

## Anti-Fraud Dilemma: Defining Materiality

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**July 30, 2004**

Materiality is one of the more important and oft-used concepts in interpreting the requirements of the federal securities laws. Yet the term has never been definitively defined by the administrator of those laws, the Securities and Exchange Commission. This is as it should be in the eyes of this commentator.

Nevertheless, the clamor for certainty through an SEC administrative definition of the term "material" never ceases. Though the Grand Inquisitor may have been correct in noting in while administering his charge that at some point there must be certainty, that necessity may not exist in this area. In the securities area, the search for certainty is rather like the quest for the holy grail. It is the quest itself however, that continually modifies and refines the concept and therefore the definition of materiality. It is the common law development of securities law interpretations at its best. It is a practical recognition that materiality can differ over time and circumstance.

A hard and fast definition would require courts and administrators to find new tools to accomplish the purposes of the securities laws in this area and the fulfillment of the overall objective of those laws, namely the protection of investors and the stimulation of efficient, free and fair markets. Such a development would, at least in the short run, lead to a greater uncertainty than now exists in this area. The purpose of this article is to explore the development of the meaning of materiality, to place it in its various contexts within the securities law scheme and finally to attempt the impossible job of offering a contemporary working definition of the oft-damned term.

The proposal by the SEC to adopt Regulation FD in December 1999 was the occasion for renewed demands for a definition of materiality. Regulation FD regulates the dissemination of material nonpublic information. An earlier SEC enforcement case, Dirks v. SEC, created the requirement for a showing of breach of fiduciary duty as a predicate to establishment of a violation of Rule 10(b)(5). Although the SEC had some success in cases in which the tipper of the information did not trade or benefit monetarily from such activities, those cases were particularly fact dependent. For example, breach of fiduciary duty was found when a CFO tipped an analyst on an impending earnings shortfall in order to protect his own reputation. The analyst and his clients were thus able to "steal a march" on the unsuspecting buying public. In the main, however, company officials found it increasingly necessary for the benefit of their company to curry favor with the analyst community by selectively disclosing nonpublic material information to them. These activities generally would not involve a breach of fiduciary duty since they were done for the benefit of the company. As a result, the SEC lacked effective tools to stop this activity in order to protect unsuspecting trading markets. At the same time, most of these same company officials scrupulously adopted and observed strictures against trading by themselves and other similarly situated until after such information was released to the

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