PERSONAL FACTS ABOUT EXECUTIVE OFFICERS: A PROPOSAL FOR TAILORED DISCLOSURES TO ENCOURAGE REASONABLE INVESTOR BEHAVIOR

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When federal prosecutors asked for—and received—the indictment of Martha Stewart for criminal securities fraud in June 2003, they based their case on Stewart's alleged misstatements of material fact and omissions to state material fact regarding a personal stock trading transaction. Specifically, Stewart was alleged to have defrauded the stockholders of Martha Stewart Living Omnimedia, Inc., of which she then was the Chief Executive Officer, based on asserted inadequate and nonexistent disclosures about the facts surrounding her personal sale of securities of another, unrelated corporation, ImClone Systems Incorporated.[1]

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1. United States v. Stewart, 305 F. Supp. 2d 268, 370 (S.D.N.Y. 2004), ("Count Nine of the Indictment charges that defendant Stewart made materially false statements of fact regarding her sale of ImClone securities with the intention of defrauding and deceiving investors by slowing or stopping the erosion of the value of the securities issued by her own company, Martha Stewart Living Omnimedia . . . ."); Superseding Indictment ¶¶ 56–66, *Stewart*, 305 F. Supp. 2d 268 (No. 03 Cr. 717), *available at* http://news.findlaw.com/hdocs/docs/mstewart/usmspb10504sind.pdf [hereinafter Indictment]. The Indictment also suggests that the statements made by Stewart were misleading in that they omitted certain material facts necessary to make those statements not misleading. Indictment, *supra*, ¶¶ 60, 61, 63, 64. Stewart also faced civil claims for insider trading based on other facts surrounding the same stock sale. *See* Joan MacLeod Heminway, *Save Martha Stewart? Observations About Equal Justice In U.S. Insider Trading Regulation*, 12 TEX. J. WOMEN & L. 247, 248–49 n.2 (2003).

Stewart was not required to publicly disclose the facts surrounding her ImClone stock disposition; her public statements were voluntary. However, this scenario raises the question of whether Stewart *should have been required to publicly disclose* the facts relating to her trading transaction in light of public disclosures that she was the target of a federal insider trading inquiry. More broadly, the Stewart securities fraud charge, and other more common circumstances involving executives' personal lives, raise questions as to whether (and if so, to what extent) public company[2] executive officers[3] should be required, through federal securities regulation, to publicly disclose (or facilitate corporate public disclosure of) personal facts, including events and conduct. These common personal circumstances may include criminal investigations,[4] terminal or other serious illness and related medical treatments,[5] financial troubles (e.g., relating to an individual bankruptcy or divorce settlement),[6] and extramarital affairs (especially those with subordinates).[7] However, less common

2. For purposes of this Article, a "public company" is an issuer of securities that is required to register one or more classes of securities in accordance with Section 12 of the Securities Exchange Act of 1934, as amended. 15 U.S.C. § 78*l* (2000). In general, references to "corporation" in this Article are intended to reference public companies.

3. In this Article, the terms "executive officer" and "executive" are used to reference a member of corporate management defined as an "executive officer" in Rule 3b-7 promulgated under the Securities Exchange Act of 1934, as amended. 17 C.F.R. § 240.3b-7 (2007).

4. *See, e.g.*, *supra* note 1 and accompanying text.

5. *See, e.g.*, Jayne W. Barnard, *Sovereign Prerogatives* 21 J. CORP. L. 307, 321–28 (1996) (reviewing CONNIE BRUCK, MASTER OF THE GAME: STEVE ROSS AND THE CREATION OF TIME WARNER (1994)) (setting out issues raised by failures to accurately and completely disclose Steve Ross's heart attack and prostate cancer while he was at the helm of Time Warner Inc.)); Andrew K. Glenn, Note, *Disclosure of Executive Illnesses Under Federal Securities Law and the Americans with Disabilities Act of 1990: Hobson's Choice or Business Necessity?*, 16 CARDOZO L. REV. 537 (1994) (analyzing disclosure questions relating to executive and key employee illnesses); Brett D. Fromson, *Coca-Cola's CEO Hospitalized With Lung Cancer*, WASH. POST, Sept. 9, 1997, at C3; Benjamin Pimentel, *Public Disclosure: Health of CEOs Brings up Issues of Personal Privacy*, S.F. CHRON., Aug. 3, 2004, at C1.

6. *See, e.g.*, *In re* Franchard Corp., 42 S.E.C. 163 (1964) (assessing the materiality of, among other things, personal financial transactions and difficulties); Katherine Yung, *Dean Foods Keeps Move in the Open: Company Says its CEO Will Sell Stock to Help in Divorce Settlement*, DALLAS MORNING NEWS, Aug. 28, 2003, at 2D.

7. *See* Carol Hymowitz, *Personal Boundaries Shrink as Companies Punish Bad Behavior*, WALL ST. J., June 18, 2007, at B1 (mentioning, among other embarrassing private activities of executives, multiple affairs involving David Colby, the one-time Chief Financial Officer of Wellpoint Inc., for which

circumstances also raise the same or similar issues. For example, it recently was reported that John Mackey, the Chief Executive Officer of Whole Foods Market Inc., posted messages to weblogs unaffiliated with Whole Foods, under an assumed name, commenting on Whole Foods's business, competitors, and industry.[8] This Article attacks the broad question of the desired nature and extent of an executive's duty to disclose personal facts by: isolating existing disclosure duties relevant to personal facts under the Securities Act of 1933, as amended (the "1933 Act"),[9] and the Securities Exchange Act of 1934, as amended (the "1934 Act");[10] identifying deficiencies in the existing disclosure regime relating to executives' personal facts; and fashioning a targeted proposal for minimal additional disclosures designed to resolve the identified deficiencies.

The Article begins in Part I with a summary of significant existing requirements for disclosure about executive officers under the 1933 Act and 1934 Act. These disclosure requirements are found in both mandatory disclosure (line-item and gap-filling) and antifraud rules. Some disclosures are made to the public by the executives themselves; some are made to the public by the corporation using information supplied to the corporation by executives. Through these existing disclosure obligations, executive officers of public companies are required to divulge personal information to the public.

Part II of the Article argues that the existing federal securities law regime applicable to public company executive disclosures of personal facts is deficient in three respects. Specifically, existing disclosure requirements place too much discretion in the hands of executives, cause pressure on important individual rights, and tend to cause investors and markets to overreact. These concerns require serious attention.

Part III proposes limited regulatory changes designed to better manage the public release of personal facts about public company

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he was fired); Posting of Dave Hoffman to Concurring Opinions, http://www.concurringopinions.com/archives/2005/11/sex_sells_contr_1.html (Nov. 12, 2005) (raising disclosure questions about a CEO's affair with a subordinate).

8. *See* David Kesmodel, *Whole Foods Sets Probe as CEO Apologizes*, WALL ST. J., July 18, 2007, at A3; David Kesmodel & Jonathan Eig, *Unraveling Rahodeb: For Whole Foods CEO, A History of Brashness*, WALL ST. J., July 20, 2007, at A1; David Kesmodel & John R. Wilke, *Whole Foods Is Hot, Wild Oats a Dud—So Said 'Rahodeb'*, WALL ST. J., July 12, 2007, at A1.

9. 15 U.S.C. §§ 77a–aa (2000) (originally enacted as Act of May 27, 1933, ch. 38, § 1, 48 Stat. 74).

10. 15 U.S.C. §§ 78a–nn (originally enacted as Act of June 6, 1934, ch. 404, § 1, 48 Stat. 881).

executives. The proposed regulatory changes are designed to minimize the identified defects in the current federal disclosure scheme as it applies to personal facts about executive officers—and to do so at a minimal additional cost. The suggested adjustments work within the overall parameters of current disclosure regulation as reflected in related statutory and decisional law. In addition, the proposal for change may have collateral corporate governance benefits.

Part IV offers a brief conclusion.

I. EXISTING FEDERAL SECURITIES LAW DISCLOSURE REQUIREMENTS APPLICABLE TO FACTS ABOUT PUBLIC COMPANY EXECUTIVES

The 1933 Act and the 1934 Act principally exist to protect investors in, and to promote and sustain the integrity of, the U.S. securities markets.[11] The chief means used by and under these laws to achieve their core policy objectives is the public disclosure of investor-relevant information.[12] This public disclosure is compelled by mandatory disclosure provisions and antifraud rules contained in the statutes, in regulations of the Securities and Exchange Commission ("SEC"), and in federal judicial decisions. In explaining the perceived need for mandatory disclosure rules, one pair of noted securities law scholars states that "[i]mplicit in both the 1933 and 1934 Acts is the Brandeisian philosophy that mandatory disclosure is likely to deter not only conflicts of interest and waste of corporate assets but also other wrongful conduct by managers or outside controlling security holders."[13] As to antifraud rules that compel disclosures, one scholar summarizes their role as follows:

> [T]he antifraud provisions are extremely important in inducing voluntary disclosure. Nevertheless, antifraud regulation alone is unlikely to induce the level of voluntary disclosure that economists associate with full scale unraveling. Absent additional methods of signaling or regulation, issuers would withhold significant amounts of material firm-specific information and investors would be able to make only imprecise inferences regarding issuer candor and integrity

11. *See* STEPHEN J. CHOI & A.C. PRITCHARD, SECURITIES REGULATION: CASES AND ANALYSIS 1 (2005); Susanna Kim Ripken, *The Dangers and Drawbacks of the Disclosure Antidote: Toward a More Substantive Approach to Securities Regulation*, 58 BAYLOR L. REV. 139, 194 (2006).

12. *See* CHOI & PRITCHARD, *supra* note 11, at 1; JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 3 (5th ed. 2006); MARC I. STEINBERG, SECURITIES REGULATION 1 (4th ed. 2004).

13. LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 675–76 (3d ed. 1989).

based on information that the issuer voluntarily discloses.[14]

Thus, both mandatory disclosure rules and antifraud rules are designed to work hand-in-hand to protect investors and promote market integrity. The remainder of this Part describes both types of rules as they relate to public revelations of facts about executive officers under the 1933 Act and the 1934 Act.

A. *Mandatory Disclosure*

Most of the required disclosures applicable to public companies under the 1933 Act and the 1934 Act relate to corporate disclosures of corporate facts—information coming from and relating to the corporation itself and transactions in which the corporation is involved. However, these federal disclosure requirements also include rules that compel disclosure by and about executive officers of public companies.

1. *Disclosure by Executive Officers About Themselves*

For example, an executive, as an affiliate of a public company issuer under the meaning of Rule 144(a)(1) under the 1933 Act,[15] must file a Form 144 before offering or selling, during any period of three months, a specified amount of securities (over 500 shares or other units, or shares or units having an aggregate sale price in excess of $10,000) of the issuer in the public market without registration.[16] Form 144 requires disclosure of the name and address of the executive, as well as transaction-related information (including the name and contact information for the transacting broker or market maker).[17] In addition, an executive must report his or her ownership of and transactions in the public company's securities on Forms 3, 4, and 5[18] in order to comply with Section

14. Joseph A. Franco, *Why Antifraud Prohibitions Are Not Enough: The Significance of Opportunism, Candor and Signaling in the Economic Case for Mandatory Securities Disclosure*, 2002 COLUM. BUS. L. REV. 223, 277.

15. 17 C.F.R. § 230.144(a)(1) (2007).

16. *Id.* § 230.144(h).

17. Form 144: Notice of Proposed Sale of Securities Pursuant to Rule 144 under the Securities Act of 1933, 17 C.F.R. § 239.144, *available at* http://www.sec.gov/about/forms/form144.pdf.

18. Form 3: Initial Statement of Beneficial Ownership of Securities, 17 C.F.R. § 249.103, *available at* http://www.sec.gov/about/forms/form3.pdf [hereinafter Form 3]; Form 4: Statement of Changes in Beneficial Ownership, 17 C.F.R. § 249.104, *available at* http://www.sec.gov/about/forms/form4.pdf [hereinafter Form 4]; Form 5: Annual Statement of Changes in Beneficial Ownership of Securities, 17 C.F.R. § 249.105, *available at* http://www.sec.gov/about/forms/form5.pdf [hereinafter Form 5].

16(a) of the 1934 Act.[19] These forms require disclosure of the executive's name and address (which may be a business address), as well as information relating to the ownership of the reported securities, which may be personal in nature.[20] And if an executive should acquire beneficial ownership of more than five percent of an outstanding class of publicly traded securities, he or she must report those holdings by filing a Schedule 13D report and making subsequent adjustment filings, as required.[21] An executive filing a Schedule 13D must disclose personal facts (name, residence or business address, employment information, significant criminal convictions, citizenship, etc.),[22] as well as facts relating to the transaction, some of which may also have personal elements (e.g., the source of funds for the subject securities acquisition).[23] Each of these executive disclosure duties requires the executive to make a filing that includes limited personal facts in connection with personal stock ownership and transactions, but in each case the disclosure is triggered only by transactions in securities of the public company for which the executive serves.

2. Disclosure by Public Companies About Their Executive Officers

Also, both registration requirements of the 1933 Act and periodic, proxy-related, and transaction-triggered disclosure requirements in and under the 1934 Act require public companies to make specified disclosures about personal facts relating to their executive officers. These disclosures are mandated by the requirements of numerous different disclosure forms (e.g., Forms S-1 and S-3 under the 1933 Act,[24] Form 10-K and Schedule 14A under the 1934 Act,[25] etc.). As a result of SEC initiatives (first adopted in the early 1980s) to standardize and integrate disclosure requirements under the 1933 Act and the 1934 Act, many of the requirements of these various forms liberally reference specialized,

19. 15 U.S.C. § 78p (2000). To enforce these reporting requirements, public companies are required to disclose known late filings and filing failures relating to these reporting requirements. 17 C.F.R. § 229.405.

20. *See supra* note 18 and accompanying text.

21. 15 U.S.C. § 78m(d); 17 C.F.R. §§ 240.13d-1(a), -2(a); Schedule 13D, 17 C.F.R. § 240.13d-101, *available at* http://www.sec.gov/about/forms/sched13d.pdf.

22. 17 C.F.R. § 240.13d-101.

23. *Id.*

24. Form S-1, 17 C.F.R. § 239.11, *available at* http://www.sec.gov/about/forms/forms-1.pdf; Form S-3, 17 C.F.R. § 239.13, *available at* http://www.sec.gov/about/forms/forms-3.pdf.

25. Form 10-K, 17 C.F.R. § 249.310, *available at* http://www.sec.gov/about/forms/form10-k.pdf; Schedule 14A, 17 C.F.R. § 240.14a-101, *available at* http://www.sec.gov/about/forms/sched14a.pdf.

non-financial disclosure requirements listed in a central, standard "menu" of mandatory disclosure rules known as Regulation S-K.[26]

The mandatory disclosure rules in Regulation S-K require that public companies make various disclosures relating to their executive officers in four overarching subject matter areas: personal and professional biographical data, including family relationships among corporate constituents and involvement in certain legal proceedings; compensation; ownership of corporate securities; and potential conflicting interest transactions.[27] So, for example, on a regular basis, a public company must disclose: each executive's age, five-year employment history, term of office, and arrangements or understandings with respect to his or her service as an executive officer;[28] the nature of any family relationship between or among each executive and any director, executive officer, or person nominated or chosen by the corporation to become a director or executive officer;[29] each executive's filings of or specified involvements in bankruptcy proceedings within a five-year period;[30] criminal convictions of and pending actions against each executive within a five-year period (with certain exceptions for de minimis criminal activity);[31] curtailment of specified business-related activities of each executive through court or administrative orders, decrees, and judgments within a five-year period;[32] and violations by each executive of federal or state securities or commodities law within a five-year period.[33] Moreover, on a periodic basis, each public company is required to describe in detail (in many cases, in a chart-based format) both the nature and amount of each element of compensation (cash and non-cash, under plans and otherwise) it pays to each of the "named executive officers" (its principal executive officer and principal financial officer, its three other most highly compensated executive officers, and up to two others as designated under the rule),[34] as well as the number and percent of each class of the corporation's securities beneficially owned by each of the "named executive officers."[35] And finally,[36] a public company must regularly

26. 17 C.F.R. §§ 229.10–.1123.
27. *See id.* §§ 229.401–.404.
28. *Id.* § 229.401(b), (e).
29. *Id.* § 229.401(d).
30. *Id.* § 229.401(f)(1).
31. *Id.* § 229.401(f)(2).
32. *Id.* § 229.401(f)(3), (4).
33. *Id.* § 229.401(f)(5), (6).
34. *Id.* § 229.402.
35. *Id.* § 229.403(b).
36. Not noted here, but noted earlier, is an additional requirement that the corporation report executives' late filings and filing failures under mandatory

disclose transactions that it has entered into with its executive officers or entities in which its executive officers are principals or have leading or controlling roles.[37] All of this information is, in some way, personal to the executive, although much of it (other than, for example, age, employment history, and involvement with personal legal actions) also involves the corporation in a relatively direct way.

3. Disclosure by Executive Officers and Public Companies Under Gap-Filling Rules

Regulations under the 1933 Act and the 1934 Act include, among their disclosure provisions, "gap-filling" rules that require, in addition to statements mandated by line-item requirements, disclosure of any further material information necessary to make the required statements not misleading.[38] Nothing in the gap-filling rules or related guidance excludes executives' personal facts from the information that may be subject to disclosure.[39] After identifying additional information that may be necessary to contextualize mandatory line-item disclosures, the key determination that must be made in complying with the applicable gap-filling rule is whether that information is "material."[40]

"The term *material*, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance" in making an investment decision.[41] This regulatory definition codifies one formulation of the materiality standard first articulated in the proxy fraud context by the U.S. Supreme Court in *TSC Industries, Inc. v.*

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disclosure rules applicable to executives themselves. *See supra* note 19.

37. 17 C.F.R. § 229.404(a).

38. *See id.* §§ 230.408(a), 240.12b-20.

39. In fact, Professor Jayne Barnard has expressly noted that a gap-filling rule may compel disclosure of an individual's prior bad acts. Jayne W. Barnard, *Rule 10b-5 and the "Unfitness" Question*, 47 ARIZ. L. REV. 9, 19 (2005).

40. Materiality is also a significant disclosure predicate under the fraud proscriptions described *infra* Part I.B. and under stock exchange rules (although the definition of materiality under stock exchange rules may be different). *See, e.g.*, NADAQ, Inc., Regulatory Requirements 8 (July 2007), *available at* http://www.nasdaq.com/about/RegRequirements.pdf; NYSE, Inc., Listed Company Manual §§ 201.00–204.00 (2002), *available at* http://www.nyse.com/Frameset.html?nyseref=http%3A//www.nyse.com/regulation/listed/1182508124422.html&displayPage=/lcm/lcm_section.html; *see also* Barnard, *supra* note 5, at 323–24 (mentioning materiality as a determinant of disclosure under New York Stock Exchange and National Association of Securities Dealers rules then in effect).

41. 17 C.F.R. § 230.405; *see also* § 240.12b-2.

Northway, Inc.,[42] and later adopted for use in materiality considerations for purposes of Rule 10b-5 under the 1934 Act ("Rule 10b-5")[43] in *Basic Inc. v. Levinson*.[44] It is possible that a court would find that there is a substantial likelihood that a reasonable investor would attach importance to personal information about an executive.[45] Accordingly, the gap-filling rules may require public disclosure of executives' personal facts.

B. Disclosure Compelled by Antifraud Rules

Antifraud rules under the 1933 Act and the 1934 Act may similarly compel disclosure of personal facts about executives. Antifraud provisions under the federal securities laws, when they are invoked, act as broad gap-filling disclosure rules.[46] For example, Section 17 of the 1933 Act[47] "makes unlawful transactions involving material misstatements and omissions."[48] Rule 10b-5, modeled after Section 17,[49] does the same.[50] Rule 10b-5 is at issue in huge

42. 426 U.S. 438, 449 (1976). The definition of "material" in the gap-filling rules was adopted in response to the *TSC* decision. *See* Adoption of Integrated Disclosure System, 47 Fed. Reg. 11,380, 11,393–94 & n.67 (Mar. 16, 1982).

43. 17 C.F.R. § 240.10b-5; *see also* Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2000).

44. 485 U.S. 224, 232 (1988).

45. *See* Barnard, *supra* note 5, at 323–25 (analyzing generally the materiality of a CEO's serious illness).

46. *See* Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131, 1193 (2003) (making this point about Rule 10b-5 in the insider trading context).

47. Securities Act of 1933 § 17, 15 U.S.C. § 77q (2000).

48. Adam D. Hirsh, Comment, *Applying Section 12(2) of the 1933 Securities Act to the Aftermarket*, 57 U. CHI. L. REV. 955, 955–56 (1990).

49. Peoria Union Stock Yards Co. Ret. Plan v. Penn Mut. Life Ins. Co., 698 F.2d 320, 323 (7th Cir. 1983) ("Rule 10b-5 tracks section 17(a) closely . . . ."); Douglas M. Branson, *Statutory Securities Fraud in the Post-*Hochfelder *Era: The Continued Viability of Modes of Flexible Analysis*, 52 TUL. L. REV. 50, 56 n.16 (1977) ("Largely tracking the language of section 17(a), the Commission adopted rule 10b-5 proscribing fraud and other types of conduct 'in connection with the purchase or *sale* of any security.'"); Paula J. Dalley, *From Horse Trading to Insider Trading: The Historical Antecedents of the Insider Trading Debate*, 39 WM. & MARY L. REV. 1289, 1290 n.4 (1998) ("The language of Rule 10b-5 comes from section 17(a) . . . ."); Milton Freeman, Remarks at the Conference on Codification of the Federal Securities Laws (Nov. 18–19, 1966), *in* 22 BUS. LAW. 793, 922 (1967); Harry S. Gerla, *Issuers Raising Capital Directly From Investors: What Disclosure Does Rule 10b-5 Require?*, 28 J. CORP. L. 111, 115 (2002) ("Rule 10b-5 was copied from section 17."); Kimberly D. Krawiec, Gustafson v. Alloyd Co.*: The Wrong Decision, But It Is Still Business As Usual in the Securities Markets*, 31 TULSA L.J. 509, 519 n.67 (1996) ("The language of Section 17(a) is nearly identical to that of Rule 10b-5, the only difference being that Section 17(a) applies only to fraud in connection with 'the

numbers of transactions because, as it has been interpreted by the courts, it is a wide-ranging proscription on manipulative and deceptive conduct in connection with purchases and sales of securities.[51] Specifically, Rule 10b-5 requires (among other things) that "all material information disclosed by parties involved in purchasing or selling securities be complete and correct" and that "certain parties refrain from trading in particular securities unless they disclose all material information in their possession."[52] Where there is a duty to disclose (e.g., under mandatory disclosure rules or when a public company or one of its executives is trading the company's securities in the market), the entity or individual with the duty is required to completely and accurately disclose all material nonpublic information in its possession (or refrain from trading).[53] Similar fraud prevention rules relating to accurate and complete disclosures of material facts are implicated in more targeted transactional contexts, including proxy and tender offer regulation under the 1934 Act.[54] A significant factor in determining whether disclosures are required under these antifraud rules is whether specific facts are material. Here, as with the gap-filling rules, material facts are not restricted to corporate information.

Under the dual standards set by the U.S. Supreme Court in *TSC*,

> "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . Put another way, there

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offer or sale of any securities' and does not extend to purchases of securities as does Rule 10b-5."); Margaret V. Sachs, *Exclusive Federal Jurisdiction for Implied Rule 10b-5 Actions: The Emperor Has No Clothes*, 49 OHIO ST. L.J. 559, 562 n.23 (1988) ("[Section] 17(a) was the model for rule 10b-5.").

50. *Peoria Union*, 698 F.2d at 323 ("Both section 17(a) and Rule 10b-5 forbid using misrepresentations (including omissions of material fact) to sell 'securities.'"). Section 17 expressly prohibits fraud in connection with the offer or sale of a security. 15 U.S.C. § 77q(a).

51. *Peoria Union*, 698 F.2d at 323.

52. Theresa A. Gabaldon, *The Disclosure of Preliminary Merger Negotiations as an Imperfect Paradigm of Rule 10b-5 Analysis*, 62 N.Y.U. L. REV. 1218, 1218–19 (1987) (noting these attributes with respect to Rule 10b-5). This description effectively encompasses both traditional applications of Rule 10b-5 and insider trading claims. Both types of claims were made against Martha Stewart in connection with her December 2001 ImClone stock sale. *See supra* note 1 and accompanying text.

53. *See, e.g.*, Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639, 1646–74 (2004) (describing the current state of law on duties to disclose and materiality determinations under Rule 10b-5).

54. *See* 17 C.F.R. §§ 240.14a-9, .14e-3 (2007).

> must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[55]

TSC involved questions of proxy fraud under Rule 14a-9 under the 1934 Act.[56] Twelve years after *TSC*, in *Basic Inc. v. Levinson*, the U.S. Supreme Court endorsed the use of these same two materiality formulations under Rule 10b-5[57] and also established a test for use in applying the standard to assessments of the materiality of contingent or speculative information (in that case, premerger negotiations).[58] This materiality test for contingent or speculative information—current information relating to a potential future event or condition—involves balancing the probability of the future event or condition occurring against the magnitude of the future event or condition.[59]

Although personal facts about an executive are less likely to be material than corporate facts,[60] a court may find that it is substantially likely that a reasonable investor would consider certain personal facts important in making an investment decision relating to the corporation's securities. Moreover, a court may find it substantially likely that a reasonable investor would have viewed disclosure of an omitted personal fact about an executive officer as a significant alteration of the total mix of available information. In this regard, it is important to note that executives' personal facts may be contingent or speculative information, as they relate to the public company in which the executive serves. News of a possible criminal prosecution or a terminal illness, for example, is important not just as a statement of current fact, but also as information that may impact the future of the public company. Accordingly, in those circumstances, *Basic*'s probability/magnitude balancing test presumably would be used in gauging materiality.

II. CURRENT FEDERAL DISCLOSURE DUTIES WITH RESPECT TO PERSONAL FACTS ARE INADEQUATE

This Part assesses the efficacy of the current system of federal securities regulation in managing disclosures of personal facts about

55. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

56. *Id.* at 460–63.

57. Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988).

58. *Id.* While the Court restricted use of this test to the facts at issue in the case, *id.* at 232 n.9, lower courts and practitioners seemingly routinely use the test in other circumstances involving contingent or speculative information. *See* Heminway, *supra* note 46, at 1160 n.114.

59. *Basic*, 485 U.S. at 238–39.

60. *See infra* Part II.A.3.

executives. Both the analysis that follows and the related proposal for change set forth in Part III of this Article are built on certain important assumptions and other premises. This Part begins with a recitation of these foundational principles and continues by detailing three deficiencies in the current disclosure regime as applied to the disclosure of executives' personal facts. Specifically, existing rules governing the disclosure of personal facts afford too much discretion to executives, unnecessarily pressure important individual rights, and promote disproportionate reactions by investors and the market.

A. Basic Premises in the Analysis of the Existing Disclosure Regime

This Article assumes that the existing overall disclosure regime described in Part I (consisting of mandatory disclosure rules and antifraud provisions) is here to stay, for better or for worse. Accordingly, the Article works within that regime to suggest ways to better effectuate disclosure policy and to better fulfill the theoretical promise of disclosure regulation.

1. Materiality Analysis Under the Antifraud Rules Is a Key Pressure Point

In this existing system of disclosure regulation, it is significantly easier to comply with mandatory disclosure rules than it is to comply with disclosure compelled by antifraud rules. This is true for several reasons. First, it is relatively simple to ascertain when compliance with mandatory disclosure rules is required. Public companies and their executives by and large know when events or transactions involve filings, and the line items in each form reference required information, either directly or indirectly (i.e., by reference to integrated disclosure requirements in Regulation S-K or Regulation S-X[61]). Although line-item mandatory disclosure rules are not completely transparent, they do provide relatively clear disclosure guidance, as compared with the guidance provided in gap-filling and antifraud rules. In contrast, disclosures made strictly to comply with antifraud rules (i.e., not in response to line-item or gap-filling mandatory disclosure requirements) are triggered by the existence of a duty to make *all* material information public.[62] This duty to disclose may arise in a variety of circumstances. For example, disclosing persons have a duty to correct information previously disclosed that was inaccurate when

61. *See* 17 C.F.R. § 210 (2007); *supra* note 26 and accompanying text.
62. *See* 17 C.F.R. § 240.10b-5.

the disclosure was made.[63] In certain circumstances, disclosing persons also may have a duty to update information that, while accurate when disclosed, has become inaccurate with the passage of time and, perhaps, the occurrence of other intervening events.[64] In addition, when public companies and their executives (among others) trade in the public company's securities, they assume a duty to disclose.[65] It often is not easy to recognize whether and when a duty to disclose exists.[66]

Second, mandatory disclosure rules often are more transparent in conveying disclosure content. The determination of what to disclose under these rules often is straightforward, since line-item disclosure requirements can be quite pointed (e.g., name, age, five-year employment history, etc.).[67] Even where these requirements are qualified by materiality, the qualification typically applies to *specific types* of information (e.g., legal proceedings, properties, etc.) rather than *all* information.[68] However, even assuming knowledge of the existence of a disclosure duty, the determination of what to disclose to comply with an antifraud rule alone tends to rely heavily on a difficult materiality determination of "facts." "Matters of materiality . . . are often difficult to work through confidently, and courts have not been solicitous in cases of reliance on counsel."[69] Materiality determinations are open-textured; the wording of the relevant antifraud rules is quite broad and susceptible to multiple interpretations, even with SEC and federal court guidance. Materiality analyses also involve consideration of both quantitative and qualitative factors.[70] Moreover, materiality assessments are more easily made ex post than ex ante given the incompleteness of ex ante information.[71] Although materiality judgments also may be involved in disclosure assessments made under line-item disclosure rules (and certainly are involved in assessments made under the gap-filling rules), the real stress in making materiality

63. *See* Langevoort & Gulati, *supra* note 53, at 1669.

64. *See id.* at 1664–69.

65. *See id.* at 1654–64.

66. *See id.* at 1640–42.

67. *See, e.g.*, 17 C.F.R. § 229.401(b), (e) (2007).

68. *See, e.g.*, *id.* §§ 229.102–.103.

69. Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 644 (1996).

70. John M. Fedders, *Qualitative Materiality: The Birth, Struggles, and Demise of an Unworkable Standard*, 48 CATH. U. L. REV. 41, 46–47 (1998); Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional?*, 39 U.C. DAVIS L. REV. 1, 15–16 (2005).

71. *Cf.* Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 953, 961 n.23 (1995) (referencing this issue with respect to insider trading assessments under Rule 10b-5).

determinations is created by antifraud rule compliance.[72]

2. Personal Facts About Executives May Be Material on Several Different Bases

Given that disclosure questions with respect to executives' personal facts generally involve compliance with gap-filling and antifraud rules and that materiality is vital in disclosure determinations under these rules, it is important to understand the possible bases for materiality of personal facts about executives. Personal facts about an executive may be important to a reasonable investor or have a significant impact on available public information because they may indicate the possibility that the corporation will be without the executive's services either temporarily or permanently.[73] For example, if an executive will be involved as a party in a criminal or civil trial, the executive will lose time away from his or her duties to the corporation during that time. And a conviction in a criminal trial may result in the executive serving jail time or other detention that will keep him or her away from the office, perhaps for a more extended period of time.[74] Similarly, serious or terminal illness requires treatment and time for recovery, and if treatment fails to completely cure the condition, permanent disability, incapacity, or death may result.[75] These effects of illness limit or terminate the executive's ability to render services to the corporation. Investors may find an executive's unavailability especially important in making an investment decision as to a corporation's securities if the executive has a unique expertise or specialized skill critical to the corporation's successful operations.[76] Generally, an executive's absence is more likely to be considered important by a reasonable investor if his or her management or other functions are not adequately covered by others or the

72. The importance of materiality determinations throughout federal securities regulation is widely recognized. *See, e.g.*, COX ET AL., *supra* note 12, at 580 (referring to the materiality concept as "a workhorse in securities regulation").

73. *See* SEC v. Elecs. Warehouse, Inc., 689 F. Supp. 53, 67 (D. Conn. 1988) (noting that a chief executive officer's "indictment was likely to make him 'unavailable'" to the public company he served, "either through his proposed resignation, his need to prepare a defense and stand trial, or through the possibility of incarceration").

74. Martha Stewart, for example, served five months in jail and was subsequently under house arrest for more than five months (although not for insider trading, the alleged crime originally investigated).

75. *See, e.g.*, Glenn, *supra* note 5, at 539 n.16, 550 n.65, 554, 557 & n.111, 562, 590 n.279 (referencing permanent disability, incapacity, or death resulting from an executive's illness).

76. Barnard, *supra* note 5, at 324.

executive continues to earn compensation from the corporation during a period of absence from his or her corporate duties.

However, service limitations are not the only potential bases for the materiality of personal facts about executives. Personal information about executive officers also may be important to a reasonable investor or have a significant impact on available public information because the executive has unique attributes that benefit the corporation independent of his or her overall service availability and capabilities. For example, when the reputation of the executive and the corporation are tied, especially because the executive's identity effectively *is* the corporation's brand[77] or the executive is otherwise iconic,[78] personal facts about the executive may be more important to investors or have a more significant informational effect. Also, the reliability or integrity of certain key members of management may form the basis of a materiality determination, depending on the personal information at issue.[79]

77. This basis for materiality played an important role in the criminal securities fraud charge brought against Martha Stewart. *See* Cynthia A. Caillavet, Comment, *From* Nike v. Kasky *to Martha Stewart: First Amendment Protection for Corporate Speakers' Denials of Public Criminal Allegations*, 94 J. CRIM. L. & CRIMINOLOGY 1033, 1039 n.36 (2004).

78. A recent column describes iconic chief executive officers as being either founders ("birthers") or "those who built a new company on the ashes of an old business" ("builders"). C. Warren Neel, Column, *Balance of Power: Boards, 'Birthers' and Builders*, DIRECTORS & BOARDS, Apr. 2007, http://directorsandboards.com/DBEBRIEFING/April2007/ColumnApril2007.html; *see also Elecs. Warehouse*, 689 F. Supp. at 67 (noting, in a materiality assessment, that a chief executive officer's indictment "cast a cloud upon the bona fides" of the public company he served, "which was essentially the alter ego" of the executive). These iconic executives may even use personal publicists and other professionals "to extend their public image beyond that of the firm." Neel, *supra*. This behavior increases the likelihood that investors and publicly available information will be impacted by the executives' personal facts.

79. *See* SEC v. Jos. Schlitz Brewing Co., 452 F. Supp. 824, 829–30 (E.D. Wis. 1978); *In re* Franchard Corp., 42 S.E.C. 163, 169–73 (1964). Management integrity is, however, a disfavored basis for materiality. *See* Fedders, *supra* note 70, at 42, 46–47 ("Those trying to parse the obligations concerning management integrity through the SEC's imprecise standard became vocal opponents of the new standard. Then, when the SEC stubbornly refused to promulgate rules designed to fill in the details of a broadly stated qualitative standard of materiality, its initiatives suffered fatal consequences."). Yet, in spite of its disfavor, the SEC persists in asserting the applicability of management integrity as a basis for materiality. *See, e.g.*, SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150 (Aug. 12, 1999), *available at* http://www.sec.gov/interps/account/sab99.htm; *see also* Caroline A. Antonacci, Note, *SAB 99: Combating Earnings Management with a Qualitative Standard of Materiality*, 35 SUFFOLK U. L. REV. 75, 81–94 (2001) (summarizing decisional

Ultimately, the materiality of personal facts about executive officers determined on any of these bases should depend on an assessment of the specific capabilities or attributes of the executive, their importance (financially or otherwise) to the value of the public company that the executive serves, and the market for executive talent. If the executive is more fungible (easily replaceable without considerable cost to the corporation), his or her personal information should be less important to investors or less significant to the total mix of available information. Although almost every public company undoubtedly would, if prompted, indicate that its chief executive officer and other key executives are important to its business, many will not, without significant thought, be able to indicate precisely why. In many cases, executives are relatively fungible, even if they are talented, intelligent, and knowledgeable about the corporation and its business.

3. Personal Facts About Executives Are Less Likely to Be Material than Corporate Facts

Even where an executive is not fungible, personal facts about the executive are less likely to be important to the reasonable investor or less significant to the total mix of available information than corporate facts. Executives' personal facts are less likely to be directly related to fundamental corporate value and are less apt to impact corporate behavior (apart from the potential for a change in the executive's management responsibilities or a termination of the executive's management or employment status). The value of a public company to its shareholders and others is comprised of many components and can be measured in numerous ways. But it is safe to say that most personal facts about executives have little impact on the corporation's assets, profitability, stability, earnings or growth potential, efficiency (by any measure), or any other fundamental internal value metric when compared with information about the corporation's products or services, financial condition, or results of operations. Of course, public disclosure of a personal fact about an executive may affect the short-term price of the corporation's stock, but that price effect does not necessarily indicate that the personal fact is material.[80]

Personal facts about public executive officers also are less likely

law and SEC action regarding qualitative materiality).

80. *See* David Monsma & 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, 142 (2007) ("Not all information that is interesting to investors and analysts is material to the financial condition of a company.").

to be qualitatively important to the public company. Although the SEC has promoted the possibility that facts related to management competence, reliability, and integrity may be material, there are few court cases expressly endorsing qualitative materiality.[81] In fact, at least one case appears to outright reject qualitative materiality, noting that the SEC can and should provide for mandatory disclosure in areas raising the potential for qualitative materiality claims.[82] Based on existing decisional law, qualitative materiality is most likely to exist where the facts include concealment of self-dealing transactions or illegal activities.[83] However, self-dealing claims cannot be converted from state law fiduciary duty claims to federal securities fraud claims without allegations of manipulation or deception (including principally false or misleading disclosures).[84]

B. The Existing Disclosure Regime Places Too Much Discretion in the Hands of Executive Officers

Current federal securities law applicable to disclosure of private facts about executives divides mandatory disclosure responsibilities between the executive and the corporation. Public companies have adopted compliance policies and other methods for reminding executive officers of the executives' reporting requirements under the federal securities laws and have established systems for capturing information from their executive officers that enable the companies to comply with their SEC reporting responsibilities.[85] For

81. *See supra* note 79 and accompanying text.

82. *See, e.g.*, United States v. Matthews, 787 F.2d 38, 49 (2d Cir. 1986) ("We hold that at least so long as uncharged criminal conduct is not required to be disclosed by any rule lawfully promulgated by the SEC, nondisclosure of such conduct cannot be the basis of a criminal prosecution."). The *Matthews* court rested its decision on both the history of the SEC's attempts to assert the applicability of a qualitative materiality analysis and due process concerns arising out of a lack of adequate notice of criminal wrongdoing. *Id.* Interestingly, in terms of history, the *Matthews* case notes that the initial SEC focus on qualitative materiality occurred as a result of post-Watergate concerns about disclosure integrity. *Id.* at 47–48. The post-Enron era exhibits similar attributes (each era being comprised of, among other things, various regulatory reactions to actual and perceived abuses of trust), which underlie the concern about disclosure of executives' personal facts.

83. *See id.* at 48 ("We found merit in the plaintiff's claim of wrongdoing only insofar as it alleged self-dealing by the defendant directors, a matter 'explicitly covered by SEC disclosure regulations.'"); *supra* note 79.

84. *Matthews*, 787 F.2d at 48–49.

85. A typical compliance device is a questionnaire distributed on an annual basis by the public company to its directors and officers, commonly known as a "D&O Questionnaire." *See, e.g.*, *In re* W.R. Grace & Co., 53 S.E.C. 235, 240 (1997) ("The Company provided Grace, Jr. with directors' and officers' questionnaires ('D&O Questionnaires') in the course of preparing its 1992 Form

the most part, these systems seem to work well in encouraging accurate, complete, and timely public disclosures.[86]

1. Disclosure Decisions Relating to Personal Facts Are Complex

However, in determining their own and their corporation's disclosure obligations with respect to executives' personal facts, public company executives are required to make important decisions under gap-filling and antifraud rules with respect to the public release and dissemination of noncorporate information of a personal nature—noncorporate information that is outside the scope of line-item mandatory disclosure requirements. Some of these decisions are, no doubt, quite difficult.

Although other issues also may make for challenging disclosure assessments (e.g., whether disclosure of a fact is necessary in order to make existing statements not misleading), materiality determinations are perhaps the most tricky. Many people may have an intuition about what may be material; but the decision is a mixed question of law and fact[87] and, as such, typically is outside the

10-K and 1993 proxy statement and its 1993 Form 10-K and 1994 proxy statement."); Milton C. Regan, Jr., *Teaching Enron*, 74 FORDHAM L. REV. 1139, 1221 (2005) ("Fastow was required to provide Enron with information about his interest in the LJM transactions in his response to a questionnaire sent annually to directors and officers."); *see also* A.A. Sommer, Jr., *Internal Controls*, 61 N.C. L. REV. 505, 513–14 (1983) (noting the role of annual questionnaires in helping to ensure compliance with Form 4 filings). D&O Questionnaires help public companies keep track of certain personal information about executives (and others) on an annual basis. Also, many—if not most—public companies have securities trading compliance policies, some of which provide for preclearance of securities trades by corporate officers. *See* Steven Chasin, *Insider v. Issuer: Resolving and Preventing Insider Trading Compliance Policy Disputes*, 50 UCLA L. REV. 859, 861–64 (2003). These compliance policies give public companies both personal stock information and knowledge, if not control, of securities transactions by their executive officers. Some public companies also supplement their D&O Questionnaires and activities under their securities trading compliance policies with periodic intracorporate communications that remind executives of their responsibilities under federal securities laws.

86. *But see In re Grace*, 53 S.E.C. at 240–42 (noting lapses in executive officers' responses to D&O Questionnaires and compliance with other procedures designed to ensure corporate compliance with annual disclosure requirements).

87. *See, e.g.*, TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976) ("The issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts."); Press v. Chem. Inv. Servs. Corp., 166 F.3d 529, 538 (2d Cir. 1999) ("The determination of materiality is a mixed question of law and fact that generally should be presented to a jury."); United States v. Peterson, 101 F.3d 375, 380

expertise of the executive. With the applicable law consisting of two principal formulations of a materiality standard and a subsidiary test used to assess contingent or speculative information, materiality—especially qualitative materiality—is an elusive concept even for some well-trained legal counsel.[88]

2. *Disclosure Decisions Relating to Personal Facts May Be Highly Stressful and Emotionally Charged*

Worse yet, executives must make these decisions in what may be highly stressful or emotionally charged situations (e.g., under threat of criminal prosecution or civil enforcement, in the wake of a medical diagnosis of a serious or terminal illness, at a time of financial strife, or during the course of a divorce or nonpublic extramarital affair). Of course, it is impossible to remove emotions from decision making completely.[89] But decision making in times of stress, especially on matters involving a high level of sophistication and focus, has a low probability of being accurate, rational, or optimal.[90] Even if counsel is engaged by the executive to assist him or her in making disclosure determinations, decision making may be impacted by the strained personal environment surrounding the

(5th Cir. 1996) ("Because materiality is a mixed question of law and fact, it is usually left for the jury."); SEC v. Shapiro, No. 4:05cv364, 2007 U.S. Dist. LEXIS 17703, at *23 (E.D. Tex. Mar. 14, 2007) ("[M]ateriality is a mixed question of law and fact."). Some commentators see materiality principally or wholly as a question of fact. *See* Langevoort & Gulati, *supra* note 53, at 1644.

88. *See* Fedders, *supra* note 70, at 46–47.

89. *See* Benedict Sheehy, *The Importance of Corporate Models: Economic and Jurisprudential Values and the Future of Corporate Law*, 2 DEPAUL BUS. & COM. L.J. 463, 471 (2004) ("[P]sychologists have demonstrated that humans are unable to make rational decisions without emotions.").

90. *See, e.g.*, Terry A. Maroney, *Emotional Competence, "Rational Understanding," and the Criminal Defendant*, 43 AM. CRIM. L. REV. 1375, 1400–08 (2006) (noting, in a discussion of relevant research findings, that "[c]ertain aspects of emotional experience unquestionably can distort rational decision-making: scholars have largely legitimated the folk wisdom, reflected in numerous areas of legal doctrine, that emotion can be a powerful and sometimes disruptive force"); Richard E. Redding, *The Brain-Disordered Defendant: Neuroscience and Legal Insanity in the Twenty-First Century*, 56 AM. U. L. REV. 51, 70 (2006) ("[P]articularly in threatening or emotionally-charged situations, the amygdala's evaluation and response occurs before the higher cognitive processes in the frontal lobes can become fully engaged to rationally analyze the situation."); Jeremy A. Matz, Note, *We're All Winners: Game Theory, The Adjusted Winner Procedure and Property Division at Divorce*, 66 BROOK. L. REV. 1339, 1353 (2001) ("While negotiation assumes rational actors, people in divorce do not always make decisions under the standard rational choice model. Divorce is an emotional time and decisions will likely be affected accordingly." (footnote omitted)).

executive.[91]

3. Disclosure Decisions Relating to Personal Facts May Be Subject to Irrational Cognitive Processes and Result from Behavioral Biases

Emotions are not, however, the only limitations on accurate, rational, optimal decision making. Executive decision making on disclosure of personal facts also may be influenced by heuristics and behavioral biases. These processes and biases tend to favor under-disclosure by executives of their personal facts.

For example, public company executive officers are likely to exhibit a self-serving or self-interest bias in making disclosure determinations relating to personal facts. "[T]he *self-serving bias* means, among other things, that people's judgments, including judgments of fairness, tend to be influenced by their self-interest. Even if people are trying to be fair, what seems fair to them is inevitably influenced by what is in their own best interests."[92] It would seem to be highly likely that an executive's decisions about disclosure of personal facts would be influenced by this bias, especially to the extent that he or she is protesting innocence during a criminal investigation or desiring to keep illness, financial woes, marital squabbles, or extramarital affairs from the public eye.

Moreover, public company executive officers may have the tendency to "satisfice"—make decisions based on less than full information, perhaps by adopting the first, or an early-identified, suitable resolution.[93] Optimal materiality determinations are rich in legal and factual detail and result from considered judgments, made after considerable thought and consultation. Satisficing, by definition, has the capacity to create bad disclosure decisions in this

91. *See* Lorraine M. Bellard, Note, *Restraining the Paternalism of Attorneys and Families in End-of-Life Decision-Making While Recognizing That Patients Want More Than Just Autonomy*, 14 GEO. J. LEGAL ETHICS 803, 807–10 (2001) (describing legal counsel's ability to assist clients with decision making relating to terminal illness).

92. Robert Prentice, *Enron: A Brief Behavioral Autopsy*, 40 AM. BUS. L.J. 417, 425 (2003); *see also* Thomas S. Ulen, *Human Fallibility and the Forms of Law: The Case of Traffic Safety*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR 397, 409–10 (Francesco Parisi & Vernon L. Smith eds., 2005).

93. *See* Robert H. Frank, *Departures from Rational Choice: With and Without Regret*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR, *supra* note 92, at 13, 14 ("[M]uch of the time, we come up with serviceable, if imperfect, solutions. . . . [W]e are 'satisficers,' not maximizers."); Robert A. Prentice, *The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation*, 95 NW. U. L. REV. 133, 145 (2000) (defining the term "satisfice" as a rule-of-thumb heuristic in which the decision maker settles for merely satisfactory decisions rather than optimizing).

environment. One can imagine, for example, an executive deciding to delay disclosure of an investigation, illness, financial or marital difficulties, or an extramarital affair because of initial information minimizing the actual or probable importance of that information.

Similarly, public company executives' disclosure decisions may reflect a confirmation bias, "in that they seek out and process information in such a way as to confirm pre-existing beliefs rather than in a more optimally neutral manner."[94] Further, cognitive dissonance may operate independently from, or together with, satisficing and the confirmation bias to buttress suboptimal choices. Cognitive dissonance (or "path-dependence"[95]) may enable executives to disregard alternative solutions to problems once an initial decision has been made.[96] So, a self-serving or confirmation bias, together with satisficing or cognitive dissonance, may operate on an executive making a disclosure decision in the following ways:

- the executive might seek out, at least initially, only information that minimizes the importance of an investigation, illness, financial or marital difficulties, or an extramarital affair;
- the executive then may decide for or against disclosure at the outset based only on that information; and
- having made that decision, the executive will stay with and support that decision in subsequent decision making, even when new information indicates that the initial decision was flawed.

Executive officers of public companies also may be subject to an overconfidence bias.[97] Overconfidence may have the effect of

94. Prentice, *supra* note 92, at 424; Ulen, *supra* note 92, at 409.

95. *See* A. Mechele Dickerson, *A Behavioral Approach to Analyzing Corporate Failures*, 38 WAKE FOREST L. REV. 1, 5–6 (2003) ("[P]eople will be over committed to decisions they made, will often ignore or discount new information that contradicts their belief that their prior decisions are correct, and will remain wedded to those decisions even if they later obtain information that should lead them to question the decisions.").

96. *See* Robert Cooter, *Treating Yourself Instrumentally: Internalization, Rationality, and the Law*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR, *supra* note 92, at 95, 97–100; Prentice, *supra* note 92, at 424.

97. *See* Prentice, *supra* note 92, at 424.

> Overconfidence is a common human tendency, and highly successful people in particular have a tendency to overestimate their ability to control their environments and to avoid harm. The problem of the "overconfidence bias" is well-documented and recently has been discussed in the law and behavioral science literature. An actor is susceptible to this bias if she believes that the probability of a negative event happening to her is less than the likelihood of the event happening to someone else or, conversely, that it is more likely that a positive event will happen to her than the likelihood that a

distorting the importance of particular personal facts. For example, an executive who is under investigation for criminal or civil infractions may believe that he or she will not be indicted or subject to suit because he or she "can beat this thing"—even when informed judgments of legal counsel (and others) may be to the contrary. Similarly, an executive may believe that a serious or terminal illness, financial troubles, or divorce issues can be overcome or may believe that an extra-marital affair can easily be handled or kept under wraps. In this way, the overconfidence bias would tend to minimize the importance of the relevant personal facts, making disclosure less likely.

The immediacy bias[98] (or availability heuristic[99]) and the representativeness heuristic[100] are apt to play roles in an executive's determination of whether to disclose personal facts. An executive may base a materiality analysis on recent examples of similar circumstances involving other executives, rather than on an independent analysis of his or her own circumstances. The circumstances of others may or may not be comparable when taken in context, and the decisions of others may or may not have been correct. Accordingly, these behavioral tendencies also may lead to suboptimal decisions.

On a related note, public company executives may fall into time-delay traps, making it unlikely that they will take into account and properly weigh long-term future effects of a current decision.[101] Framing effects may further impact an executive's determinations

> negative event will happen to her. This bias purportedly exists even if the actor is an expert and even if she knows the actual probability distribution of any particular event. Likewise, behavioral studies suggest that people, especially successful ones, have an enhanced sense of their abilities to control events in their lives and that they will likely attribute positive outcomes to their own decision-making abilities. These tendencies combine to encourage people to accept too many risks based on their belief that adverse risks are unlikely to occur and that, in any event, they can prevent harm from occurring.

Dickerson, supra note 95, at 5 (footnotes omitted); see also Ulen, supra note 92, at 408–09.

98. *See* David A. Dana, *A Behavioral Economic Defense of the Precautionary Principle*, 97 NW. U. L. REV. 1315, 1324–26 (2003) (describing the immediacy bias and terming it the "myopia bias").

99. *See* Gerd Gigerenzer, *Is the Mind Irrational or Ecologically Rational?*, *in* THE LAW AND ECONOMICS OF IRRATIONAL BEHAVIOR, *supra* note 92, at 37, 45–46 (citing and describing various availability errors and effects).

100. *See* Prentice, *supra* note 92, at 425 (describing the heuristic as "the tendency to judge probabilities via nonstatistical methods, for example, by relying on salient examples rather than base rates").

101. *See id.* at 426 (describing a time-delay trap as "difficulty appreciating the long-range implications of decisions" that results in a tendency "to value immediate over delayed gratification").

on the disclosure of personal facts.[102] For example, the disclosure question may be posed in such a way that law or facts bolstering the possibility of immateriality are made more prominent than law or facts supporting the possibility of materiality (or vice versa), skewing decision making in favor of the outcome logically dictated by the framing.

These cognitive errors and effects, when taken together with the complexity and stress involved in making disclosure decisions (especially materiality determinations) about personal facts, render executives poor repositories for that decision-making process. Yet our current disclosure system, which relies principally on gap-filling and antifraud rules to foster disclosure of executives' personal facts, leaves these difficult disclosure judgments to public company executives. Moreover, existing law and regulation provide executives with no guidance on decision making in this environment. If disclosure of personal facts is to be required and encouraged, then the present system is deficient.

C. The Existing Disclosure Regime Creates Unresolved Tensions with Individual Rights

Rights to privacy and free speech, as well as the right against self-incrimination, are implicated in and challenged by disclosures compelled under the federal securities laws.[103] This is especially true for mandatory disclosure and antifraud rules associated with the revelation of personal facts about executives.

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102. *See id.* at 425.

103. *See generally, e.g.*, Aleta G. Estreicher, *Securities Regulation and the First Amendment*, 24 GA. L. REV. 223 (1990) (arguing that commercial speech is protected under the First Amendment and that certain elements of securities regulation are inconsistent with the First Amendment); James D. Redwood, *Qualitative Materiality under the SEC Proxy Rules and the Fifth Amendment: A Disclosure Accident Waiting to Happen or Two Ships Passing in the Night?*, 1992 WIS. L. REV. 315 (assessing the Fifth Amendment issues relating to disclosures of unadjudicated illegal activities under the federal securities laws); Frederick Schauer, *The Speech of Law and the Law of Speech*, 49 ARK. L. REV. 687, 690–92 (1997) (describing tension between the 1933 Act and the First Amendment); Kenneth E. Scott, *Insider Trading: Rule 10b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801, 817–18 (1980) (setting forth and analyzing "three possible general levels of social attitude toward privacy and disclosure" and applying them to analyze insider trading under Rule 10b-5); David S. Nalven & Thomas A. Bockhorst, *Taking the Fifth with the SEC: No Longer an Easy Option*, 40 BOSTON BAR J. 12, 12 (1996) (describing conflict between disclosure obligations and self-incrimination); Glenn, *supra* note 5, at 543–44 (exploring tensions between the privacy rights under the Americans with Disabilities Act and disclosure obligations under the federal securities laws).

1. Interference with the Right to Privacy

Privacy and the right to privacy are not well delineated, and the legal basis for a right to privacy in the United States is variously stated and attributed.[104] However, one can distinguish two principal forms of privacy—"information privacy" and "decisional privacy."[105] This Article essentially is concerned only with information privacy—privacy relating to "the collection, use, and disclosure of personal information."[106] Information privacy is an interest that is recognized to be rooted in tort law and constitutional law,[107] as well as in an increasing number of federal and state statutes.[108] Especially relevant to the analysis here is Congress's enactment of legislation protecting health care information and personal financial information—two types of information encompassing earlier identified common personal facts about executives that may be the subject of difficult disclosure determinations under the federal securities laws (e.g., executive illnesses and health treatments and executive financial troubles).[109]

The right to information privacy generally is conceptualized as one or more legal protections relating to the public revelation of personal information. This conceptualization may involve

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104. *See, e.g.*, MADELEINE SCHACHTER, INFORMATIONAL AND DECISIONAL PRIVACY 3–21 (2003); William L. Prosser, *Privacy*, 48 CAL. L. REV. 383 (1960); Anita L. Allen, *Privacy in American Law*, *in* PRIVACIES: PHILOSOPHICAL EVALUATIONS 19, 19–36 (Beate Rössler ed., 2004) [hereinafter PRIVACIES]; Beate Rössler, *Privacies: An Overview*, in PRIVACIES, *supra*, at 1; Daniel J. Solove, *A Taxonomy of Privacy*, 154 U. PA. L. REV. 477 (2006); Judith Jarvis Thompson, *The right to privacy*, *in* PHILOSOPHICAL DIMENSIONS OF PRIVACY: AN ANTHOLOGY 272, 272–87 (Ferdinand D. Schoeman ed., 1984) [hereinafter PRIVACY ANTHOLOGY]; Samuel D. Warren & Louis D. Brandeis, *The Right to Privacy*, 4 HARV. L. REV. 193 (1890); *see also* Amy L. Peikoff, *The Right to Privacy: Contemporary Reductionists and Their Critics*, 13 VA. J. SOC. POL'Y & L. 474 (2006) (surveying various articulations and bases for a right to privacy).

105. DANIEL J. SOLOVE ET AL., PRIVACY, INFORMATION, AND TECHNOLOGY 1 (2006) (defining these two forms of privacy).

106. *Id.*

107. *See* Whalen v. Roe, 429 U.S. 589, 599 (1977) (recognizing an individual's interest in avoiding disclosure of personal matters).

108. SOLOVE ET AL., *supra* note 105, at 26–33.

109. *See* Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 and 15 U.S.C) (providing for the handling of consumer financial information by financial institutions, and also known as the "GLBA"); Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936 (1996) (codified as amended in scattered sections of 18, 26, 29 and 42 U.S.C.) (providing for, among other things, regulatory action governing medical privacy, and also known as "HIPAA"); *see also* 45 C.F.R. §§ 160, 164 (2006) (including federal regulations governing medical privacy under HIPAA).

protecting the secrecy of personal information or protecting the right to determine whether, when, how, and to what extent personal information is publicized.[110] Protecting privacy, then, may not necessarily involve preserving the nonpublic nature of personal information so much as preserving individual control over the release of personal information.

These protections may be important to individuals or society for a variety of different reasons. For example, confidentiality or personal choice may give an individual time and space for reflection and growth. The precise interests to be protected and the extent of legal protection for those interests necessarily are highly contextual.[111]

Privacy in the context of federal securities regulation is limited. Federal securities regulation involves governmental, rather than corporate or individual, control over the public dissemination of information. Disclosure regulation that brings facts to public light that an individual otherwise would keep confidential creates unavoidable tensions with individual privacy rights. It is clear from the mandatory and antifraud disclosure rules described in Part I that the SEC, under the power delegated to it by Congress, intends that public company executives surrender some of their privacy rights in favor of the compulsory public disclosure of facts about them—at least to the extent that disclosure promotes the policies underlying the federal securities laws. This is especially (but not exclusively) true with respect to personal information about executive officers that involves otherwise nonpublic matters at the intersection of the corporation's relationship with its executives.

> An insider of a corporation that is asking the public for funds must, in return, relinquish various areas of privacy with respect to his financial affairs which impinge significantly upon the affairs of the company. That determination was made by the Congress over 30 years ago when it expressly provided in the Securities Act for disclosure of such matters as remuneration of insiders and the extent of their shareholdings in and the nature of their other material transactions with the company.[112]

110. ALAN F. WESTIN, PRIVACY AND FREEDOM 7 (1967) ("Privacy is the claim of individuals, groups, or institutions to determine for themselves when, how, and to what extent information about them is communicated to others."); Charles Fried, *Privacy*, 77 YALE L.J. 475, 482 (1968) ("Privacy is not simply an absence of information about us in the minds of others; rather it is the *control* we have over information about ourselves.").

111. *See* Helen Nissenbaum, *Privacy as Contextual Integrity*, 79 WASH. L. REV. 119, 155–56 (2004).

112. *In re* Franchard Corp., 42 S.E.C. 163, 174 (1964).

However, Congress did not expressly strip executive officers of their information privacy rights (or delegate authority to the SEC to do so). Moreover, no court has found that individuals check all of their information privacy rights at the door when they become public company executives. Privacy protections for executives may, in fact, serve both individual and corporate purposes.[113] For example, a highly qualified individual may be more sanguine about accepting a position as a public company executive officer if he or she is able to maintain the confidentiality of personal information to a reasonable extent. Moreover, a reasonable expectation of information privacy may enable an executive to work more efficiently and effectively, free from worry about unintended or unknown public revelations or compelled disclosures of his or her personal information. Accordingly, any obligation of an executive to disclose confidential personal information should result from a considered balancing of the public's need for an executive's personal facts against the executive's desire to keep those facts private—ex ante. The law often is responsible for performing that kind of balancing.

Unfortunately, current federal securities disclosure rules do not apparently recognize the tension they create with privacy rights or provide a concrete basis or process for performing the requisite balancing of governmental (or public) and individual interests. Where a duty to disclose exists, what is material must be disclosed. Only in the event that a legal challenge is mounted to a particular disclosure requirement or its application in a specific context will privacy rights be considered—*ex post*. Accordingly, if a harmonization of individual information privacy rights and federal securities disclosure regulation is to occur under current law, the federal courts are required to step in and perform the necessary balancing in specific cases. This *ex post*, *ad hoc* means of handling conflicts between privacy and disclosure is inefficient and undesirable.

2. *Interference with the Right of Free Speech*

The First Amendment of the U.S. Constitution provides that "Congress shall make no law . . . abridging the freedom of speech."[114] This right to free speech, like the right to privacy, is complex and variously defined.[115] "American free speech law is as much a product

113. *Cf.* PRISCILLA M. REGAN, LEGISLATING PRIVACY: TECHNOLOGY, SOCIAL VALUES, AND PUBLIC POLICY 213 (1995) (arguing that privacy is of value to the individual and society in general).

114. U.S. CONST. amend. I.

115. *See, e.g.*, Lawrence B. Solum, *The Value of Dissent*, 85 CORNELL L. REV.

of our history as it is a true deduction from valid premises. Its contours are the result of particular struggles and compromises, played out against the background of familiar doctrinal structures in adjacent fields of public and private law."[116] In general, however, constitutional free speech protections prevent the government from restricting or otherwise regulating the expression of information, including beliefs, views, and ideas.[117]

> Government may not suppress or regulate speech because it does not like its content—unless it is obscene or demonstrably defamatory. If government regulates the time, place or manner of speech, it must regulate in a way that does not take sides between competing ideas. And if a government regulation directed at other ends has the effect of restricting speech, that regulation too must be neutral.[118]

However, false speech is not protected.[119] Judicial scrutiny of speech regulation employs a number of different standards, depending on the factual context.[120]

859, 859–60 (2000) (reviewing STEVEN H. SHIFFRIN, DISSENT, INJUSTICE, AND THE MEANINGS OF AMERICA (1999)) (noting that there are varied theories of free speech under the First Amendment); Howard M. Wasserman, *Symbolic Counter-Speech*, 12 WM. & MARY BILL RTS. J. 367, 383 (2004) ("First Amendment doctrine is complicated, perhaps by necessity, given the range of speech issues arising in a complex society.").

116. Charles Fried, *The New First Amendment Jurisprudence: A Threat to Liberty*, 59 U. CHI. L. REV. 225, 229 (1992).

117. Police Dep't of Chicago v. Mosley, 408 U.S. 92, 95 (1972) ("[A]bove all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content."); Fried, *supra* note 116, at 234 ("The First Amendment does not protect a person from lies or imposition by private individuals. Rather the First Amendment protects against impositions by government—'Congress shall make no law . . . abridging the freedom of speech,' 'nor shall any state deprive any person . . . [of his free speech liberties].'" (footnotes omitted) (alteration in original)).

118. Fried, *supra* note 116, at 225.

119. Va. State Bd. of Pharm. v. Va. Citizens Consumer Council, 425 U.S. 748, 771 (1976) ("Untruthful speech, commercial or otherwise, has never been protected for its own sake."); Fried, *supra* note 116, at 238 ("Defamation and deception are actionable wrongs . . . : they vindicate private rights invoked by, or at least on behalf of, private individuals.").

120. Although this Article suggests the general propriety of an approach that balances the governmental interest in protecting investors and markets against free speech rights, no attempt is made here to assess whether restrictions on speech involving personal facts about an executive deserve heightened scrutiny, are entitled to a rational basis review, are subject to a due process analysis, or would be evaluated under another standard. In a similar context, two commentators note that

> [d]epending on how it chose to weigh the Supreme Court's precedents, a court could apply rational review, intermediate *Central Hudson*

Among the most inscrutable parts of U.S. free speech doctrine is the area related to compelled speech—government regulation that requires speech in circumstances where the speaker otherwise would not communicate information to the public.[121] Sometimes referred to as "negative free speech rights,"[122] the right to avoid compelled speech is a limited one, most often applied in cases involving public media and individual expressions of a religious, political, or ideological nature.[123] Historically, compelled *commercial* speech has not been a well-protected area, largely because overall commercial free speech rights have been limited.[124] However, negative free speech rights have been validated in a commercial context[125] as long as the government-compelled speech is not necessary to ensure consumer protection.[126]

These guarantees of rights to free speech protect a variety of important individual and societal interests. In a 1989 article about speech in the context of capital markets, Professor Burt Neuborne offered four principal "justifications" in defense of free speech:

> review, or strict scrutiny. Regardless of the standard of review, a court would analyze the nature of the government's interest and how well the regulation relates to or fits the interest.

Page & Yang, *supra* note 70, at 66 (footnotes omitted) (making this point in reference to a First Amendment analysis of the SEC's Regulation FD). Accordingly, while the assessment of the appropriate review standard is beyond the scope of this Article, that assessment likely would require a blending of commercial and individual speech doctrines, and ultimately should involve a balancing of the competing governmental interests, as suggested in this Article.

121. Professor Charles Fried captures this issue well:

> The real trouble begins when this conception of the First Amendment is pressed further to *deny* free speech protection to speakers who wish *not* to pronounce certain views. The speech-as-silence principle has been part of free speech law at least since the flag salute case, *West Virginia Board of Education v Barnette*—which held that it is unconstitutional to compel an unwilling speaker to speak.

Fried, *supra* note 116, at 227 (footnote omitted).

122. Pac. Gas & Elec. Co. v. Pub. Utils. Comm'n, 475 U.S. 1, 26 (1986) (Rehnquist, J., dissenting).

123. Nicole B. Cásarez, *Don't Tell Me What to Say: Compelled Commercial Speech and the First Amendment*, 63 MO. L. REV. 929, 948–50 (1998) (stating that "[t]he fact that the First Amendment prohibits the state from compelling speech of a religious, political, or ideological nature has been determined beyond question" and illustrating the claim with applicable decisional law).

124. *Id.* at 947.

125. *Pac. Gas & Elec. Co.*, 475 U.S. at 20–21. *But see* Glickman v. Wileman Bros. & Elliott, Inc., 521 U.S. 457 (1997) (failing to apply First Amendment protection to government-mandated contributions to government-sponsored industry advertising). *See generally* Cásarez, *supra* note 123, at 955–65 (describing and critiquing the *Glickman* case).

126. Cásarez, *supra* note 123, at 950–53.

> (1) The inherent correctness of respecting an individual's attempt at self-expression;
>
> (2) The wisdom of operating a 'free market in ideas' to assist in discovering truth;
>
> (3) The wisdom of enhancing the free flow of information to assist persons in making lawful choices open to them; and
>
> (4) The inability of the government to function acceptably as a censor.[127]

Professor Neuborne's list of justifications contributes usefully to an understanding of the rationales for the protections afforded by constitutional rights to free speech by categorizing and consolidating applicable underlying principles.

The compelled public disclosure of personal facts by an executive (whether directly or by a corporation as a conduit for information about the executive)[128] competes with an individual's (or, where disclosure is made by a corporation, the corporation's) right to control the timing, content, and manner of speech.[129] Various SEC rules, together with related guidance and decisional law, may compel speech about certain things, at specific times, in specific documents, and in required formats.[130] This compelled disclosure is

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127. Burt Neuborne, *The First Amendment and Government Regulation of Capital Markets*, 55 BROOK. L. REV. 5, 15 (1989).

128. *Cf. id.* at 23 (indicating that courts may find it easier to regulate conduits—like publishers of information about others—than speakers).

129. In fact, in a pretrial motion, Martha Stewart unsuccessfully sought to dismiss the criminal securities fraud charge brought against her on First Amendment grounds. *See* Brief for Defendant-Appellant Martha Stewart at 17, United States v. Stewart, 433 F.3d 273 (2d Cir. 2004) (No. 04-3953(L)-cr); Caillavet, *supra* note 77, at 1039 ("[P]rior to trial Stewart moved to dismiss Count Nine based on a First Amendment defense, among others."). In response to a subsequent pre-trial motion from the prosecution, the trial judge ruled that Stewart's public statements about her personal stock trade were not protected under the First Amendment and that Stewart could not raise her First Amendment assertions at trial. Memorandum Opinion at 4, United States v. Stewart (No. 03 Crim. 717) (Jan. 26, 2004), *available at* http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/mstewart/usmspb12604opn.pdf; *see* Caillavet, *supra* note 77, at 1039–40 ("[The court] later held that Stewart could not argue at trial the potential First Amendment problem posed by Count Nine. Rather, the court ruled as a matter of law that Count Nine poses no First Amendment problem because 'the First Amendment does not protect false statements of fact that are part of a course of criminal conduct.'").

130. *See* Neuborne, *supra* note 127, at 51–54. SEC rules also may impose prior restraints on speech. Professor Neuborne notes:

> At least four aspects of the SEC's primary market speech regulations raise serious first amendment issues: (1) forced disclosure by the

intended to serve the policy interests underlying the securities laws: investor protection and the maintenance of market integrity. Although these policy interests often are consistent with Professor Neuborne's justifications for free speech (especially the second and third justifications—support for a truth-based free market in ideas and choice-enhancing free information flow), they also may create tensions with some or all of the principles underlying free speech.[131] By promoting mandatory disclosure and fraud protection (also through disclosure), the securities laws and regulations use speech regulation as a tool for protecting investors and maintaining market integrity.

The tensions between the First Amendment and the federal securities law scheme always have been noteworthy, but they are increasingly important in our current post-Enron,[132] post-Sarbanes-Oxley,[133] pro-disclosure world of securities regulation. Yet, scholarly analyses of the speech regulation imposed by the federal securities laws have been few and (sometimes) far between.[134] What has been written to date tends to focus on the regulation of corporate speech through compelled corporate transactional, periodic, and fraud-

> issuer; (2) prior SEC approval of each registration statement and prospectus; (3) restrictions on the contents of the registration statement and the prospectus; and (4) restrictions on the form and timing of pre- and post-prospectus promotional speech.

Id. at 59. Three of the four aspects (all aspects other than prior approval) apply to periodic reporting as well as registration statement and prospectus issues.

131. *Cf.* Jonathan D. Varat, *Deception and the First Amendment: A Central, Complex, and Somewhat Curious Relationship*, 53 UCLA L. REV. 1107, 1109–10 (2006) ("[T]he complexity of the relationship between deception and the First Amendment resides to a significant degree in the fact that the First Amendment values of enlightenment and autonomy sometimes support—and sometimes resist—government attempts to reduce deception.").

132. References to Enron in this Article are intended to invoke the period commencing in late 2001 and extending through the summer of 2002, a time during which massive corporate fraud was revealed at Enron Corp., WorldCom, Inc. (now MCI, Inc.), and other large public companies.

133. Reference is made here to the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scatted sections of 15 U.S.C. and 18 U.S.C.), which was enacted into law in the summer of 2002.

134. *See, e.g.*, Henry N. Butler & Larry E. Ribstein, *Corporate Governance Speech and the First Amendment*, 43 U. KAN. L. REV. 163 (1994); Lloyd L. Drury, III, *Disclosure Is Speech: Imposing Meaningful First Amendment Constraints on the SEC Regulatory Authority*, 58 S.C. L. REV. 757 (2007); Estreicher, *supra* note 103; Neuborne, *supra* note 127; Arthur R. Pinto, *The Nature of the Capital Markets Allows a Greater Role for the Government*, 55 BROOK. L. REV. 77 (1989); Michael R. Siebecker, *Corporate Speech, Securities Regulation, and an Institutional Approach to the First Amendment*, 48 WM. & MARY L. REV. 613 (2006); Nicholas Wolfson, *The First Amendment and the SEC*, 20 CONN. L. REV. 265 (1988).

based disclosures.[135] There is, however, a more broad and deep body of literature relating to corporate speech in general commercial and economic contexts that may play a role in better defining and illuminating the relationship between the First Amendment and securities regulation.

For example, most scholars concede that there is less of a First Amendment interest in protecting corporate (or any commercial or economic) speech than there is in protecting an individual's freedom of speech.[136] Individual speech more clearly implicates the first of Professor Neuborne's free speech justifications: support for individual expression. Moreover, the federal securities laws do not often regulate corporate speech in content areas that have been traditionally among the most protected as crucial parts of the free market in ideas and the free flow of information—namely, political and religious communications and scientific and artistic expression.[137] And finally, the government may be a more acceptable censor of corporate free speech than it is of individual free speech in that corporate free speech rights exist only because of the existence of the corporation itself, which is a matter of legislative grace.[138] Accordingly, based on Professor Neuborne's free speech justifications, compelled speech by an *individual* in a corporate or commercial context should be accorded more First Amendment protection than speech by a *corporation* in a commercial or economic context, principally because of the perceived interest in "respecting an individual's attempt at self-expression" and, as a result of privacy and other concerns not relevant to corporations, the "inability of the

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135. *See, e.g.*, Neuborne, *supra* note 127; Pinto, *supra* note 134.

136. *See, e.g.*, Neuborne, *supra* note 127, at 5 ("Until recently, a structural divide in first amendment theory provided effective protection to speech about religion, politics, science, and art, but no protection at all to speech about consumer affairs, labor relations, or capital formation. During the past decade, the Supreme Court has shattered the symmetry of that structural divide by affording significant, albeit limited, first amendment protection to speech about consumer affairs."); Pinto, *supra* note 134, at 87 ("[T]he capital markets require a lesser burden on the government to justify regulation in the face of an attack under the first amendment.").

137. One scholar notes that

> [l]aws restricting commercial speech arguably do not result in ideological traumas, yet they are still viewed as affecting the advertiser's freedom of expression. Furthermore, the suggestion that speakers must truly disagree with a message to be free from compelled speech raises serious implications with respect to both commercial and political speech.

Cásarez, *supra* note 123, at 961.

138. It should be noted, however, that the federal government principally engages in speech regulation in and under the securities laws, while states typically charter corporations.

government to function acceptably as a censor."[139]

In addition, speech about *personal* facts should be accorded more First Amendment protection than speech about *corporate* facts. Personal facts are less likely than corporate facts to assist investors "in discovering truth" or "in making lawful choices open to them."[140] However, personal facts do contribute to the free market of ideas and free flow of information and, in certain circumstances (i.e., where the information, if disclosed, is substantially likely to affect firm value), may assist investors in discovering truth and making lawful choices. Moreover, in general, market integrity is promoted by truthful, complete disclosures.

Given the tension between disclosure regulation and free speech rights, a balancing of interests seems appropriate in judging the constitutionality of speech compelled through federal securities regulation, whether the disclosure is made by a corporation or an individual and whether the disclosure involves corporate or personal facts.[141] Therefore, the substance of any securities regulation compelling the disclosure of personal facts by or about executive officers should allow for First Amendment concerns as well as the need for investor and market protections. It is not clear that current disclosure-oriented securities regulation—especially the broad-based disclosures required under Rule 10b-5—appropriately accounts for free speech rights by balancing the justifications for free speech against the policies underlying the federal securities laws.

139. *See supra* text accompanying note 127.

140. *See supra* text accompanying note 127; *supra* Part II.A.3.

141. *See* Neuborne, *supra* note 127, at 41 (noting, in general, that "no serious first amendment objection to forced disclosure exists so long as the disclosures are demonstrably necessary to preserve hearers' capacity for informed and/or autonomous choice"); Pinto, *supra* note 134, at 89–90 ("[I]f the regulation deals with mandatory disclosure or with the timing and form of nonfraudulent speech, then it should not be invalidated under the first amendment as long as the regulation is reasonably necessary for the protection of investors and does not directly involve the traditional kinds of speech protected by the first amendment." (footnote omitted)); *id.* at 87 ("[T]he market must be analyzed to determine who the hearers are, what they are hearing, where the information comes from, how important the speech is to the potential harm, and whether there are sufficient nongovernmental means to protect the hearers." (footnotes omitted)); *cf.* Cásarez, *supra* note 123, at 965–77 (arguing for use of the *Central Hudson* balancing test in determining the constitutionality of any regulation that restrains or compels commercial speech); Drury, *supra* note 134, at 773–75 (applying the *Central Hudson* balancing test in a First Amendment analysis of the federal securities regulation regime).

3. *Interference with the Right Against Self-Incrimination*

Under the Fifth Amendment, "[n]o person . . . shall be compelled in any criminal case to be a witness against himself."[142] Despite its seemingly restrictive language, this constitutional provision allows an individual to assert a privilege against incriminating himself or herself when disclosures of facts otherwise may be compelled both inside and outside the criminal justice process, although invocations of the privilege may have different effects in criminal and civil proceedings.[143] The privilege protects both criminal suspects and defendants,[144] and is properly invoked when an individual has "a reasonable apprehension that the requested testimony would either 'support a conviction' or 'furnish a link in the chain of evidence' that could lead to prosecution."[145] Among other things, if invoked, the self-incrimination privilege requires the prosecution to proceed without testimony from the accused.[146] However, the privilege may be waived by voluntary disclosure of incriminating facts.[147]

Likely originating under English law, the right against self-incrimination is a foundational principle of civil society that protects individuals from abusive inquisitions in connection with criminal investigations and proceedings.[148] The self-incrimination privilege also is rooted in individual autonomy, dignity, and privacy.[149] In operation, when taken together with the Fifth Amendment rights to a grand jury indictment and freedom from double jeopardy (retrial for the same criminal offense), the right against self-incrimination limits prosecutorial power in criminal proceedings.[150] Although the self-incrimination privilege also gives some clout to suspects and defendants in criminal investigations and proceedings, its protections do have limits. For example, an individual cannot assert the self-incrimination shield of the Fifth Amendment to protect the privacy of certain information and then attempt to later disclose and

142. U.S. CONST. amend. V.

143. ABA SECTION OF ANTITRUST LAW, THE RIGHT AGAINST SELF-INCRIMINATION IN CIVIL LITIGATION 3–6 (2001).

144. ALFREDO GARCIA, THE FIFTH AMENDMENT: A COMPREHENSIVE APPROACH, at ix (2002).

145. ABA SECTION OF ANTITRUST LAW, *supra* note 143, at 5.

146. GARCIA, *supra* note 144, at ix.

147. ABA SECTION OF ANTITRUST LAW, *supra* note 143, at 6, 59–70.

148. *Id.* at 1–3; GARCIA, *supra* note 144, at 8–11; Robert S. Gerstein, *Privacy and self-incrimination*, *in* PRIVACY ANTHOLOGY, *supra* note 104, at 245, 245–46.

149. GARCIA, *supra* note 144, at 11; Gerstein, *supra* note 148, at 246–54.

150. GARCIA, *supra* note 144, at ix ("Underlying these clauses is the axiom that the government must not overpower the individual in the criminal process.").

use that same information to his or her benefit.[151]

The Fifth Amendment right to remain silent may conflict with the pro-disclosure approach to federal securities regulation where incriminating disclosure is required by the securities laws. In fact, the right against self-incrimination may be invoked by an executive to forestall disclosure of personal information that may constitute material facts required to be disclosed under the federal securities laws.[152] But, in the face of required disclosure of personal facts under the federal securities laws, an executive may be forced to choose between compliance with (or liability under) the federal securities laws and his or her constitutional right to remain silent.[153] Moreover, where an executive is pursued both civilly and criminally for a failure to disclose material facts under Rule 10b-5, testimony at a civil trial can be used against the testifying witness in a subsequent criminal or civil trial.[154] Although this conflict is seemingly unavoidable, securities rule making should take the conflict into account and attempt to minimize it. Again, a rule-making approach that carefully balances investor protection and market integrity promotion against Fifth Amendment policies would

151. ABA SECTION OF ANTITRUST LAW, *supra* note 143, at 87–91.

152. *See, e.g.*, United States v. Matthews, 787 F.2d 38, 46 (2d Cir. 1986) ("The issue . . . is . . . whether section 14(a) of the Exchange Act and the SEC rules enacted pursuant thereto required Matthews to state to all the world that he was guilty of the uncharged crime of conspiracy."); Report of Investigation in the Matter of the Cooper Companies, Inc. as it Relates to the Conduct of Cooper's Board of Directors, Exchange Act Release No. 34-35082, 1994 SEC LEXIS 3975, at *13 n.9 (Dec. 12, 1994) ("The fact that an officer or director of a public company has asserted his Fifth Amendment privilege against self incrimination does not negate a public company's disclosure obligations under the federal securities laws."); *see also* Redwood, *supra* note 103 (analyzing and minimizing the potential conflict between federal proxy disclosure requirements and the Fifth Amendment right against self-incrimination).

153. For example, Martha Stewart asserted her Fifth Amendment privilege by declining to testify about the facts relating to the personal stock transaction at the center of her criminal trial, which included a securities fraud charge based on misstatements and omissions of material facts about that very stock transaction. Julie Hilden, *Should Martha Stewart's Lawyer Have Strongly Advised Her to Testify?*, FINDLAW WRIT, Mar. 15, 2004, http://writ.news.findlaw.com/hilden/20040315.html (discussing the pros and cons of Stewart's decision to exercise her Fifth Amendment right not to testify at her trial).

154. ABA SECTION OF ANTITRUST LAW, *supra* note 143, at 75–77. However, a defendant may be able to obtain a stay of civil proceedings until the full prosecution of parallel criminal actions or obtain a protective order. *Id.* at 131–61.

seem like a sensible strategy.[155]

D. The Existing Disclosure Regime Likely Encourages Investor and Market Overreactions

Personal facts about an executive may be less likely to impact firm value than corporate facts because personal facts typically are less directly related to corporate operations.[156] Yet, an executive's personal facts may engender significant public interest. Some of that public interest may translate into investor or market behavior that is out of proportion to the effect of the personal facts on firm value, especially in the short term. This effect likely is exacerbated by the open-textured nature of current federal securities disclosure rules applicable to personal facts about an executive, which do not adequately direct investors to the firm-value significance of an executive's personal facts. Although much is not yet known about the specific effects of these personal facts on firm value, investor conduct, and the securities markets, certain relevant hypotheses may be derived from recent scholarly work on investor and market reactions to public disclosure.

1. Investors and the Market May Overreact to the Public Disclosure of Personal Facts About Executives

Although our existing securities regulation regime generally presumes economically rational investor responses to publicly available information, research indicates that investors do not always behave in an economically rational manner.[157] Investors may

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155. *See* Redwood, *supra* note 103, at 404–09 (suggesting this kind of approach). The *Matthews* court seems to suggest that a valid disclosure rule effectuating this balance may be possible by noting that its decision might have been different if the SEC had adopted a rule requiring disclosure. *Matthews*, 787 F.2d at 49 ("We hold that at least *so long as uncharged criminal conduct is not required to be disclosed by any rule lawfully promulgated by the SEC*, nondisclosure of such conduct cannot be the basis of a criminal prosecution." (emphasis added)).

156. *See supra* Part II.A.3.

157. *See, e.g.*, Jill E. Fisch, *Regulatory Responses to Investor Irrationality: The Case of the Research Analyst*, 10 LEWIS & CLARK L. REV. 57, 59 (2006). However, the line between investor rationality and irrationality may be hard to draw, which presents distinct regulatory difficulties.

> In a market in which prices can and do deviate from fundamental value, in a market where investor sentiment plays an important role, in a market that functions like the famous Keynes beauty contest, it is hard to decide what information constitutes a rational basis for trading. Investors may lose money when trading on the basis of fundamentals, or make money by following the length of women's skirts. The difficulty of identifying appropriate and inappropriate bases for trading decisions suggests a challenge for regulators in

overreact to uncertainty, for example, and sell based on any news that they perceive to be unfavorable.[158] This reaction may occur even where the unfavorable news is unlikely to have any significant effect on corporate assets, earnings, or operations.[159] The presence of unsophisticated investors in the market may account for some of this kind of trading activity.

Moreover, investors, like executives, are subject to psychological biases that may dictate economically unexplainable or irrational behavior.[160] Both unsophisticated and sophisticated investors may overreact to the disclosure of personal facts about an executive.[161] The rapid dissemination of information to investors through the Internet, and the ability of investors to engage in securities trading over the Internet, may contribute to the operation or strength of investor biases.[162] These biases may operate when investors are confronted with disclosures of, or failures to disclose, personal facts about executives.

For example, investors, like executives, may fall into a time-delay trap; they may make investment decisions based on short-term, rather than long-term, corporate or market effects.[163] The time-delay trap may cause investors to react to personal facts about executives based on the perceived immediate effects of those facts on

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> attempting to reduce irrational investor behavior.

Id. at 73.

158. *See* Thomas Lee Hazen, *The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law*, 70 N.C. L. REV. 137, 145 (1991) (noting that market volatility may be explained by investors' "irrational judgments about uncertainty").

159. *Cf.* Fisch, *supra* note 157, at 68 (observing that "investor irrationality can cause prices to deviate from fundamental values").

160. Fisch, *supra* note 157, at 67.

161. Professor Susanna Ripken explains:

> Sophisticated investors and professionals can suffer from the same cognitive and behavioral biases that constrain individual, unsophisticated investors. Experts can become information overloaded in ways that affect their decision-making processes. In fact, under certain circumstances, experts can actually perform worse than non-experts. Overconfidence and optimism biases can be even more pronounced in professional investors than lay investors. Sophisticated investors' past investment experience may lead them to take greater risks in the belief that they are much better stock-pickers than they really are. They may also be overconfident in their ability to assess corporate executives' credibility and performance, and reluctant to admit their own shortcomings in decision-making. Some evidence shows that even professional security analysts and economic forecasters overreact to information in the market.

Ripken, *supra* note 11, at 181–82 (footnotes omitted).

162. Fisch, *supra* note 157, at 68–69 (making this observation with respect to the overconfidence bias).

163. *See supra* note 101 and accompanying text.

the corporation and the market for its securities rather than the long-term impacts of those facts on firm value.[164] Similarly, investors may exhibit an anchoring bias,[165] leading them to make and sustain investment decisions based on knee-jerk, initial reactions to enticing, easily digested, information—even as a moderated reaction or no reaction emerges as a more economically rational response in the aftermath of disclosure.[166] Personal facts about executives typically are relatively easy to understand and may engender immediate positive or negative responses from investors that may not be easily offset by subsequent mediating facts.

Also, scholars have determined that investors may be overconfident in their investment acumen, causing frequent trading that inures to their financial detriment.[167] Overconfident investors may place disproportionate reliance on public representations relating to corporations; they engage in active trading because they believe that they know and understand the effects of that information on firm value—or at least stock price.[168] Accordingly, investors who are overconfident may be more likely to trade on the basis of publicly released personal facts about executives, even where the disclosure of those facts does not and will not affect firm value.

The overall market or the market for a specific company's

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164. Professor Larry Cunningham notes that this type of trading may not, in fact, be irrational under certain circumstances.

> [I]nvestor overreaction or inaction in the face of specific news (such as improved earnings or a new product announcement) may not be irrational because of different investor time horizons. Such behavior also may not be irrational if broader macroeconomic, technical, or structural factors dictate that optimism or caution should accompany a particular bit of news.

Lawrence A. Cunningham, *From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis*, 62 GEO. WASH. L. REV. 546, 603 (1994).

165. Fisch, *supra* note 157, at 67 (describing anchoring as "the tendency for people to make decisions based on an initial estimate that is later adjusted, but not sufficiently to eliminate the influence of the initial estimate").

166. *Id.* at 69 ("Studies show that investors are likely to respond more heavily to salient information—'information that stands out and captures attention.'").

167. *Id.* at 67–69; *see also* Donald C. Langevoort, *Selling Hope, Selling Risk: Some Lessons for Law from Behavioral Economics About Stockbrokers and Sophisticated Customers*, 84 CAL. L. REV. 627, 639 (1996) ("A fair body of research suggests that people (perhaps especially those high in social and economic status) exhibit a predictable overconfidence in their ability to control future events and avoid risks. Investors probably overrate their stock-picking abilities, leading to an underestimation of risk." (footnotes omitted)).

168. *Cf.* Fisch, *supra* note 157, at 68 (making analogous points with respect to investor reactions to analyst recommendations).

securities may react to irrational investor behavior.[169] A market reaction is not, of course, automatic.[170] However, if enough investors trade irrationally in accordance with these or other biases, or if investors not subject to these biases engage in herding behaviors (where investors follow prevailing buy or sell trends), the market will react in an economically irrational manner.[171] Accordingly, to the extent that individual investors overreact to the public disclosure of personal facts about an executive, a more broad-based market overreaction may follow.

2. *Public and Private Enforcement Is Encouraged in an Environment Where Few Tangible Benefits Are Likely to Result*

The investor and market behaviors summarized above, when added to uncertainties as to the legal compulsion to disclose private facts about executives under gap-filling and antifraud rules, are a veritable recipe for investor dissatisfaction. Investor dissatisfaction is likely to result in public or, more likely, private enforcement under Rule 10b-5 for the inaccurate or incomplete disclosure of material facts[172] (in addition to increased selling, the so-called Wall

169. *See* Richard A. Booth, *The End of the Securities Fraud Class Action as We Know It*, 4 BERKELEY BUS. L.J. 1, 8 n.16 (2007) ("Some commentators have . . . suggested that the market overreacts to bad news.").

170. Professor Marcel Kahan explains, using an example relevant to the thesis of this Article:

> Excess volatility in the price of individual stocks will not necessarily result in excess market volatility. Assume, for example, that investors overreact only to company-specific information (e.g., the state of health of the CEO). As a result, individual stock prices may be excessively volatile, but stock markets in the aggregate would not (because the "overreaction" element in the stock price is diversifiable).

Marcel Kahan, *Securities Laws and the Social Costs of "Inaccurate" Stock Prices*, 41 DUKE L.J. 977, 995 n.81 (1992).

171. *See* Hazen, *supra* note 158, at 145 ("As volatility increases, the herd instinct causes many investors to follow, which in turn magnifies price movements. To the extent that investors overreact, the markets are focusing on the short-term rather than long-term view . . . ." (footnotes omitted)).

172. Daniela Nanau, Note, *Analyzing Post-Market Boom Jurisprudence in the Second and Ninth Circuits: Has the Pendulum Really Swung Too Far in Favor of Plaintiffs?*, 3 CARDOZO PUB. L. POL'Y & ETHICS J. 943, 946 (2006) ("[M]ost of the corporate fraud that occurred during the late 1990s will come to light solely through the class action lawsuits filed on behalf of aggrieved investors."); Nanette L. Stasko, Comment, *Competitive Bidding in the Courthouse:* In re *Oracle Securities Litigation*, 59 BROOK. L. REV. 1667, 1668 (1994) ("Less tolerant of a corporation's faulty predictions, investors no longer wait for the tide to turn. Instead, they allege that a hopeful, but mistaken, prediction about the way stock will perform is a false and misleading statement of material fact in violation of federal securities law.").

Street option, and investor activism).[173] Litigation under Rule 10b-5 has become the most significant way that a shareholder can participate in corporate governance and constrain management behavior.[174] Liability uncertainties in this environment have tended to favor class action plaintiffs. This is especially true in securities class actions; most corporate and individual defendants in those actions settle their cases out of court and pay significant damages to plaintiff classes in doing so.[175] These damages exceed corporate liabilities resulting from public enforcement efforts.[176] Both the

173. *See* Sharon Hannes, *Corporate Stagnation: Discussion and Reform Proposal*, 30 J. CORP. L. 51, 75 (2004) ("Traditionally, institutions expressed dissatisfaction with firm management by taking the 'Wall Street Walk' and selling their shares. However, with the increased concentration of equity in institutional hands, this exit strategy became difficult to employ. Consequently, institutions became long-term investors, a position that heightened interest in their monitoring role." (footnotes omitted)).

174. Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections upon Federalism*, 56 VAND. L. REV. 859, 878–86, 905–08 (2003).

175. *See* Elaine Buckberg et al., *Recent Trends in Securities Class Action Litigation: 2003 Update*, 5 CLASS ACTION LITIG. REP. 305 (2004), *available at* http://www.nera.com/image/200405BNA_Trends.pdf (indicating that eighty percent of securities class actions settle); Todd Foster et al., *Recent Trends in Shareholder Class Action Litigation: Filings Plummet, Settlements Soar*, NERA ECON. CONSULTING, Jan. 2, 2007, http://www.nera.com/Publication.asp?p_ID=3028 (noting that seven of the ten highest dollar-value settlements occurred in 2005–06 and documenting increases in average and median settlement amounts in 2006); *see also* Stephen J. Choi & Robert B. Thompson, *Securities Litigation and its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1498 (2006) ("[M]ost securities class actions settle."); James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions To Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411, 418 (2005) ("Settlements are the end game for securities class action suits. Even though several hundred securities class actions are settled annually, fewer than one or two securities class action suits are tried in any year."); Gideon Mark, *Accounting Fraud: Pleading Scienter of Auditors Under the PSLRA*, 39 CONN. L. REV. 1097, 1107 n.23 (2007) ("Federal securities class actions that are not dismissed almost always settle."); Jerod Neas, Note, Dura *Duress: The Supreme Court Mandates a More Rigorous Pleading and Proof Requirement for Loss Causation Under Rule 10b-5 Class Actions*, 78 U. COLO. L. REV. 347, 372 (2007) ("[N]early every Rule 10b-5 claim that survives dismissal will be settled.").

176. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1542 (2006) ("[S]ecurities class action settlements averaged an annual aggregate amount . . . exceeding the sum of all public monetary sanctions. To be sure, the federal securities laws are also enforced by criminal penalties (chiefly, incarceration) and by SEC suspensions, expulsions, cease and desist orders, and other

number of Rule 10b-5 class actions brought each year and the settlement amounts in those actions may be impacted by irrational investor and market behaviors.[177]

Accordingly, enforcement against an executive or the corporation under Rule 10b-5 is likely to be costly to the corporation and the investing public. Enforcement involves financial expenditures and consumes human resources, siphoning these financial and nonfinancial assets from the corporation and diverting them from more important, value-enhancing operational uses.[178] Market irrationality may enhance these costs.[179] When corporate resources are squandered or redirected through litigation, certain investors may benefit (as plaintiffs or plaintiff class members), while others suffer (as nonplaintiff security holders).[180] Moreover, "it is an open question as to whether the typical securities class action settlement actually produces any net recovery, particularly to diversified shareholders."[181]

Enforcement against corporations or executives for misstatements and omissions of personal facts may also have negative effects on a corporation's or executive's willingness to disclose an executive's personal facts. One scholar notes, in this context, that

> corporations and insiders may choose not to make discretionary efficiency-enhancing disclosures rather than

nonmonetary relief. Nonetheless, plaintiffs' attorneys appear to extract more funds from corporate pocketbooks than do all federal and state regulators."). Interestingly, settlement values are apparently higher in securities class actions for which there is a parallel SEC enforcement action. James D. Cox et al., *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 763–66 (2003).

177. *See* Larry E. Ribstein, *Fraud on a Noisy Market*, 10 LEWIS & CLARK L. REV. 137, 146 (2006) ("[E]xpanding liability to account for irrationality may increase litigation by reducing courts' ability to screen frivolous suits.").

178. In fact, the magnitude of current securities class action settlements has the capacity to negatively impact the market for a corporation's securities or send a corporation into financial ruin. *See* Richard A. Bierschbach & Alex Stein, *Overenforcement*, 93 GEO. L.J. 1743, 1763–64 (2005).

179. Ribstein, *supra* note 177, at 146 ("[M]arket irrationality may force defendants to pay more by holding them accountable for stock price fluctuations that resulted from investor overreaction to the misrepresentations, or that might not even have been connected with defendants' misrepresentations.").

180. *See* Coffee, *supra* note 176, at 1536–37 (describing the inequitable effect of securities class actions, and noting generally that, "because the costs of securities class actions—both the settlement payments and the litigation expenses of both sides—fall largely on the defendant corporation, its shareholders ultimately bear these costs indirectly and often inequitably").

181. Coffee, *supra* note 176, at 1547.

> risking draconian liability . . . . Corporate insiders are particularly vulnerable to litigation risk since, even if the corporation or insurance pays the judgment, the insiders have a non-diversifiable risk of reputation loss. The business judgment rule in state corporate law is intended to minimize this risk of over-deterrence, but there is no such rule in federal securities law.[182]

Reputational and related individual effects on executives may be more significant in actions brought on the basis of personal facts than in actions brought on the basis of corporate facts, given that the substance of the disclosure itself, as well as the alleged disclosure lapse, is personal in nature. Still, because of insurance and corporate indemnification, executives, unlike corporations, rarely face actual out-of-pocket financial liability in securities class actions.[183] Accordingly, the overall incentives for accurate and complete disclosure by corporations and executives under the antifraud rules are somewhat unclear, as are the benefits of litigation on the basis of inaccurate or incomplete disclosures of an executive's personal facts.

III. FEDERAL DISCLOSURE DUTIES WITH RESPECT TO EXECUTIVES' PERSONAL FACTS SHOULD AND CAN BE BETTER CONSTRUCTED

With all of the foregoing in mind, Part III maps out a "better way." Specifically, this Part suggests a disclosure scheme applicable to executives' personal facts that:

(a) decreases discretion placed in the hands of executives through meaningful, routinized corporate disclosures about the organizational importance of specific executives;

(b) limits incursions of important individual rights through tailored corporate disclosures prompted by specific events or transactions;

(c) encourages more rational investor and market behaviors to promote investor protection and market integrity by using disclosure rules and guidance as investor education tools; and

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182. Ribstein, *supra* note 177, at 146 (footnotes omitted); *see also* Bierschbach & Stein, *supra* note 178, at 1764 (mentioning "both the corporate and the individual defendants' prospect of sustaining reputational losses" and other factors that increase the risk aversion of executives); Franco, *supra* note 14, at 269–71 (noting that the interests of management and the corporation in making antifraud disclosure determinations may not be the same and that withholding disclosure is a likely effect of broad antifraud disclosure prescriptions); Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 845–46 (1995) (making the point that antifraud provisions deter voluntary disclosures, using management disclosures as an example).

183. Coffee, *supra* note 176, at 1550–52.

(d) minimizes corporate and individual costs associated with any suggested regulatory changes.[184]

The suggested disclosure system involves the implementation of specialized, limited enhancements to existing mandatory disclosure rules applicable to public companies in periodic and current reporting contexts. These enhancements can be promulgated and adopted by the SEC through ordinary notice-and-comment rule making as an addition to Subpart 400 of Regulation S-K.[185]

A. The Proposal

Because uncertainty regarding the disclosure of executives' personal facts places too much discretion in the hands of executives, fails to adequately resolve tensions between securities disclosure rules and individual rights, and promotes irrational investor behavior, more certainty should obviate or minimize some of these concerns. Accordingly, the proposed mandatory disclosure enhancements involve creating more certainty by layering new current reporting obligations onto new baseline reporting obligations. Each of the two proposed obligations is described below, followed by a summary indicating how these obligations may meet the four objectives identified at the outset of this Part.

1. Minimally Enhance Corporate Mandatory Disclosure Requirements to Focus the Attention of Corporations, Executives, Investors, and the Market

First, the SEC should establish baseline mandatory corporate disclosures of executives' personal facts in the 1933 Act registration statements and the 1934 Act periodic reports (Form 10-K or Form 10-Q). These mandatory disclosures would establish, at the outset of public company status or an individual's service as an executive and on a periodic basis during the executive's term of office,[186] the corporate significance of the executive's service and other attributes (e.g., name-as-the-brand or other elements of iconic status)—importance to operations, financial condition or results of operations, or other aspects of firm value. This baseline disclosure

184. The reader no doubt will recognize that the first three listed objectives emanate directly from the deficiencies identified in Part II of this Article. The fourth objective invokes cost assessment as an important (but often overlooked) additional element applicable to proposals for regulatory change.

185. Management and Certain Security Holders, 17 C.F.R. §§ 229.401–.407 (2007).

186. These baseline disclosures would operate in much the same way that Form 3 operates in establishing a starting point for disclosures to be made on an ongoing basis on Forms 4 and 5 under Section 16(a) of the 1934 Act. *See supra* note 18 and accompanying text.

about each executive should address the fungibility of the executive—how easy it would be to replace him or her in the then-applicable market for executive services. The baseline disclosures would have to be meaningful; they should focus specifically on the attributes of each executive as they relate to the specific public company for which the executive serves and should consist of more than mere boilerplate or generalized statements (as are typical in "Risk Factors" disclosures on executive importance in current 1933 Act prospectuses).[187] Certain executives would merit specific and detailed disclosures about ways in which their presence, availability, integrity, or reputation may impact the corporation; others would warrant disclosure of a more limited nature. In any event, disclosure about each executive would have to be considered and resolved by management (including the board of directors) and corporate counsel on an individual basis. The relevant baseline disclosures would be updated annually in the corporation's Form 10-K or sooner, if made necessary by intervening facts.[188]

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187. *See, e.g.*, Geovera Ins. Holdings, Ltd., Amendment No. 3 to Registration Statement (Form S-1), at 15 (May 16, 2007), *available at* http://www.sec.gov/Archives/edgar/data/1393941/000119312507123021/ds1a.htm. This registration statement includes the somewhat standard disclosure set forth below:

> If we lose key personnel or are unable to recruit qualified personnel, our ability to implement our business strategies could be delayed or hindered.
>
> Our success depends, in part, upon the efforts of certain of our executive officers and other key personnel. We rely substantially upon the services of Kevin Nish, our President and Chief Executive Officer. Although we are not aware of any planned departure by Mr. Nish, the loss of his services could prevent us from fully implementing our business strategies and materially adversely affect our business, financial condition and results of operations. We have an employment agreement with Mr. Nish which provides for a term through November 2010, but either we or Mr. Nish may terminate his employment with us earlier. See "Executive compensation—Narrative description of summary compensation and grants of plan-based awards—Employment Agreements; termination benefits." We currently maintain a key man insurance policy that provides coverage only for Mr. Nish.
>
> As we continue to grow, we will need to recruit and retain qualified management personnel, but we may not be able to do so. Our ability to recruit and retain such personnel will depend upon a number of factors, such as our results of operations, prospects and the level of competition then prevailing in the market for qualified personnel. Failure to recruit and retain such personnel could materially adversely affect our business, financial condition and results of operations.

Id.

188. These updates would be made in the same manner as updates to corporate risk factors disclosed on a periodic basis in accordance with Item

2. Provide Disclosure Guidance for Public Companies and Their Executive Officers for Use in Managing and Making Current Disclosures of Executives' Personal Facts

Next, the SEC should provide specific guidance on event-based and transaction-triggered corporate disclosures of executives' personal facts in current reports (on Form 8-K) under the 1934 Act. These disclosures would be prompted only when a personal fact impacts a specific executive's articulated importance to the company, as identified in the corporation's baseline disclosures about the executive (as the same are updated from time to time) and could be simply implemented as an addition to the items required to be reported on Form 8-K.[189] This corporate mandatory disclosure requirement should make it easier for an executive to know when to report a personal fact to the corporation's board because he or she would be familiar with the baseline public disclosures about his or her corporate importance and should be better able to assess the potential significance of personal facts in light of those pre-existing public disclosures.

3. Meet Objectives by Reducing Identified Deficiencies in the Current Fraud-Based Disclosure Regime and Using Existing Disclosure Law Principles and Practices

The proposed mandatory disclosure enhancements outlined in this Part (collectively, the "Proposal") are designed to address the three observed deficiencies in the existing scheme of disclosure outlined in Part II of this Article and to do so at a low additional cost to the corporation.

a. *Reduce Executive Discretion in Disclosure Decision Making.* By providing for targeted mandatory disclosure about executives' corporate importance and personal facts, the Proposal decreases in

503(c) of Regulation S-K, 17 C.F.R. § 229.503(c) (2007), through requirements like those set forth in Item 1A of Form 10-Q, 17 C.F.R. § 249.308a, *available at* http://www.sec.gov/about/forms/form10-q.pdf (providing for updates to preexisting disclosures of corporate risk factors). These risk factors are required to be disclosed in the 1933 Act registration statements and in annual reports on Form 10-K. *See, e.g.*, Form S-1, *supra* note 24, at Item 3; Form S-3, *supra* note 24, at Item 3; Form 10-K, *supra* note 25, at Item 1A. Although the obligation to disclose and update risk factors also covers the corporate importance of an executive, the disclosure currently required is not sufficiently detailed to reliably elicit targeted disclosures about the ways in which executives, including those other than the chief executive officer, are important to firm value.

189. *See* Form 8-K, at Item 5.02, 17 C.F.R. § 249.308, *available at* http://www.sec.gov/about/forms/form8-k.pdf (regarding various management-oriented disclosures).

several respects the amount of discretion in the hands of executives faced with the possible public disclosure of personal facts. First, it puts primary mandatory disclosure responsibility on the corporation. This responsibility should create an incentive for the corporation to establish policies and procedures to ensure compliance with its new, targeted mandatory disclosure obligations under the federal securities laws. As part of these policies and procedures, the corporation would request information on personal facts periodically from its executives (as it does to ensure compliance with other mandatory disclosure rules). Accordingly, the Proposal casts executives principally in the role of responders rather than initiators in the disclosure of their personal facts. The corporation's board is in the driver's seat of the disclosure bus.

The Proposal's mandatory disclosure rules also create a duty to disclose, in certain contexts. Because isolating the source of a duty to disclose can be difficult for executives under current antifraud provisions,[190] the Proposal offers executives a clearer path and narrows the scope of their decision making.

Executive discretion is further decreased under the Proposal because the Proposal more narrowly focuses a corporation's and executive's materiality analyses under applicable antifraud disclosure provisions[191] by creating, through carefully crafted baseline disclosures, presumptive elements of materiality (based on the ways in which the executive is important to the corporation).[192] Well-considered and well-documented board decisions on the

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190. *See supra* notes 62–66 and accompanying text. Professors Donald Langevoort and Mitu Gulati describe this difficulty accurately and succinctly:

> [T]he question of whether and when there is a duty to disclose is often *the* central question in any given case. Certainly, the Securities & Exchange Commission (SEC) has broad powers to compel disclosures by issuers and certain others and has crafted a mandatory disclosure regime that creates many explicit duties. For a variety of reasons, however, this explicit regime falls short of a comprehensive answer to the duty question. For some sixty years now, the hardest duty questions have been addressed under the rubric of fraud, mainly under Rule 10b-5, the principal antifraud provision of the securities laws.

Langevoort & Gulati, *supra* note 53, at 1640.

191. *See supra* notes 69–72 and accompanying text.

192. The baseline disclosures in the Proposal would share certain attributes with the meaningful cautionary statements required under the statutory safe harbor provisions for forward-looking information enacted as part of the Private Securities Litigation Reform Act of 1995 ("PSLRA"). *See* 15 U.S.C. §§ 77z-2(c), 78u-5(c) (2000). Under both the Proposal and the PSLRA safe harbor, ex ante disclosures increase publicly available information and decrease potential liability for securities fraud claims "based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading." *Id.* §§ 77z-2(c), 78u-5(c).

importance of an executive to the corporation's business, financial condition, and results of operations should be given deference by a court and, therefore, should provide executives with a known and reliable basis for their decision making about what and when to disclose. Not all criminal investigations, terminal or other serious illnesses, financial troubles, extramarital affairs, or other personal facts would need to be disclosed by the executive to the corporation or by the corporation to the public. Corporate disclosure only would be required if personal facts would impact an area in which the executive is important to the corporation.

b. *Reduce Friction Between Federal Securities Disclosure Rules and Individual Rights.* Any compelled public disclosure by an individual creates obvious tensions with the rights to privacy, free speech, and avoidance of self-incrimination, since each of these rights protects (on some level) the ability of an individual to remain silent. No proposal promoting disclosure can eliminate those tensions.

However, the current disclosure of executives' personal facts is based principally on whether those facts are material facts within the meaning of applicable securities laws and rules.[193] Little salient guidance is offered by the SEC or the courts on the application of existing materiality standards in this context. Moreover, there is no apparent emphasis, in gauging materiality or the overall need for disclosure, on balancing the policies underlying federal securities laws (investor protection and market integrity promotion) against the policies underlying applicable individual rights (although an occasional case or controversy may force a court's hand in this regard).

The Proposal offers a more direct opportunity for the SEC to engage in some of that policy balancing ex ante. SEC action in adopting line-item corporate disclosure requirements would mandate more tailored disclosures in a specific disclosure environment (as opposed to calling for open-ended disclosures of material fact when a duty to disclose is deemed to exist). This reliance on explicit, targeted periodic and current reporting focuses the scope of potential disclosures and, therefore, creates less potential for conflict between securities regulation and individual rights. Specific mandatory disclosures of personal facts should be limited to those that best serve applicable policy objectives underlying both securities regulation and individual rights.

Moreover, the actual text of the disclosure requirements drafted in accordance with the Proposal can be constructed with sensitivity

193. *See supra* Part I.A.3.

to the competing interests posed by the federal securities laws and applicable individual rights. While this Article leaves the drafting of that text for a later day, one can imagine, for example, the incorporation of concepts from Fifth Amendment jurisprudence on self-incrimination in the rules regarding event-based and transaction-triggered disclosures (or the related instructions). In addition, the SEC may determine, either internally or through the notice-and-comment process necessary to its rule making, that there are specific personal facts relating to executives that may remain private because the policies underlying the related individual rights always supervene those underlying the securities laws.

Finally, the codification of disclosure rules relating to executives' private facts in accordance with the Proposal affords executives a clearer expectation of the extent to which they can exercise their rights to privacy, free speech, and avoidance of self-incrimination while serving as public company executive officers. Although executives do have to accede to a curtailment of their individual rights in taking on service with a public company, adoption of the Proposal will put them on notice as to the extent of that curtailment ex ante and enable them to better weigh the benefits and detriments of that service. This transparency also should help prosecutors avoid claims that nondisclosing executives were denied due process when faced with criminal securities charges.[194]

c. *Encourage More Rational Investor and Market Behaviors.* The Proposal also is designed to promote investor protection and market integrity by embedding relevant market information in the market price for publicly traded securities and by using disclosure rules and guidance as investor education tools. The baseline corporate disclosures of executives' corporate importance should prime the market for future disclosures of executives' personal facts. Logically, the market would then discount the value of the corporation's publicly traded securities to account for the potential disclosure of relevant personal facts relating to the corporation's executives. The discount rate would vary from corporation to corporation. Assuming accurate baseline disclosures, the more rational the investor base is, the more accurate the discount should be.

Also, by codifying the bases for public disclosure of executives' personal facts, the Proposal should sensitize investors to these bases and enable them to be better informed about the need for and relevance of corporate and individual disclosures of executives'

194. *See* United States v. Matthews, 787 F.2d 38, 49 (2d Cir. 1986) (noting this claim with favor in an analysis under the existing disclosure regime).

personal facts. In essence, the Proposal should better equip investors to know what is important about particular executives' personal facts even before any facts may be disclosed and would be able to promptly react to actual disclosures of personal facts on a more economically rational basis. In short, the rules comprising the Proposal may be deemed a form of investor education.[195]

Finally, because the Proposal should better inform investors and encourage more rational investor and market behaviors, corporations and executives should have less fear about liability emanating from irrational investor or market behavior. When combined with the additional clarity provided by the mandatory disclosure rules comprising the Proposal, this decreased apprehension should enable corporations and executives to make better, more objective disclosure decisions.

d. *Minimize Costs Associated with Legal Change.* The mandatory disclosure enhancements embodying the Proposal are not without cost. However, the costs of this legal change[196] can be minimized by using existing disclosure regulation principles and practices to effectuate compliance with the new regime.[197] Learning costs,[198] for example, would be minimal, since the proposed line-item rules would not be complex or lengthy and represent only a modest enhancement of existing disclosure requirements applicable to public companies.[199] Public companies, executives, counsel, judges, law professors, and practitioners all should find the proposed rule changes relatively easy to understand and digest.

Uncertainty costs[200] associated with the proposed disclosure enhancements also should be quite low. In principal part, this is because the enhancements are designed to work within the existing

195. *See* Fisch, *supra* note 157, at 74. However, investor education may not be able to correct for investor behavioral biases. *Id.* at 74–75.

196. *See generally* Michael P. Van Alstine, *The Costs of Legal Change*, 49 UCLA L. REV. 789, 793 (2002) (noting that legal change, itself, generates costs: "Whatever one's normative perspective, a legal system will incur costs simply in adjusting to the existence of a new legal norm.").

197. *Cf.* Andrea M. Matwyshyn, *Material Vulnerabilities: Data Privacy, Corporate Information Security, and Securities Regulation*, 3 BERKELEY BUS. L.J. 129, 199–200 (2005) (suggesting the use of existing structures of securities law in the context of corporate information security).

198. *See generally* Van Alstine, *supra* note 196, at 816–22 (describing and explaining learning costs).

199. *See id.* at 819 ("The extent of . . . learning costs . . . is likely to increase in direct relation to the ambition, novelty, and complexity of the reform project. An incrementally new common law rule, for example, likely will impose lower learning costs than a comprehensive legislative product." (footnote omitted)).

200. *See generally id.* at 822–35 (describing and explaining negative and positive uncertainty costs).

securities disclosure system to clarify and hone vague, amorphous disclosure requirements already in existence under current antifraud rules. Legal precedent and interpretive value under existing law would be used, rather than abandoned, in constructing and interpreting the new disclosure rules. Moreover, although there is always uncertainty with new rules, there are unlikely to be many new planning, legal counsel, or litigation costs associated with uncertainties created by the new disclosure rules proposed here. Costs associated with compliance planning, legal advice, and litigation borne of uncertainty under the proposed mandatory disclosure regime logically should be lower than those associated with the existing fraud-based disclosure regime, since the Proposal is designed to cure ambiguities in the existing regime.[201] The rule changes comprising the Proposal should enhance, rather than detract from, legal stability.

Precision in drafting the text of the new disclosure rules included in the Proposal should help avoid significant opportunity costs.[202] The legal change brought about by the Proposal is designed to increase, rather than decrease, guidance on existing law and should act to encourage, rather than discourage, desirable disclosures in more circumstances than existing law.[203] In fact, if drafted precisely, the mandatory disclosure rules comprising the Proposal should decrease uncertainty and make corporations and executives less risk averse in disclosure decision making.[204]

Adoption of the Proposal would create certain (but ostensibly

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201. The corporation should not have to engage accountants or financial advisors to assist it in addressing legal and operational uncertainties resulting from the Proposal. And while both the executives and the board of directors will spend time analyzing the corporate importance and personal facts of executives and crafting related disclosures, this time will not be as extensive as would be required for compliance with most of the requirements of Sarbanes-Oxley and would represent an incremental addition to the corporation's overall disclosure burden.

202. *See generally* Van Alstine, *supra* note 196, at 835–36 (describing and explaining uncertainty and opportunity costs).

203. *See supra* note 182 and accompanying text (describing, among other things, the deterrence of desirable disclosures under the current regime).

204. Professor Van Alstine acknowledges this possibility:

> Many existing bodies of law, for instance, are themselves highly uncertain or otherwise substantively defective. Moreover, the existing legal costs of a socially desirable activity may be the problem a new body of law is designed to redress. The adoption of new legal norms thus may serve, among other things, to clarify contentious legal problems, simplify excessive complexity, facilitate new and valuable forms of human interaction, and otherwise advance the interests of legal certainty.

Van Alstine, *supra* note 196, at 857.

few) private adjustment costs.[205] Private drafting costs would increase because existing corporate disclosures in SEC filings and D&O Questionnaires, compliance policies and memoranda, and other documents involved in corporate and executive legal compliance will need to be supplemented to include information required to be supplied in accordance with the Proposal. However, most (if not all) existing periodic disclosures should remain the same, so these drafting costs will not be significant.

Private administrative costs also would be incurred by corporations and executives as a result of adoption of the Proposal. Specifically, existing compliance structures would need to be altered to reflect the additional requirements of new mandatory disclosure rules. However, these costs should be nominal, since internal compliance and risk-reduction mechanisms resulting from the Proposal can easily be implemented by corporations as part of their existing internal disclosure compliance processes for periodic and current reporting.[206] Corporations and executives need not reinvent the veritable compliance wheel in order to comply with the new rules suggested in the Proposal.

Because adoption of the Proposal would principally affect internal governance only (the relationship among corporations, executives, and investors), the rule changes embodied in the Proposal should have little impact on accrued private networks. Said another way, the corporation's standard contractual and business relations with third parties should not be affected by adoption of the Proposal.

Error costs[207] resulting from adoption of the Proposal should be small. Even without precise text on which to reflect, the likelihood that there would be "imperfections in the articulation, or inaccuracies in application,"[208] of the mandatory disclosure rules comprising the Proposal is minimal. These rules operate in narrow subject matter areas—executives' importance to the corporation and executives' private facts—making it easier to draft the rules

205. *See generally id.* at 836–45 (describing and explaining private adjustment costs).

206. *See supra* note 85 and accompanying text. Unlike Sarbanes-Oxley, the mandatory disclosure enhancements proposed in this Article do not overburden the corporation and its executives with compliance costs. For a description of some of the disclosure-related burdens of Sarbanes-Oxley on corporations and their executives, see Jeannie Nelson, Comment, *New Corporate Responsibility Law Increases Liabilities for Directors, Officers, and Attorneys, But Does It Increase Protections for Investors?*, 34 TEX. TECH L. REV. 1165, 1189–93 (2003).

207. *See generally* Van Alstine, *supra* note 196, at 845–50 (describing and explaining error costs).

208. *Id.* at 845.

precisely. Moreover, the new rules are likely to be easier to apply than existing antifraud rules because of their relative specificity. Still, applicable rule makers at the SEC should endeavor to avoid "formulation errors of unintended vagueness or ambiguity, incompleteness, overbreadth, and (more destructive) inconsistency,"[209] and should ensure that their intent is well understood by illuminating the rule text with helpful instructions (like those that exist for other line-item disclosure rules under Regulation S-K[210]) and by carefully crafting the promulgating and adoption releases relating to the new rules.[211]

Finally, public transition costs[212] associated with adoption of the Proposal also are nominal. The changes made by the Proposal are limited in scope and consistent with existing law and regulation. Accordingly, dispute resolution costs are not likely to increase significantly, if at all. In fact, the hope is that by narrowing the possible range of disclosures of executives' private facts, dispute resolution costs would decrease. Of course, the SEC will have to adjust its rules, forms, and internal compliance procedures (just like the companies it regulates). But, as earlier noted with respect to those corporate compliance costs, the limited nature of the proposed rule changes minimizes the nature and amount of these outlays.

B. *Comparative Institutional Choice*

Having addressed the substance of the Proposal and its perceived benefits as an improvement over the existing antifraud-based regime applicable to the public disclosure of executives' personal facts, it is important to briefly discuss the rationale for implementing the Proposal through SEC rule making as opposed to congressional legislation or federal court adjudications.[213] A comparative analysis of four factors is relevant to the identification

209. *Id.* at 846 (footnotes omitted).

210. *See supra* note 26 and accompanying text.

211. *See* Van Alstine, *supra* note 197, at 858 ("[L]awmakers have at their disposal a variety of means to mitigate transitional friction, even for large-scale or complex legal reforms.").

212. *See generally id.* at 850–52 (describing and explaining public transition costs).

213. This Article assumes a federal approach because the immediate problem to be resolved is created by failures in the federal disclosure rules. It should be noted, however, that state corporate law may play a role in executive disclosures of personal facts. *See, e.g.*, MODEL BUS. CORP. ACT § 8.42(b) (2003) (establishing state law disclosure/informational duties of corporate officers, including the obligation of an officer to inform a superior officer or the board or a board committee of material information about the affairs of the corporation); *id.* §§ 8.60(4), 8.62, 8.63 (required disclosure of conflicting interests); *id.* § 8.70 (disclosure relating to corporate opportunities).

of the appropriate rule-making body: (1) institutional power, authority, or jurisdiction; (2) relative structural and substantive competence; (3) influence and the potential for resulting bias; and (4) relative transition costs.[214] Although a full analysis will not be undertaken here, it is easy to see that a balancing of these four factors favors SEC rule making.

First, the adoption of public company disclosure rules applicable to the revelation of an executive's personal facts is within the institutional power of Congress,[215] the authority of the SEC,[216] and the jurisdiction of the federal courts.[217] Accordingly, any of these three federal rule makers is eligible to act on the Proposal.

Second, although the federal courts have done the heavy lifting to date by making most of the rules governing disclosure under Rule 10b-5 and other antifraud rules (and, therefore, have developed some expertise in the area), case-by-case adjudications of varied plaintiffs' claims in multiple federal districts and circuits over time have not provided, and cannot easily provide, the same comprehensive resolution of issues concerning public disclosures of executives' personal facts as congressional or SEC rule making can. The changes in disclosure law that would be made by adoption of the Proposal are seemingly politically uncontroversial and limited in scope to disclosures about executives that have long been within the expertise of the SEC. The deliberative, representative, accessible nature of a Congress with relatively little expertise is therefore not necessary to achieve adoption of the Proposal and, in fact, could represent an impediment to the adoption of the Proposal.[218]

214. Joan MacLeod Heminway, *Rock, Paper, Scissors: Choosing the Right Vehicle for Federal Corporate Governance Initiatives*, 10 FORDHAM J. CORP. & FIN. L. 225, 233–34 (2005).

215. Congress has the power to engage in securities rule making as part of its constitutional power to regulate interstate commerce. U.S. CONST. art. I, § 8, cl. 3.

216. The SEC has authority to engage in securities rule making as part of its congressionally ordained role under the 1934 Act as the promulgator and adopter of line-item and other disclosure rules, including the various forms used in securities registration, periodic and current reporting, and event-based or transaction-triggered disclosures. *See, e.g.*, 15 U.S.C. §§ 77f(a), 78m(a), 78m(d), 78n(d) (2000); Heminway, *supra* note 214, at 257 n.96. The SEC was established in Section 4 of the 1934 Act. 15 U.S.C. § 78d.

217. Among other things, the federal courts have jurisdiction over claims brought under the federal securities laws, e.g., 15 U.S.C. §§ 77v(a), 78aa, including Section 10(b) of the 1934 Act and Rule 10b-5. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5 (2007).

218. For example, a bill to implement the Proposal may get bogged down in unnecessary debates over language that can more easily and expertly be resolved at the SEC, which has greater expertise in this area.

Third, a comparative assessment of institutional impartiality depends upon a comparative assessment of each institution's capacity for influence on a particular matter. The rules governing public disclosure of executives' private facts are not currently a political flashpoint or even an apparent concern of any particular interest group.[219] Any political party allegiances favoring or opposing the Proposal may depend on the facts of specific cases. This means that the capacity for influence and resulting bias should not weigh heavily as a factor in the comparative institutional analysis.

However, the potential for influence does exist. This potential makes Congress a less desirable rule-making body since it is most susceptible to public influence. Moreover, the more pure political independence of the federal courts seems to be unnecessary, even if desirable. Accordingly, while the SEC is potentially subject to some influence (notably from public companies and their executives), that capacity for influence is more limited than that of Congress—especially given the limited points of public access to the SEC. Therefore, an analysis of impartiality weakly favors the SEC as the appropriate rule-making body.

Fourth, the overall costs of legal change[220] should be less for SEC rule making than for congressional or judicial rule making, since the existing disclosure framework is "owned" and maintained by the SEC. This means, among other things, that the SEC should be the rule-making body capable of drafting "the most clear, complete, comprehensive statement of the rule"[221] and integrating it seamlessly into the existing mandatory disclosure scheme. As a result, learning, uncertainty, opportunity, error, and public transition costs all should be lower with proficient SEC rule making.[222] Private adjustment costs associated with adoption and implementation of the Proposal should be the same for each rule-making body, assuming full implementation of the Proposal.

C. Possible Collateral Benefit

Before concluding, it should be noted that the Proposal may

219. Although one could imagine political activity involving representatives of one or more of the following potential interest groups: public companies, executives, those favoring individual rights, or those favoring market-based, rather than regulatory, disclosure solutions.

220. *See supra* notes 196–212 and accompanying text (identifying the various operative costs of legal change associated with the Proposal).

221. Heminway, *supra* note 214, at 367.

222. *See* Van Alstine, *supra* note 196, at 859 (noting that "increased care in . . . articulation can prospectively mitigate much of the learning, uncertainty, and kindred costs of new legal norms").

have a benefit to corporations and investors unrelated to disclosure regulation. By forcing public company boards of directors to more closely and routinely analyze executive importance and, presumably, be exposed more directly to executives' personal facts (even when they do not end up being publicly disclosed), the Proposal may encourage more and better planning for management succession. If management succession planning were, in fact, encouraged, it would become more a part of the culture of public companies, and executive searches then should be more efficient and, one would hope, more effective.

IV. CONCLUSION

A corporation or executive faced with the decision about whether to disclose information relating solely or principally to an executive's private (i.e., noncorporate) life will have a difficult time making that decision under current law. In most cases, the corporation or executive will have to determine, under applicable antifraud laws and rules, whether there is a duty to disclose and, if so, whether the executive's personal information is material such that it must be disclosed. These are difficult legal determinations to make, even for those not directly involved with the personal facts at issue. However, the determinations are made more difficult by the fact that the executive *is* involved with those personal facts and may desire to keep them private, a feeling compounded by a perception that investors may tend to overreact to public disclosure of those facts, potentially causing unwarranted disruptions in the market for the public company's securities or securities fraud actions against the corporation, the executive, or both.

These difficulties can and should be resolved, however, by the adoption of two relatively straightforward mandatory disclosure rules by the SEC as part of its integrated disclosure system—one rule calling for detailed, tailored, updatable baseline disclosures regarding each executive's importance to the corporation, and one that provides for focused event-based and transaction-triggered disclosure of executives' personal facts. The new rules embodied in the Proposal are designed to protect investors and promote market integrity by correcting identified deficiencies in the existing disclosure scheme—and to do so at a relatively low cost. Moreover, the rules should encourage succession planning at public companies. Accordingly, the SEC should adopt the Proposal to benefit corporations, executives, investors, and others saddled with the burdens of making, advising on, and interpreting disclosure decisions regarding executives' personal facts.