

SULLIVAN & CROMWELL

48 WALL STREET

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Professor William L. Douglas,
Yale University Law School,
New Haven, Conn.

My dear Professor Douglas:

I have read with much interest your letter of April 3rd which appeared in last Sunday's Times, and as I am greatly interested in your letter, I am taking the liberty of calling to your attention certain observations in connection therewith.

Your letter deals with two main points, the first, the question of how far a governmental body should go in protecting purchasers of securities. There is obviously no difference of opinion as to the desirability of protecting purchasers from fraud and of insuring the fullest publicity. However, the further question remains whether it is desirable for any governmental body to attempt to pass upon the soundness or unsoundness of the securities. My reason for believing that it is undesirable to extend governmental power to such extent is primarily due to the fact that the difficulties of forming such a judgment are well-nigh insuperable and that passing such a judgment is not a function which a governmental body should attempt to assume. It seems to me that it would result in the government attempting to appraise every business in this country which issued securities and the burden of such a task would be so staggering, the political objections so great and the important decisions which would be made by subordinate employees so numerous that it seems to me that the consequences would be far more harmful than the benefit which would result in protecting the investor. Again, there is the further question of the undesirability of having any governmental body give its stamp of

approval to the soundness of certain business enterprises. As far as I know in the writings of economists on the subject there has been little, if any, approval of such a proposal other than by those who believe that the government should itself conduct industry.

I realize, of course, that many investors have invested unwisely and lost heavily as a result thereof. This, of course, is most unfortunate and should be prevented in the future, if possible. My own difficulty, however, is that I see no way of preventing it and protecting the people against their own mistakes without extending governmental control to an extent that for the reasons above set forth seems to me undesirable. The losses which most of us have suffered in recent years have resulted primarily from an economic catastrophe and even the wisest economists were unable to foresee and I question very much if any governmental body had been in existence and had the power under discussion, that it would have been wise enough to foresee the future. Certainly the Federal Reserve Board did not have this foresight.

The other part of the Bill discussed in your letter is the question of directors' liability. You suggest that perhaps the courts will construe the Bill somewhat more narrowly than the language would justify. This, of course, is a matter of speculation. However, you apparently approve of the principle of the Bill of holding the directors personally responsible for misrepresentation of material facts. It does seem to me that this doctrine of liability without fault is one which one should hesitate to approve of. Granted that you are of course right in that directors should be responsible, does it follow that they should be made responsible for matters as to which they have no personal knowledge of the falsity and likewise have been free from any negligence? Such a doctrine of absolute liability is, it seems to me, not a sound one. Liability without fault is certainly, except in very unusual cases, foreign to the concept of our law. The British Companies Act provides with respect to this matter that directors are not liable if they had

reasonable grounds for believing the false statement to be true or if it was a false statement of an expert which they had reasonable grounds for believing to be true. This principle of the British Companies Act is, I suggest, an entirely reasonable one and personally I have difficulty in seeing any sound reason for extending the liability further. The practical effect of it would be as I have already suggested, that persons at all responsible would hesitate to continue on boards of directors and that subordinates or dummies would be appointed in their place. The effect of this would be, it seems to me, a harmful development in American business without any corresponding benefit to anyone.

I realize that you may feel that the above views are colored by the fact that my practice is largely in corporation matters. I grant that this may perhaps unconsciously affect my judgment but I nevertheless conscientiously believe that the views which I have expressed above are views which merit serious consideration by persons such as yourself who do not represent any particular group in the community but who are interested solely in the development of our law along sound channels.

Yours sincerely,

Eustace Seligman