Id.*
[15] U.S. SEC. & EXCH. COMM'N, FORM 10-K: ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934: GENERAL INSTRUCTIONS 9 (2012), *available at* https://www.sec.gov/about/forms/form10-k.pdf.
[16] *Id.*
[17] *Id.* at 8.
[18] *Id.* at 10.
[19] *Id.*

Since investment decisions are often made on a continuing basis, there are obvious disadvantages to limiting investor insight to a single annual report. Thus, at the end of each fiscal quarter,[20] a reporting company must also file a Form 10-Q with information similar to Form 10-Ks. It must include quarterly financial data prepared in accordance with Generally Accepted Accounting Principles (GAAP) pursuant to Rule 10-01 of Regulation S-X, [21] a management report similar to that in a Form 10-K,[22] similar disclosures on legal proceedings,[23] any unregistered sales of securities pursuant to Item 701 of Regulation S-K,[24] defaults upon senior securities,[25] and any submission of matters to a security holder vote.[26] Although the information is delivered more frequently in Form 10-Qs, it is generally less detailed than the information in its Form 10-K counterpart. Furthermore, financial statements in Form 10-Qs are not required to be audited.

B. Development of Reporting Methods

When the integrated disclosure system was first introduced in 1982, company disclosures, offering documents, and other filings were both submitted to the SEC and available to investors exclusively in paper form.[27] Though technology has changed dramatically since 1982, the architecture of the reporting requirements has remained in place. This section will discuss the effect of technology on reporting, including EDGAR, XBRL, and most recently IDEA.

1. EDGAR

In 1983, a pilot program for the Electronic Data Gathering, Analysis and Retrieval ("EDGAR") was established pursuant to a Congressional mandate.[28] The program took advantage of the technology available at the time, with the SEC accepting three different forms of media: computer diskettes, magnetic tapes, and direct transmission over telephone lines using modems.[29]

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[20] The final quarter of a firm's fiscal year is included in the Form 10-K, so a reporting company actually only issues three Form 10-Qs per fiscal year.
[21] U.S. SEC. & EXCH. COMM'N, FORM 10-Q: GENERAL INSTRUCTIONS 5 (2012), *available at* https://www.sec.gov/about/forms/form10-q.pdf.
[22] *Id.*
[23] *Id.* at 5–6.
[24] *Id.* at 6.
[25] *Id.*
[26] *Id.*
[27] STAFF, SEC. & EXCH. COMM'N , *supra* note 6, at 13.
[28] *Id.* at 13 n.31.
[29] *Id.*

Modern advances in technology have made it easier for companies to file their required periodic reports. Now, filings are made electronically[30] through the EDGAR system, which is free for companies to use. In May 2002, the SEC moved from a delay of at least 24 hours before filings appeared on the SEC web site to today's real-time access.[31] Electronic submissions are governed by Regulation S-T in addition to the EDGAR Filer Manual and applicable rules, regulations, and forms.[32]

2. XBRL

In an effort to improve the EDGAR system, in 2005 the SEC adopted amendments allowing reporting companies to voluntarily use "supplemental tagging"[33] in their financial information by using the eXtensible Business Reporting Language (XBRL) format.[34] Although participation was initially voluntary, the use of XBRL for interactive data became mandatory just four years later.[35] This mandate was primarily due to the 2008 announcement of EDGAR's successor: Interactive Data Electronic Applications (IDEA).[36]

3. IDEA

IDEA, a "completely new architecture being built from the ground up," will first supplement EDGAR before eventually replacing it.[37] In EDGAR, most filings are only available in the SEC-prescribed reporting forms. An investor searching for comparative information, for example, must sift through one form at a time, a task the SEC itself admits to be "painstaking."[38] In the press release announcing IDEA as

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[30] The SEC requires a paper filing of Form 1-A. 17 C.F.R. 239.90 (2015).
[31] Press Release, Secs. & Exch. Comm'n, SEC Announces Free, Real-Time Public Access to EDGAR Database at www.sec.gov (May 30, 2002), *available at* http://www.sec.gov/news/press/2002-75.htm.
[32] Adoption of Updated EDGAR Filer Manual, Exchange Act Release No. 33-8656, [71 FR 5596] (Feb. 2, 2006).
[33] "Companies create interactive data files by defining – or "tagging" – their financial statements using elements and labels from a standard list of interactive data tags." STAFF, SEC. & EXCH. COMM'N , *supra* note 6, at 14 n.34.
[34] XBRL Voluntary Financial Reporting Program on the EDGAR System, Exchange Act Release No. 33-8529, [70 FR 6556] (February 8, 2005).
[35] Interactive Data to Improve Financial Reporting, Exchange Act Release No. 33-9008, [74 FR 6776] (Feb. 10, 2009).
[36] Press Release, Secs. & Exch. Comm'n, SEC Announces Successor to EDGAR Database (Aug. 19, 2008), *available at* http://www.sec.gov/news/press/2008/2008-179.htm.
[37] *Id.*
[38] *Id.*

EDGAR's eventual replacement, the SEC further illuminated the advantages of interactive data:

> Interactive data relies on computer "tags," similar in function to bar codes, which identify individual items in a company's financial disclosures. With every number on an income statement or balance sheet individually labeled, information about thousands of companies contained on thousands of forms could be easily be searched on the Internet, downloaded into spreadsheets, reorganized in databases, and put to any number of other comparative and analytical uses by investors, analysts, journalists, and financial intermediaries.[39]

C. Towards Continuous Reporting

Continuous reporting, as opposed to periodic reporting, is the release of information on a real-time basis for the purpose of allowing investors and shareholders access to information as the events occur, rather than waiting for annual or quarterly reports. The adoption of interactive data and the SEC's eventual move towards IDEA have all furthered the SEC's goal of increased disclosure to the investing community.[40] The current trend toward continuous reporting, facilitated by the technologies discussed above, also furthers this benefit for the investor. Nowhere is this trend more apparent than in analyzing the Form 8-K.

III. OVERVIEW OF THE FORM 8-K

In addition to the annual Form 10-K and the quarterly Form 10-Q, public companies are required to report certain material corporate events on a more current basis via the Form 8-K. This section will discuss the history and evolution of the Form 8-K, events triggering a Form 8-K requirement, and a brief discussion on determining materiality.

A. History and Evolution of the Form 8-K

Under the original guidelines for the Form 8-K, SEC filings were required within ten days of the end of any month during which a significant event had occurred.[41] The significant events at that time

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[39] *Id.*

[40] *See generally*, The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, U.S. SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/whatwedo.shtml (last visited Apr. 14, 2015) (describing the SEC).

[41] Alina Lerman & Joshua Livnat, The New Form 8-K Disclosures 3, (Dec. 19, 2008) (unpublished paper), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1126816.

included "a change in control of the registrant, an acquisition or disposal of assets, bankruptcy or receivership, change in registrant's certifying accountants, resignation of registrant's directors, a change in fiscal year end and other unspecified events deemed important, as well as any related exhibits and financial statements."[42] In the 1980s, two more events were added[43] and the deadline was reduced to fifteen calendar days or five business days after the event's occurrence, depending on the event.[44]

The next development followed in Section 409 of the Sarbanes-Oxley Act of 2002, titled "Real Time Issuer Disclosures," which stated that "[e]ach issuer reporting under section 13(a) or 15(d) shall disclose to the public on a *rapid and current basis* such additional information concerning material changes in the financial condition or operations of the issuer . . . ."[45]

The SEC, motivated by both an investor demand for real-time access and the enactment of Sarbanes-Oxley, in 2004 increased the number of items triggering a Form 8-K from twelve to twenty-two.[46] Additionally, the form must be filed within four business days of the reported event (some events must be disclosed in as soon as two days),[47] tightened from the earlier requirement of five business days or fifteen calendar days.[48] The SEC estimated that the average company would be required to file five additional Form 8-K's each year.[49]

There were eight new mandatory 8-K disclosures added in 2004: entry into or termination of a material agreement, creation or increase of an off-balance sheet obligation, exit or disposal activities, material impairments, notice of delisting, and non-reliance on a previously issued report.[50] Furthermore, the unregistered sale of securities and

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[42] *Id.* at 3–4.
[43] Amendments to or waivers of the company's code of ethics and a temporary suspension under the company's employee benefit plan. *Id.* at 4.
[44] *Id*.
[45] Final Rule: Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Exchange Act Release No. 33-8400, [69 FR 15594] (Mar. 25, 2004) (emphasis added) [hereinafter SEC Release No. 33-8400].
[46] Valerie F. Jacob et al., *The New Form 8-K: Fifteen Items Every General Counsel Needs to Know*, 60 CONSUMER FIN. L.Q. REP. 42, 43 (2006).
[47] Except for Item 7.01 for Regulation FD, disclosure is typically required the same day information was intentionally disclosed to others or within 24 hours of unintentional disclosures.
[48] Jacob et al., *supra* note 46, at 43.
[49] *Id.*
[50] Lerman & Livnat, *supra* note 41, at 4.

modifications to security holder rights—formerly on the 10-K and 10-Q periodic reports—were transferred to the continuous Form 8-K.[51]

B. Determining Materiality Under the Form 8-K

A brief glance through the Form 8-K items will reveal that the materiality of an event must be decided in nearly half of the Form 8-K disclosures.[52] As there are multiple approaches to determining materiality, making the determination is no easy task. Materiality determinations are confounded by the generality of the underlying test, the highly fact-intensive nature of the inquiry, and judicial developments that have balkanized materiality determinations by discrete forms of disclosure. Rule 405 of the Securities Act limits "material" to "information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."

The SEC's adoption of the new Form 8-K requires reporting companies to make continuous determinations of materiality, whereas before they only made the determinations four times a year in the Form 10-K and Form 8-Qs.[53]

Acknowledging the uncertainty surrounding the Form 8-K triggering events, the SEC adopted a new safe harbor from public and private claims under Exchange Act § 10(b) and Rule 10b-5 for failing to timely file a Form 8-K for Items 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, and 4.02(a).[54] The safe harbor does not, however, affect liability for material misstatements or omissions *in* a Form 8-K, which continue to be subject to both § 10(b) and Rule 10b-5 liability.[55]

The failure to file a Form 8-K will also not disqualify a firm from eligibility to use Securities Act Form S-2 and S-3 registration statements and will not affect a security holder's ability to rely on Securities Act Rule 144 to resell that security.[56]

IV. WEIGHING CONTINUOUS REPORTING

The much-debated topic of continuous reporting certainly has both advantages and disadvantages. In this section, I will begin by

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[51] *Id.* at 5.
[52] U.S. SEC. & EXCH. COMM'N, FORM 8-K, at 4–5, 7–8, 10–11, 13, 15–16, 19–20 (2014), *available at* https://www.sec.gov/about/forms/form8-k.pdf.
[53] Jacob et al., *supra* note 46, at 43.
[54] SEC Release No. 33-8400, *supra* note 45.
[55] *Id.*
[56] *Id.*

highlighting a few advantages of an increasingly continuous reporting system, including the ability for investors to respond to important business events as they occur, the incorporation of social media, and the increased utility of the existing periodic reports. Then, I will discuss a few disadvantages, including compliance costs, information overload, and competitive advantage both domestically and globally. Ultimately, I conclude continuous reporting has a net benefit to the investing community as a whole. Finally, in light of this net benefit, I discuss four amendments that should be removed from the Form 10-Q and added to the Form 8-K.

A. Advantages of Continuous Reporting

1. Continuous Reporting responds to important business events as they occur.

As the SEC noted in the release adopting the new Form 8-K, "[m]arkets rely on timely dissemination of information to accurately and quickly value securities."[57] Continuous disclosure facilitates responsive markets. Expanding the number of events deemed significant enough to be continuously disclosed enhances the ability for markets to respond to those events.

By definition, periodic reporting cannot keep market investors continuously informed. Under a reporting regime consisting primarily of quarterly reporting, the securities of a company could be trading in the market at a price that does not reflect its true value because certain material information, such as a termination of a material agreement, will be unavailable to outside investors. Consider the example below:

Assume Company X files their annual Form 10-K (which will contain their latest quarterly report as well) on April 5. On April 10, Company X's largest distributor declares bankruptcy and terminates the distribution agreement, leaving Company X without a way to get their product to consumers. Though the company is likely to contract with another distributor in a week or two, revenue for this upcoming quarter will be reduced due to a decrease in sales.

In a periodic reporting environment, Company X will not disclose this information until its next periodic report, the July 5 Form 10-Q. Company X's stock, however, continues trading from April 5 to July 5, with investors oblivious to the material decline in value. Alternatively, in a continuous reporting environment (and under the new Form 8-K rules), information about such a termination would have been

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[57] *Id.*

conveyed to investors within four business days following its occurrence. The demands of Form 8-K partially shift the SEC reporting requirements toward continuous reporting. Thus, we see that the Form 8-K gets market-influencing information to investors much sooner than would simple periodic reporting; as we have seen, with the expansion of Form 8-K, much more market-influencing information is now compelled by the Exchange Act.

2. Continuous reporting is the best method for dealing with growing use of social media.

From MySpace to Facebook and LinkedIn and Twitter, social media has experienced exponential growth since the dot-com bubble. The SEC even has its own Facebook page and Twitter account, @SEC_Enforcement. Investors' increasing reliance on social media for marketing has also created interesting questions as to how reporting companies may best use social media to rapidly communicate with investors while complying with securities laws.

An increasingly continuous disclosure system is the best way to incorporate the growing use of social media into public equity markets. Investors want quick access to information, and the social media platform most companies use for marketing affords a platform by which continuous disclosure could easily be implemented.

On July 3, 2012, Netflix, Inc. CEO Reed Hastings updated his Facebook status to read:

> Congrats to Ted Sarandos, and his amazing content licensing team. Netflix monthly viewing exceeded 1 billion hours for the first time ever in June. When House of Cards and Arrested Development debut, we'll blow these records away. Keep going, Ted, we need even more![58]

On December 5, the SEC issued a notice to Netflix (and Hastings), showing an interest in potentially pursuing an SEC enforcement action based on a potential Regulation FD violation.[59] The Commission's principal issue with Hastings' status update was that neither he nor Netflix had ever used Facebook to announce company metrics.[60] Furthermore, neither had ever taken any steps to alert investors that a

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[58] Reed Hastings, FACEBOOK (July 23, 2012), www.facebook.com/reed1960 (while logged into a Facebook account, select "2012" on the right side of the screen; then select "July").
[59] Sesi Garimella, *Regulation FD and Social Media*, 32 REV. BANKING & FIN. L. 234, 234 (2013).
[60] *Id.*

personal Facebook page may "be used as a medium for communicating information about Netflix."[61] Though Regulation FD was originally implemented in response to companies leaking information to market analysts or institutional investors, in its Investigation Report the SEC called Regulation FD "inclusive", noting "the prohibition does not turn on an intent or motive of favoritism."[62]

Rather than ultimately pursuing enforcement action, the SEC opted to release further guidance on compliance with Regulation FD in social media postings.[63] The SEC report clarified that Regulation FD applies to social media and other emerging means of communication in the same way it applies to company websites.[64]

By alerting investors that company information may be released through social media and providing equal access to all investors, reporting companies may leverage their current social media platforms to provide continuous disclosure to investors. The benefits of incorporating social media into continuous disclosure would be mutual as both investors and companies are likely already using social media. Investors could learn more about companies without navigating a new platform, while companies could simply implement disclosure into their already-existing social media accounts, reducing compliance cost. Companies would also enjoy the benefit of having easy access to a market of interested retail investors.

3. Continuous reporting increases the utility of periodic reports without displacing them.

Notwithstanding the benefits of continuous reporting, periodic reports remain crucial to investors. Still, continuous reporting could actually increase the utility of periodic reports. Several studies have suggested that the introduction of mandated quarterly Form 10-Q filings reduced the detail of the annual Form 10-K reports.[65] This finding has led to a concern among some commentators that increased mandatory Form

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[61] *Id.*

[62] Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Netflix, Inc., and Reed Hastings, Release No. 69279 (Apr. 2, 2013), available at http://www.sec.gov/litigation/investreport/34-69279.pdf.

[63] Press Release, SECS. & EXCH. COMM'N, SEC Says Social Media OK for Company Announcements if Investors Are Alerted (April 2, 2013), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513574.

[64] *Id.*

[65] *E.g.*, Maureen McNichols & James G. Manegold, *The Effect of the Information Environment on the Relationship Between Financial Disclosure and Security Price Variability*, 5 J. ACCT. & ECON. 49 (1983).

8-K filings would further dilute the 10-K and 10-Q.[66] However, a study performed by one commentator analyzed filings of Form 8-K, 10-K, and 10-Q from 1994 to 2007 and subsequent market reaction concluding that "additional real-time disclosure of material events did not diminish the informativeness of periodic reports."[67]

The same study suggested that an increased continuous disclosure environment would actually cause investors to pay greater attention to the periodic reports following Form 8-K filings in order to adequately assess the full effects triggering events on a financial period.[68] In this sense, the periodic reports place the isolated announcement in Form 8-K in context. Investors must use the sum of all the available information to make informed investment decisions. These decisions can be further informed by analyzing the effect an event has had on the periodic financials, thus increasing the usefulness of the filings while furthering the overarching goal of full and fair disclosure for the investing community.

B. Disadvantages of Continuous Reporting

1. Continuous reporting involves high Compliance Cost.

One of the most glaring criticisms of continuous reporting is its high compliance cost. In the SEC release adopting the new Form 8-K, the Commission noted that companies would, on average, file five additional Form 8-Ks per year.[69] On compliance cost, the Commission calculated that each entity spends five hours completing the form, with 75% prepared by the company and 25% by outside counsel at an average cost of $300 per hour.[70] In 2003, there were an estimated 11,800 companies filing reports.[71] Based on the estimated five additional reports per company per year, the SEC estimated an increase of 59,000 filings representing a further $22,125,000 in outside counsel fees.[72] The Commission, however, noted that new developments like EDGARLink allow a company to file reports easily and directly with the SEC using the Internet, eliminating costs of using third parties to submit filings.[73] It

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[66] *See generally*, Lerman & Livnat, *supra* note 41.
[67] *Id.*
[68] *Id.* at 8.
[69] SEC Release No. 33-8400, *supra* note 45. *But see id.* ("We recognize, however, that the actual number of reports a company must file is highly dependent on the nature of its activities.").
[70] *Id.*
[71] *Id.*
[72] *Id.*
[73] *Id.*

is worth noting that these costs only represent a small component of the cost of filing, with the majority of the cost coming from preparation.

2. Continuous reporting may result in Information Overload.

Another criticism of continuous reporting, specifically directed at the amendments to the Form 8-K, concerns "information overload". The criticism is that increasing the amount of disclosure will actually reduce the information content of the filings due to the complexity of certain transactions and the time it takes to analyze them, determine whether an 8-K is necessary, draft the SEC-filing, review it with the relevant parties, and ultimately file it.[74] Related is the concern that the shortened period to make these determinations will lead to lower quality reports.

Beside the increased utility associated with the greater amount of information produced via a robust continuous disclosure system rather than a more limited periodic reporting system,[75] the market has further benefits from continuous disclosure. In order to examine whether the information being released pursuant to the amended Form 8-K requirements, one study examined the price and volume reactions to newly disclosed items and compared it to price and volume reactions to items which carried over from the old 8-K.[76]

The study found that some categories elicited strong positive abnormal returns while others strong negative abnormal returns, which the author sought to explain by noting a positive implication for one company may be negative for another.[77] The study concluded that the significant market reactions to filings for all items indicates that the failure of some disclosures to yield returns was thus accounted for by this varying implication and not caused by a lack of information content.[78]

3. Continuous reporting may reduce Competitive Advantage.

Another concern about moving toward a continuous reporting system is that such reporting could give away important strategic moves and undermine competitive advantage otherwise enjoyed by the firm.

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[74] David Bernstein, *Cost of 8-K Rules Could Surpass Sarbanes-Oxley*, 23 INT'L FIN. L. REV. 20, 23–24 (May 2004).
[75] *See supra* Part IV.A.3.
[76] Lerman & Livnat, *supra* note 41, at 7.
[77] For instance, the resignation of a CEO whose tenure has been fraught with misconduct is likely to elicit a strong positive response while the stepping down of an essential CEO like the late Steve Jobs would elicit a strong negative response.
[78] Lerman & Livnat, *supra* note 41, at 25.

The SEC noted this concern in their final adoption of the new Form 8-K requirements, stating, "[c]ompanies may experience some competitive or other strategic costs caused by the requirement to disclose more categories of information more quickly than they otherwise may have chosen to disclose."[79]

Relevant to this concern is Exchange Act Section 23(a)(2) which requires the Commission to consider the impact any new rule would have on competition and prohibits the adoption of any rule that would impose a burden on competition not necessarily appropriate in further of the purposes of the Exchange Act. While considering the amendments' effect on competition, the Commission made significant changes. In the initial proposal of changes to the Form 8-K, the list of triggering events included disclosure of non-binding agreements and letters of intent.[80]

However, the Commission ultimately dropped these triggering events from the amendments, agreeing with commentators that such disclosure could cause competitive harm.[81] Furthermore, the original proposal considered the loss of a significant customer as a termination of a material agreement.[82] In response to comments, that provision was also dropped due to "the difficulty of identifying the particular date on which such loss occurs."[83] The language relating to termination of a material agreement was also relaxed in order to provide a reporting company some flexibility if it believed a claim of termination was merely a negotiation tactic.

While a further increase in continuous reporting is likely to also have effects on competition, such an increase is no less palpable to the investing community than the recent Form 8-K amendments. Increased disclosure—including the amount, quality, and timeliness of current information available to investors—enables informed investment decisions, which promotes market efficiency and capital formation.

4. Global Competition.

Global competition, however, is a separate concern, because only domestic companies subject to the reporting requirements of §§ 13 and 15 of the Exchange Act are required to make Form 8-K disclosures. There is certainly the potential for competitors not subject to the same reporting requirements to gain an information advantage. The increasing

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[79] SEC Release No. 33-8400, *supra* note 45.
[80] *Id.*
[81] *Id.*
[82] *Id.*
[83] *Id.*

globalization of capital markets should not be a reason to *reduce* reporting requirements, and thereby reduce investor protection. The oft-cited Committee on Capital Markets Regulation produced in 2006 and 2007, details a decline in U.S. market-shares in global IPO's and new foreign listings, and concludes that even U.S. issuers are increasingly likely to seek financing that "avoid[s] the need for adherence to anything more than the anti-fraud protections of U.S. securities law."[84]

Donald Langevoort argues this "slippage"—the decline in foreign issuers accessing U.S. securities markets—is actually a result of the major wealth gains in oil-producing countries like Russia and the Middle East combined with the economic emergence of India and China. Thus, "the wealth and economic activity from those regions of the globe no longer needed to come to Wall Street because they can do quite well in London or Hong Kong."[85] Conceding the possibility of endless argument about whether slippage says anything about regulatory quality in the United States, Professor Langevoort calls the argument irrelevant for two reasons: (1) the firms fearing U.S.-style regulation may be "lemons" who fear exposure in the post-Sarbanes-Oxley environment;[86] and (2) if the U.S. no longer has a competitive advantage in terms of technology, talent, or access to global wealth, striking a proper regulatory balance becomes even more essential.[87]

C. The Net Benefit & Technological Development

There is an obvious tension between increasing continuous disclosure requirements and limiting the compliance cost and the impact on competitive advantage. With the globalization of financial markets, that tension takes on increased significance as a market for regulatory regimes develops. Yet, what investor funnels his money into a company about which he knows little to nothing? Further still, federal securities laws were originally enacted both to restore market confidence and, ultimately, to *protect investors*. Paternalistic as it may be, the SEC's storied success is in no small part tied to its continued focus on this prime directive.

Technology, from EDGAR to the acceptance of social media, has and will continue to reduce the biggest disadvantage of shifting to a more continuous reporting system: cost. Thus far, the evolution of mandatory disclosure has tracked technological advancement. The most

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[84] Donald C. Langevoort, *U.S. Securities Regulation and Global Competition*, 3 VA. L. & BUS. REV. 191, 194 (2008).
[85] *Id.* at 94.
[86] *Id.*
[87] *Id.*

recent corresponding development has been the growing use of social media, which is most efficiently incorporated into the investing community by continuing to move toward continuous disclosure. As the compliance cost of continuous disclosure decreases, there is a corresponding increase in public demand for more disclosure from reporting companies to the investing community.

D. Recommended Amendments to the Form 8-K

Reporting companies may already voluntarily make whatever disclosures "the registrant deems of importance to security holders."[88] Thus, the real issue with continuous disclosure is when such disclosure is *required*. The above-discussed net benefit to the investing community could be further advanced by implementing additional duties to continuously disclose without the disadvantages of cost setting off the balance. Therefore, I recommend the following events be moved from disclosure in a Form 10-Q to the Form 8-K. As long as the benefits of these additions outweigh their disadvantages, their adoption would be both consistent with the SEC's purpose and to the benefit of the investing community.

1. Legal Proceedings

Part II, Item 1 of the Form 10-Q requires the registrant furnish the information required by Item 103 of Regulation S-K, including an update to an earlier disclosed legal proceeding and the details of its termination. Item 103 specifically limits such proceedings to those "material", "other than ordinary routine litigation incidental to the business."[89]

Material legal proceedings against a company are certainly information an investor would like to have when deciding to buy or sell. Since Form 8-Ks require no MD&A section, the Form 8-K would only need to update the market that such a proceeding has commenced or terminated, and would not require management's discussion of its import.[90] Since there is likely to be as much confusion as to which legal proceedings are material as there is for the entering into or termination of a material agreement, the safe harbor for failing to timely file a Form 8-K should be extended to this new item as well.

2. Unregistered Sales of Equity & Assets

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[88] U.S. SEC. & EXCH. COMM'N, *supra* note 52, at 21.
[89] 17 C.F.R. § 229.103 Item 103 (2015).
[90] Not requiring an MD&A section in Form 8-Ks likely allows Form 8-Ks to be filed within the requisite deadline, as MD&A sections are often the basis for management liability.

Part II, Item 2 of the Form 10-Q requires the registrant to furnish the information required by Item 701 of Regulation S-K as to any unregistered sales of equity securities sold during the covered period. Item 701 requires information on the securities sold, the consideration, the exemption claimed, and the use of proceeds.[91]

Recent sales of securities, including the consideration received, are essential information to investors because it affects share prices. A simple Form 8-K filing reporting such a sale should not be difficult to produce within four business days. There may, however, need to be a consideration for a series of multiple unregistered sales. As an unregistered sale does not have the same uncertainties as the materiality of legal proceedings or agreements, no safe harbor would be needed.

3. Defaults Upon Senior Loans

Part II, Item 3 of the Form 10-Q requires the registrant to report any "material default in the payment of principal, interest, a sinking or purchase fund installment, or any other material default not cured within 30 days" for any indebtedness of the registrant or any of its significant subsidiaries exceeding 5% of the total assets of the registrant and its consolidated subsidiaries.[92]

If anything is relevant to investors on a continuing basis, surely the failure of a company to pay its debts is as well. Like unregistered sales, there is little ambiguity as to whether a default has occurred, so the protection of a safe harbor is likely unneeded here. The continuous reporting of such defaults would only enable the market to reflect the default sooner, rather than waiting for it to appear on the quarterly report. The registrant would still have the thirty-day cure period, at which point no filing would be required. The four-business-day window to file a Form 8-K would only begin to run on the thirty-first day without cure.

4. Submission of Vote to Security Holders

Part II, Item 4 of the Form 10-Q requires the registrant to report any submission of a matter to a stockholder vote, including the date of the meeting, whether it was annual or special, and a description of what took place.[93]

Leaving such a matter to be furnished in the quarterly report is inconsistent with the goal of equal access to information by the investing community. The submission of the vote should trigger a Form 8-K,

[91] 17 C.F.R. § 229.701.
[92] U.S. SEC. & EXCH. COMM'N, *supra* note 21, at 6.
[93] *Id.* at pt. II, Item 4.

which would not be difficult to complete by the filing deadline as it is only an update on what took place at a meeting. Whether a stockholder vote took place is ambiguous, so the safe harbor should not apply.

CONCLUSION

Technology and financial reporting have experienced a correlating evolution since the adoption of the federal securities laws in the 1930s. As a natural product of this evolution, the SEC has slowly been moving from a periodic reporting system to one that is more continuous. Though such a system is not without disadvantages, such as higher compliance costs, the net effect on disclosure and the investing community generally is positive. The compliance cost of continuous disclosure is furthermore likely to decrease over time as the SEC continues to implement social media into their disclosure regime. The negative impact on competition, if any, is likely outweighed by the enduring goal of the federal securities laws: investor protection. With an evolving technological world bringing securities regulation toward continuous disclosure, the current Form 8-K used for such disclosures should be updated to reflect growing demand for information, especially information material to investing decisions—like pending legal proceedings, unregistered securities sales, debt defaults, and stockholder votes.