

NEWS

SECURITIES AND EXCHANGE COMMISSION

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THE LIMITATIONS OF GOVERNMENT REGULATION

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- * THE SECURITIES AND EXCHANGE COMMISSION, AS A MATTER OF POLICY, DISCLAIMS RESPONSIBILITY FOR SPEECHES BY ITS COMMISSIONERS. THE VIEWS EXPRESSED HEREIN ARE THOSE OF THE SPEAKER AND DO NOT NECESSARILY REFLECT THE VIEWS OF THE COMMISSION.

1. INTRODUCTION:

I WANT TO BEGIN THIS TALK ON A PERSONAL NOTE. WHEN I WAS IN COLLEGE I CONSIDERED MYSELF A LIBERAL. ACCORDINGLY, I WAS ANTI-BUSINESS, PRO-LABOR AND IN FAVOR OF GOVERNMENT INTERVENTION IN THE ECONOMY, IF NOT OUTRIGHT NATIONALIZATION OF ESSENTIAL INDUSTRIES, FOR THE PUBLIC GOOD. I DID NOT IMAGINE MYSELF BECOMING A UNION-WORKER, A MEMBER OF MANAGEMENT OR A GOVERNMENT EMPLOYEE. LIFE AFTER COLLEGE WAS A BLANK.

IN LAW SCHOOL, I WAS INSPIRED BY THE IDEA OF JOHN F. KENNEDY'S NEW FRONTIER, AND I WAS PREPARED TO GIVE MY SUPPORT TO A MAN WHO ASKED THE AMERICAN PEOPLE TO CHOOSE THE PUBLIC INTEREST OVER PRIVATE COMFORT. ALTHOUGH I STILL HAD TROUBLE PICTURING MYSELF AS PART OF EITHER THE BUSINESS OR GOVERNMENT ESTABLISHMENTS, THE WORKING WORLD BEGAN TO COME INTO CLEARER FOCUS. UPON GRADUATION, I BECAME A GOVERNMENT LAWYER. I CHOSE PUBLIC SERVICE BECAUSE IT BETTER COMPORTED WITH MY IDEALISTIC NOTIONS ABOUT THE LEGAL PROFESSION THAN DID PRIVATE PRACTICE. ALSO, THERE WERE BETTER OPPORTUNITIES FOR WOMEN IN A GOVERNMENT AGENCY THAN IN A WALL STREET LAW FIRM. THE AGENCY I CHOSE WAS THE SECURITIES AND EXCHANGE COMMISSION ("SEC"), WHICH IS AN INDEPENDENT REGULATORY AGENCY OF THE FEDERAL GOVERNMENT, CHARGED WITH INVESTOR PROTECTION AND THE PROMOTION OF FAIR AND EQUITABLE TRADING MARKETS.

AS A PROSECUTOR OF FRAUD CASES, I BELIEVED I WAS VINDICATING THE PUBLIC INTEREST. IT RARELY OCCURRED TO ME THAT LATER I MIGHT BECOME A CORPORATE AND SECURITIES LAWYER FOR A LAW FIRM, AND REPRESENT LARGE PUBLIC CORPORATIONS AND REGULATED BUSINESSES IN THE SECURITIES INDUSTRY. IT CERTAINLY NEVER OCCURRED TO ME THAT I MIGHT ONE DAY BE A COMMISSIONER AT THE SEC.

PERHAPS YOU ARE HAVING LESS DIFFICULTY IMAGINING WHAT YOU WILL DO AFTER YOU HAVE COMPLETED SCHOOL AND WHAT WORKING WILL BE LIKE THAN I HAD. THOSE OF YOU I HAVE MET SEEM WELL MOTIVATED AND ON YOUR WAY TO POSITIONS OF LEADERSHIP IN OUR SOCIETY. THE CHANCES ARE GOOD THAT MANY OF YOU WILL WORK IN EITHER THE BUSINESS WORLD OR THE GOVERNMENT. OF COURSE, THE AIR FORCE CADETS IN THIS AUDIENCE ARE ALREADY COMMITTED TO GOVERNMENT SERVICE.

I THINK THAT THE SPONSORS AND FACULTY OF THIS CONFERENCE ARE TO BE CONGRATULATED FOR BRINGING A GROUP OF COLLEGE STUDENTS TOGETHER TO WORRY AND TALK ABOUT THE ETHICS OF BUSINESS AND GOVERNMENT REGULATION OF BUSINESS. IT IS A WAY TO DIRECT YOUR IDEALISM INTO PRACTICAL CHANNELS. I WAS VERY IMPRESSED BY YOUR DISCUSSION OF YOUR FINAL REPORT THIS AFTERNOON, AS A LESSON IN POLITICAL DEMOCRACY, AS WELL AS A DEBATE ON THE ETHICS OF CORPORATE CONDUCT.

OUR SOCIETY TODAY FACES SERIOUS POLITICAL, SOCIAL AND ECONOMIC PROBLEMS WHICH DO NOT SEEM CAPABLE OF EASY SOLUTION. MOST OF US TODAY ASSUME THAT CORPORATIONS SHOULD ASSIST IN THE SOLUTION OF THOSE PROBLEMS UNDER THE OVERSIGHT OF THE GOVERNMENT. THE EXISTENCE OF CORPORATIONS DEPENDS UPON THE GOVERNMENT AND ACCORDINGLY, IN OUR DEMOCRATIC SOCIETY, CORPORATIONS MUST ULTIMATELY BE RESPONSIBLE NOT ONLY TO THEIR SHAREHOLDERS BUT ALSO TO THE PEOPLE.

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THEREFORE IT IS APPROPRIATE FOR THE GOVERNMENT TO REGULATE BUSINESS SO THAT OUR NATURAL, ECONOMIC AND HUMAN RESOURCES ARE UTILIZED FOR THE PUBLIC BENEFIT AS WELL AS FOR THE PRIVATE BENEFIT OF THE MANAGERS AND OWNERS OF OUR LARGE PUBLIC CORPORATIONS. IT SEEMS TO ME THAT IT IS DIFFICULT FOR YOU OR ME TO CONSIDER THE ETHICAL DILEMMAS OF THE BUSINESS WORLD WITHOUT UNDERSTANDING THE PROBLEMS OF THAT WORLD. ONE OF THOSE PROBLEMS IS THE COST AND COMPLEXITY OF INCREASING GOVERNMENT REGULATION.

YOU HAVE SPENT THIS WEEK CONSIDERING THE ETHICAL STANDARDS WHICH SHOULD BE APPLIED TO CORPORATIONS AND THEIR REGULATION. DESPITE MY LONG-STANDING POLITICAL CONVICTION THAT GOVERNMENT SHOULD CONTROL AND DIRECT THE POWER OF OUR LARGE PUBLIC CORPORATIONS, I DO NOT BELIEVE WE SHOULD SOLVE TODAY'S PROBLEMS THROUGH GREATER REGULATION OF BUSINESS. I HAVE REFERRED TO SOME OF THE IDEOLOGICAL PREFERENCES OF MY PAST SO YOU WILL UNDERSTAND THAT I HAVE REACHED THIS CONCLUSION SLOWLY AND RELUCTANTLY. I HAVE BECOME DISILLUSIONED BY THE BUREAUCRACY BORN OF EARLIER REFORMS.

AS A GOVERNMENT REGULATOR, I SAY TO YOU THAT I HOPE YOU DO NOT LEAVE THIS CONFERENCE WITH THE IDEA THAT THE WAY TO SOLVE THE ETHICAL QUESTIONS YOU HAVE BEEN DEBATING HERE, OR TO IMPROVE THE MORALS OF THE MARKETPLACE, IS THROUGH GREATER REGULATION OF BUSINESS.

AS BAYLESS MANNING HAS STATED:

"WE AMERICANS ACT AS THOUGH REGULATORY LAW WERE AN ALL-PURPOSE INSTRUMENT, FREE OF NEGATIVE SIDE EFFECTS AND, IN THE ECONOMISTS TERM, A FREE GOOD. OUR LEGISLATORS, JUDGES, ADMINISTRATORS AND THE PUBLIC --ALL OF US-- MUST COME TO UNDERSTAND THAT LAW IS IN FACT AN INSTRUMENT OF LIMITED UTILITY, IS ALWAYS ACCOMPANIED BY SIGNIFICANT, AND FREQUENTLY HARMFUL, SIDE EFFECTS, AND THAT IS VERY EXPENSIVE." "TOO MUCH LAW" 33 BUSINESS LAWYER 435, 440 (1977)

GOVERNMENT REGULATION IS NECESSARILY A REACTIVE FORCE WHICH SEEMS TO HAVE LIMITED ABILITY FOR CREATIVE INITIATIVES IN THE ECONOMIC SPHERE. ONE OF MY CONCERNS ABOUT OVER-REGULATION IS THAT IT IS A DRAG ON PRIVATE SECTOR DEVELOPMENT AND INNOVATION. IN ORDER TO SOLVE SUCH URGENT OBJECTIVES AS FULL EMPLOYMENT, ENVIRONMENTAL PROTECTION AND DECREASED DEPENDENCE ON FOREIGN ENERGY SOURCES, CORPORATIONS NEED INCREASED RATHER THAN DECREASED CAPITAL FORMATION. FOR A VARIETY OF COMPLEX REASONS, ONLY ONE OF WHICH IS THE EFFECT OF REGULATION, CAPITAL FORMATION BY THE PRIVATE SECTOR IS CLEARLY INADEQUATE TODAY. I AM FEARFUL THAT IF THE PRIVATE SECTOR CONTINUES TO BE UNABLE TO MEET THIS COUNTRY'S REAL CAPITAL INVESTMENT NEEDS, THE CAPITAL-RAISING FUNCTION WILL BE TRANSFERRED FROM PRIVATE CORPORATIONS TO THE GOVERNMENT.

TO SOME EXTENT, THAT IS ALREADY HAPPENING. FROM 1976 TO 1977, UNDERWRITINGS OF MUNICIPAL SECURITIES INCREASED FROM \$55.4 BILLION TO \$77.4 BILLION, WHEREAS CORPORATE UNDERWRITINGS DECREASED FROM \$36 BILLION TO \$32.4 BILLION.

PUTTING TO ONE SIDE THE VERY REAL POLITICAL QUESTIONS WHICH WOULD BE RAISED BY A FURTHER SHIFT OF OUR CAPITAL-RAISING CAPABILITY TO THE GOVERNMENT, IT IS GENERALLY BELIEVED THAT PRIVATE ENTERPRISE IS MORE EFFICIENT IN ACHIEVING RESULTS THAN THE GOVERNMENT IS.

I WOULD NOT WANT YOU TO GET THE IDEA THAT I AM HERE TO ADVOCATE THE ABOLITION OF MY AGENCY. HOWEVER, I NOTE THAT WILLIAM O. DOUGLAS, WHO BECAME CHAIRMAN OF THE SEC IN 1937, TOLD PRESIDENT ROOSEVELT THAT EVERY AGENCY HE CREATED AS PRESIDENT SHOULD BE ABOLISHED IN 10 YEARS. THE DESIRABILITY OF SUNSET LEGISLATION IS TODAY MORE GENERALLY RECOGNIZED, AND I UNDERSTAND THAT COLORADO HAS SUCH A LAW. I AM HERE TO SUGGEST THAT THERE ARE AT LEAST TWO ALTERNATIVES TO GREATER GOVERNMENT REGULATION WHICH EACH PLAY AN IMPORTANT ROLE IN THE SEC'S ADMINISTRATION OF THE FEDERAL SECURITIES LAWS, NAMELY, DISCLOSURE AND COMPETITION. I WANT TO DISCUSS THESE ALTERNATIVES WITH YOU IN THE CONTEXT OF SEC PROGRAMS WHICH IMPACT UPON CORPORATE ETHICS.

II. TENSION BETWEEN REGULATION AND DISCLOSURE IN THE SECURITIES LAWS

A. HISTORICAL PERSPECTIVE

MY BIAS AGAINST GREATER GOVERNMENT REGULATION HAS RESPECTABLE AND LONGSTANDING ANTECEDENTS AT THE SEC. THE STATUTES WE ADMINISTER REPRESENT THE RESOLUTION OF A DEBATE AS TO WHETHER INVESTOR PROTECTION SHOULD BE ACHIEVED THROUGH DIRECT REGULATION OF BUSINESS CORPORATIONS OR THROUGH FULL DISCLOSURE ABOUT CORPORATIONS AND THE SECURITIES THEY SELL.

IN 1933, WHEN FEDERAL REGULATION OF THE SALE OF SECURITIES WAS RECOMMENDED BY PRESIDENT FRANKLIN D. ROOSEVELT TO CONGRESS THERE WAS A CONSENSUS AS TO THE NEED FOR SOME TYPE OF FEDERAL REGULATION OF THE DISTRIBUTION OF SECURITIES IN INTERSTATE COMMERCE. VAST SUMS HAD BEEN LOST BY THE PUBLIC IN THE STOCK MARKET. BETWEEN 1920 AND 1933 SOME \$40 BILLION OF SECURITIES WERE SOLD IN THE UNITED STATES AND BY 1933 HALF OF THEM WERE WORTHLESS.

SECURITIES LEGISLATION ON THE FEDERAL LEVEL HAD BEEN RECOMMENDED BEFORE IN ORDER TO CONTROL SPECULATION AND TO PREVENT FRAUDULENT SALES. BUT IT TOOK THE BULL MARKETS OF THE TWENTIES FOLLOWED BY THE CRASH OF 1929 AND THE GREAT DEPRESSION OF THE THIRTIES TO BRING A FEDERAL SECURITIES LAW INTO BEING.

THE PHILOSOPHICAL DEBATE AS TO THE CHARACTER OF THIS FEDERAL REGULATION BEGAN LONG BEFORE ROOSEVELT'S MESSAGE TO CONGRESS. JUSTICE (THEN MR.) LOUIS D. BRANDEIS HAD ESPOUSED THE PHILOSOPHY OF DISCLOSURE IN HIS COLLECTION OF ARTICLES PUBLISHED IN 1914 IN OTHER PEOPLE'S MONEY. HE EXPRESSED THE FOLLOWING OFTEN QUOTED VIEW:

"PUBLICITY IS JUSTLY COMMENDED AS A REMEDY FOR SOCIAL AND INDUSTRIAL DISEASES. SUNLIGHT IS SAID TO BE THE BEST OF DISINFECTANTS; ELECTRIC LIGHT THE MOST EFFICIENT POLICEMAN... [THE] POTENT FORCE [OF PUBLICITY] MUST...BE UTILIZED IN MANY WAYS AS A CONTINUOUS REMEDIAL MEASURE."

OTHERS ARGUED FOR MORE DIRECT CONTROL OF THE SALE OF SECURITIES BY THE FEDERAL GOVERNMENT. EARLY DRAFTS OF FEDERAL LEGISLATION WOULD HAVE PROHIBITED SECURITIES DISTRIBUTIONS BY AN ISSUER IF THE BUSINESS OF THE COMPANY OR ITS SECURITIES WERE NOT SOUND OR THE ISSUER WAS FOUND TO BE "DISHONEST" OR "IN UNSOUND CONDITION OR INSOLVENT". AN INVESTIGATION OF SECURITIES FINANCING BY THE SENATE BANKING AND CURRENCY COMMITTEE BEGUN BEFORE ROOSEVELT'S INAUGURATION REVEALED THAT THE FINANCING SYSTEM AS A WHOLE HAD FAILED TO IMPOSE ESSENTIAL FIDUCIARY STANDARDS THAT SHOULD GOVERN PERSONS WHOSE FUNCTION IT WAS TO HANDLE OTHER PEOPLE'S MONEY. CRITICS OF INVESTMENT BANKERS, BROKERS AND DEALERS, CORPORATE DIRECTORS AND ACCOUNTANTS BEGAN TO DOUBT THE VALUE OF THE PRIVATE ENTERPRISE SYSTEM. THERE WAS WIDESPREAD DEMAND FOR THE INSTITUTION OF PROCEDURES OF GOVERNMENTAL CONTROL THAT WOULD IN ESSENCE HAVE CREATED A BUREAUCRACY TO CONTROL NOT ONLY THE MANNER IN WHICH SECURITIES COULD BE ISSUED BUT ALSO THE VERY RIGHT OF ANY ENTERPRISE TO TAP THE CAPITAL MARKET.

PRESIDENT ROOSEVELT DECLINED TO ENDORSE THIS DEMAND AND INSTEAD EMPHASIZED IN HIS MESSAGE TO CONGRESS THAT THE PURPOSE OF THE LEGISLATION HE WAS RECOMMENDING WAS "TO PROTECT THE PUBLIC WITH THE LEAST POSSIBLE INTERFERENCE TO HONEST BUSINESS". THE BRANDEIS FULL DISCLOSURE PHILOSOPHY WAS THEREFORE ENDORSED BY THE DRAFTERS OF THE SECURITIES ACT.

THIS PHILOSOPHY IS SET FORTH IN THE PREAMBLE TO THE SECURITIES ACT OF 1933 WHICH STATES THAT THE PURPOSE OF THE STATUTE IS "FULL AND FAIR DISCLOSURE OF THE CHARACTER OF SECURITIES SOLD IN INTERSTATE AND FOREIGN COMMERCE,"

ALTHOUGH SECURITIES ARE REGISTERED WITH THE SEC, THE REGISTRATION PROCESS IS INTENDED TO ACHIEVE THE GOAL OF FULLY INFORMING INVESTORS. THERE IS NO RESPONSIBILITY ON THE FEDERAL GOVERNMENT TO APPROVE OR GUARANTEE THE SOUNDNESS OF THE SECURITIES. SUPERVISION OVER THE QUALITY OF SECURITIES BEING SOLD IS LEFT TO STATE LAW, UNDER WHICH CORPORATIONS ARE CREATED.

ALTHOUGH THE SECURITIES EXCHANGE ACT OF 1934, WHICH CREATED THE SEC, WAS MORE OF A REGULATORY STATUTE THAN THE 1933 ACT, IT ALSO WAS NOT CONCEIVED AS LEGISLATION TO REGIMENT BUSINESS. ITS STATED PURPOSES ARE TO PROVIDE FOR THE REGULATION OF THE SECURITIES MARKETS OPERATING IN INTERSTATE AND FOREIGN COMMERCE, TO PREVENT INEQUITABLE AND UNFAIR PRACTICES ON SUCH MARKETS AND TO REQUIRE A SYSTEM OF CONTINUOUS DISCLOSURE.

NINE MONTHS AFTER THE ADOPTION OF THE SECURITIES ACT OF 1933, WILLIAM D. DOUGLAS PUBLISHED A STRONG CRITIQUE OF THE ACT. IN HIS VIEW, THE 1933 ACT FAILED BECAUSE IT "PRESUPPOSES THAT THE GLARING LIGHT OF PUBLICITY WILL GIVE THE INVESTORS NEEDED PROTECTION," WHEN INVESTORS "EITHER LACK THE TRAINING OR INTELLIGENCE TO ASSIMILATE ... AND FIND USEFUL

[THE BALANCE SHEETS, CONTRACTS OR OTHER DATA IN THE REGISTRATION STATEMENT] OR ARE SO CONCERNED WITH A SPECULATIVE PROFIT AS TO CONSIDER THEM IRRELEVANT." THE RELIANCE PLACED ON TRUTH ABOUT SECURITIES WAS AN UNREALISTIC CONCEPT IN HIS VIEW BECAUSE IT WAS BASED ON THE ERRONEOUS ASSUMPTION THAT THE COUNTRY MUST AND SHOULD RETURN TO A SIMPLER ECONOMY -- TO "MAIN STREET BUSINESS" WHERE INVESTORS COULD EASILY UNDERSTAND THE BUSINESSES WITH WHICH THEY DEAL. IT IGNORES THE MODERN DEVELOPMENT OF BIG BUSINESS.

DOUGLAS ESPOUSED A REGULATORY THEORY FOR SECURITIES WHICH WAS AN INTEGRAL PART OF A WHOLE PROGRAM OF INDUSTRIAL REGULATION AND ORGANIZATION AND WHICH IN HIS VIEW WAS NECESSARY FOR OUR MODERN AND COMPLEX ECONOMY. CONTROL OVER ACCESS TO THE MARKET "WOULD BE AN ADMINISTRATIVE CONTROL LODGED IN THE HANDS NOT ONLY OF THE NEW SELF-DISCIPLINED BUSINESS GROUPS BUT ALSO IN THE HANDS OF GOVERNMENTAL AGENCIES WHOSE FUNCTION WOULD BE TO ARTICULATE THE PUBLIC INTEREST WITH THE PROFIT MOTIVE." DOUGLAS, "PROTECTING THE INVESTOR", 23 YALE L. REV. 521 (1934).

B. ADVISORY COMMITTEE

THE DEBATE BETWEEN ADVOCATES OF DISCLOSURE AND PROPONENTS OF REGULATION BY THE SECURITIES LAWS CONTINUES TO THE PRESENT TIME. RECENTLY, THE ADVISORY COMMITTEE ON CORPORATE DISCLOSURE TO THE SEC FORWARDED COMPREHENSIVE RECOMMENDATIONS TO THE COMMISSION INTENDED TO IMPROVE THE COMMISSION'S ADMINISTRATION OF THE CORPORATE DISCLOSURE SYSTEM.

ONE OF THESE RECOMMENDATIONS WAS THAT THE "COMMISSION SHOULD NOT ADOPT DISCLOSURE REQUIREMENTS WHICH HAVE AS THEIR PRINCIPAL OBJECTIVE THE REGULATION OF CORPORATE CONDUCT."

THE COMMISSION RESPONDED TO THE ADVISORY COMMITTEE'S RECOMMENDATION BY STATING THAT "DECISIONS AS TO REQUIRED DISCLOSURE FREQUENTLY DO AFFECT CONDUCT AND CONGRESS WAS WELL AWARE OF THIS CONSEQUENCE AND THOUGHT THAT IT WOULD OFTEN BE BENEFICIAL...THE BASIC OBJECTIVE OF THE DISCLOSURE REQUIREMENTS IS TO INCREASE INVESTOR CONFIDENCE AND TO MAKE THE SECURITIES MARKETS MORE EFFICIENT AND AS FAIR AND HONEST AS POSSIBLE." SECURITIES ACT RELEASE NO. 5906 (FEBRUARY 15, 1978).

THE DISCLOSURE SYSTEM OF THE FEDERAL SECURITIES LAWS IS STILL WIDELY REGARDED AS AN EFFECTIVE WAY TO PROVIDE INVESTORS WITH THE TOOLS WITH WHICH TO MAKE INTELLIGENT INVESTMENT DECISIONS. ALTHOUGH THAT DISCLOSURE SYSTEM IS ADMINISTERED BY A GOVERNMENT AGENCY, IT ALSO IS ENFORCED BY INVESTORS. THE LIABILITIES FOR FALSE AND MISLEADING STATEMENTS PROVIDED IN THE STATUTES GIVE INVESTORS A REMEDY FOR MISREPRESENTATION IN CONNECTION WITH SECURITIES TRANSACTIONS. DOUGLAS' ARGUMENTS AND THE NEED FOR REGULATION IN ADDITION TO DISCLOSURE IN SOME SITUATIONS NOTWITHSTANDING, THE DISCLOSURE SYSTEM APPEARS TO ACHIEVE ITS GOALS WHILE BEING CONSISTENT WITH THE ECONOMIC THEORIES UNDERLYING BUSINESS IN A FREE ENTERPRISE SOCIETY.

AS I HAVE INDICATED, HOWEVER, DISCLOSURE IS NOT A COMPLETE ALTERNATIVE TO REGULATION, SINCE COMPELLED DISCLOSURE IS A FORM OF BEHAVIORAL CONTROL. THE PROPHYLACTIC EFFECT OF DISCLOSURE HAS BEEN WIDELY RECOGNIZED. INDEED, I HEARD AN ARGUMENT TO THAT EFFECT AT YOUR DISCUSSION THIS AFTERNOON. FORMER SEC CHAIRMAN WILLIAM CARY HAS WRITTEN THAT "DISCLOSURE RESTRAINS BECAUSE OF SENSITIVITY TO PUBLIC REACTION, CAUTION ABOUT RESPONSE TO THE 'DISSIDENT' SHAREHOLDER, AND THE POSSIBILITIES OF LEGAL ACTION." CARY, CORPORATE STANDARDS AND LEGAL RULES, 50 CAL. L. REV. 408, 411 (AUGUST 1962), L. REV. 408, 411 (AUGUST 1962).

C. MANAGEMENT REMUNERATION

RECENTLY, A GREAT DEAL OF PUBLICITY HAS BEEN GIVEN TO THE PERQUISITES OF CORPORATE OFFICE. ALTHOUGH HIGH FINANCIAL COMPENSATION IS CONSIDERED AN APPROPRIATE REWARD FOR REACHING THE TOP OF THE CORPORATE LADDER, SOME OF THE NON-CASH BENEFITS RECEIVED BY OFFICERS AND DIRECTORS OF CORPORATIONS APPEAR CONTRADICTORY TO THE VALUES OF A DEMOCRATIC SOCIETY. CORPORATE MANAGEMENT IS NOT AN ARISTOCRACY ENTITLED TO JEWELS, PALACE GUARDS, AND OTHER TRAPPINGS OF ROYALTY. CORPORATE OFFICERS AND DIRECTORS IN A DEMOCRATIC SOCIETY ARE SUPPOSED TO SERVE CORPORATIONS AND THE SHAREHOLDERS WHO OWN THEM, AND TO BE ACCOUNTABLE TO A MORE GENERAL PUBLIC. CERTAIN TYPES AND AMOUNTS OF NON-CASH MANAGEMENT COMPENSATION MAY BE INDICATIVE OF THE ETHICAL VALUES OF THE MANAGEMENT OF A CORPORATION.

THE COMMISSION HAS MADE AN EFFORT TO ASSURE APPROPRIATE DISCLOSURE ABOUT FRINGE BENEFITS RECEIVED BY OFFICERS AND DIRECTORS IN FILINGS BY CORPORATIONS UNDER THE SECURITIES LAWS.

IN REPORTING THE REMUNERATION RECEIVED BY OFFICERS AND DIRECTORS, CORPORATIONS MUST INCLUDE THE VALUE OF PERSONAL BENEFITS THE EXECUTIVES RECEIVE, SUCH AS THEIR PERSONAL USE OF COMPANY CARS, PLANES, YACHTS, APARTMENTS, COUNTRY CLUBS AND HUNTING LODGES. DISCLOSURE HAS NOT BEEN REQUIRED OF ALL BENEFITS RECEIVED BY MANAGEMENT, HOWEVER. BENEFITS RELATED TO AN INDIVIDUAL'S PERFORMANCE OF HIS JOB, SUCH AS BUSINESS LUNCHEES AND BUSINESS ENTERTAINMENT ACTIVITIES, DO NOT RESULT IN REMUNERATION TO AN EXECUTIVE.

IN CERTAIN EGREGIOUS CASES THE SEC TOOK ENFORCEMENT ACTION WHERE DISCLOSURE OF MANAGEMENT COMPENSATION WAS NOT ACCEPTABLE OR LACKING ALTOGETHER. FOR EXAMPLE, IN SEC V. ORMAND INDUSTRIES, INC. CIVIL ACTION No. 77-0790 (D.D.C. MAY 9, 1977), MR. J. D. ORMAND, CHIEF EXECUTIVE OFFICER OF ORMAND INDUSTRIES WAS ALLEGED TO HAVE RECEIVED UNACCOUNTED FOR CASH ADVANCES FOR EXPENSES IN EXCESS OF \$250,000 WHICH WERE NOT REPAID NOR USED FOR COMPANY BUSINESS EXPENSES. IN ADDITION, SUBSTANTIAL CORPORATE EXPENDITURES WERE ALLEGED TO HAVE BEEN MADE FOR THE ORMAND FAMILY'S BENEFIT, INCLUDING PAYMENTS IN EXCESS OF \$50,000 FOR IMPROVEMENTS ON MR. ORMAND'S PERSONAL RESIDENCE. IN ANOTHER CASE, SEC V. POTTER INSTRUMENT Co., CIVIL ACTION No. 77-0394 (D.D.C. MARCH 9, 1977) JOHN T. POTTER, CHAIRMAN OF THE BOARD OF POTTER INSTRUMENT Co., WAS ALLEGED TO HAVE RECEIVED SUBSTANTIAL UNDISCLOSED BENEFITS FROM THE COMPANY IN ADDITION TO HIS STATED SALARY WHICH INCLUDED \$100,000 IN CORPORATE FUNDS TO MAINTAIN HIS RESIDENCE AND PERSONAL RACING YACHT AND TO PAY THE SALARIES OF HIS SERVANTS AND CREW MEMBERS. (THE DEFENDANTS IN BOTH OF THESE CASES CONSENTED TO THE ISSUANCE OF INJUNCTIONS WITHOUT ADMITTING ANY OF THE ALLEGATIONS IN THE COMPLAINTS.)

SOME PERSONS, SUCH AS DONALD ALEXANDER, FORMER HEAD OF THE INTERNAL REVENUE SERVICE, HAVE APPLAUDED THE COMMISSION'S CONCERN WITH CORPORATE MORALITY, INCLUDING DISCLOSURE OF MANAGEMENT PERQUISITES, AND HAVE EXPRESSED THE HOPE THAT THE COMMISSION'S APPROACH WOULD BE UNAFFECTED BY THE ADVISORY COMMITTEE'S RECENT SUGGESTION THAT THE COMMISSION NOT REGULATE CORPORATE MORALITY. (LETTER DATED NOVEMBER 9, 1977 FROM DONALD ALEXANDER TO CHAIRMAN WILLIAMS.) MY OWN FEELINGS IN THE MATTER ARE MIXED. THERE IS NOTHING WRONG WITH DISCLOSURE REQUIREMENTS WHICH IMPROVE CORPORATE ETHICS. FURTHER, DISCLOSURE ABOUT FRINGE BENEFITS MAY BE RELEVANT TO THE ASSESSMENT OF MANAGEMENT BY SHAREHOLDERS. HOWEVER, SUCH DISCLOSURE COULD BE CARRIED TO RIDICULOUS EXTREMES. I WOULD NOT WANT THE PUBLIC TO START BELIEVING THE SEC HAS BEEN GIVEN THE AUTHORITY TO REGULATE THE GRANTING OF PERQUISITES TO MANAGEMENT. I DO NOT BELIEVE THAT THE GOVERNMENT SHOULD REGULATE EXECUTIVE COMPENSATION.

I STATED AT THE BEGINNING OF THIS TALK THAT IT IS UNFAIR TO JUDGE BUSINESS MORALS WITHOUT UNDERSTANDING BUSINESS PROBLEMS. FRINGE BENEFITS ARE PROVIDED FOR MANY REASONS. THE AVAILABILITY OF FRINGE BENEFITS SERVES AS A PSYCHOLOGICAL INCENTIVE FOR EMPLOYEES BECAUSE IT EVIDENCES PRESTIGE AND STATUS WHEN THE SALARIES OF ALL BUT THE HIGHEST PAID OFFICERS OF THE CORPORATION ARE GENERALLY NOT KNOWN. APART FROM THE EMPLOYEE DIFFERENTIATING FUNCTION OF FRINGE BENEFITS, THEY ARE GRANTED PARTLY AS A RESULT OF THE U. S. TAX LAWS.

WHEN A 70% TAX WAS IMPOSED ON TAXABLE INCOME, IT WAS LESS COSTLY FOR A COMPANY TO BENEFIT ITS OFFICERS AND DIRECTORS BY PROVIDING THEM WITH FRINGE BENEFITS. EQUIVALENT BENEFITS WOULD HAVE REQUIRED INCREASING THE AMOUNT OF THEIR SALARY BY THE VALUE OF THE BENEFIT AND AN INCREMENTAL AMOUNT TO COMPENSATE FOR THE HIGH TAX LIABILITY. THIS FACT AND THE CONTINUING AMBIGUITY AS TO THE EXTENT TO WHICH FRINGE BENEFITS RESULT IN TAXABLE INCOME TO THE EMPLOYEES RECEIVING THE BENEFITS WERE STRONG INDUCEMENTS FOR CORPORATIONS TO PROVIDE EXECUTIVES WITH PERQUISITES.

I AM AN OFFICIAL AT THE SEC, NOT THE IRS, AND SO IT IS NOT MY PLACE TO SUGGEST CHANGES IN THE TAX LAWS. AS A COMMISSIONER OF THE SEC I CAN ARGUE THAT DISCLOSURE OF MANAGEMENT REMUNERATION IMPROVES CORPORATE ETHICS, WITHOUT UNDUE GOVERNMENT REGULATION.

DISCLOSURE ENABLES INVESTORS TO EXERCISE THEIR JUDGMENT THROUGH THEIR VOTING RIGHTS AS TO WHETHER OR NOT DIRECTORS AND OFFICERS HAVE ACTED IN A COMPANY'S BEST INTEREST. DISCLOSURE MAY LEAD TO PUBLIC DEBATE ON THE MORALITY OF CORPORATE CONDUCT.

PUBLIC CRITICISM OF EXCESSIVE COMPENSATION OF MANAGEMENT HAS GROWN DURING THE LAST FEW YEARS. STOCKHOLDERS AND THE PUBLIC SEEM TO RESENT THE FACT THAT KEY EXECUTIVES ARE BECOMING OR HAVE BECOME A PRIVILEGED CLASS, A BOARDROOM ARISTOCRACY, WHO RECEIVE FAVORABLE CONTRACTS AND SECRET BONUSES ALONG WITH THEIR EXTENSIVE PERQUISITES AND OFTEN SPECTACULAR SALARIES.

IN THE SEC'S CORPORATE GOVERNANCE HEARINGS IN OCTOBER, 1977, U. S. SENATOR JOHN H. CHAFEE EXPRESSED THE VIEW THAT "INADEQUATE DISCLOSURE OF MANAGEMENT REMUNERATION INCLUDING PERQUISITES, HAS ADVERSELY AFFECTED INVESTOR CONFIDENCE IN MANAGEMENT." ADEQUATE DISCLOSURE GIVES SHAREHOLDERS AND THE BUSINESS COMMUNITY AN OPPORTUNITY TO REASSESS QUESTIONS OF APPROPRIATE MANAGEMENT REMUNERATION.

D. BRIBERY CASES AND THE FOREIGN CORRUPT PRACTICES ACT

DISCLOSURE IS NOT ALWAYS A SIMPLE ALTERNATIVE TO REGULATION. IN SOME CASES, THE DISCLOSURE PROCESS CAN RESULT IN INCREASED REGULATION.

A CASE HISTORY IN POINT WAS THE REACTION OF CONGRESS TO THE DISCLOSURE BY OVER 400 CORPORATIONS OF QUESTIONABLE OR ILLEGAL PAYMENTS. UNTIL THE SEC'S WATERGATE RELATED INQUIRIES IN 1973 AND 1974 LED TO THE DISCOVERY OF FALSIFICATION OF CORPORATE FINANCIAL RECORDS DESIGNED TO CONCEAL CERTAIN CORPORATE EXPENDITURES, IT WAS NOT WIDELY KNOWN, AT LEAST TO THE GENERAL PUBLIC THAT CORPORATIONS COMMONLY BRIBED FOREIGN OFFICIALS TO OBTAIN BUSINESS. COMPANIES WHICH WERE FOUND BY THE SEC TO HAVE MADE QUESTIONABLE OR ILLEGAL FOREIGN OR DOMESTIC PAYMENTS GENERALLY HAVE BEEN REQUIRED TO DISCLOSE THE MATTER IN A PUBLIC FILING ON THE THEORY THAT THE INFORMATION IS MATERIAL TO AN UNDERSTANDING OF THE QUALITY AND INTEGRITY OF MANAGEMENT AND OF THE CORPORATION'S BUSINESS.

THE COMMISSION PROVIDED A DETAILED ANALYSIS OF INFORMATION CONCERNING THESE ILLEGAL OR QUESTIONABLE PAYMENTS IN ITS REPORT ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS OR PRACTICES WHICH WAS SUBMITTED TO THE SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE IN MAY 1976. THE INFORMATION REPORTED SHOWED THAT FREQUENTLY A MEMBER OF CORPORATE MANAGEMENT HAD KNOWLEDGE OF, APPROVED OF, OR PARTICIPATED IN THE QUESTIONABLE OR ILLEGAL ACTIVITIES REPORTED. THE DISCOVERY OF WIDESPREAD FALSIFICATION OF CORPORATE FINANCIAL RECORDS IN CONNECTION WITH THE MAKING OF THE PAYMENTS CAST DOUBT ON THE INTEGRITY AND RELIABILITY OF CORPORATE BOOKS AND RECORDS. THIS WAS ALARMING SINCE SUCH RECORDS ARE THE FOUNDATION OF THE DISCLOSURE SYSTEM ESTABLISHED BY THE FEDERAL SECURITIES LAWS. IN ITS REPORT, THE COMMISSION EXPRESSED ITS CONCERN THAT THE DISCLOSURE OF THE PAYMENTS WAS HAVING AN ADVERSE EFFECT ON PUBLIC CONFIDENCE IN THE INTEGRITY OF AMERICAN BUSINESS.

IN DECEMBER 1977, THE FOREIGN CORRUPT PRACTICES ACT WAS PASSED IN RESPONSE TO THE PUBLIC OUTCRY TO THE DISCLOSURE OF QUESTIONABLE OR ILLEGAL FOREIGN PAYMENTS. THE STATUTE MAKES IT ILLEGAL FOR CORPORATIONS TO MAKE DIRECT OR INDIRECT PAYMENTS TO FOREIGN GOVERNMENT OR POLITICAL OFFICIALS FOR THE PURPOSE OF OBTAINING, RETAINING OR DIRECTING BUSINESS. PUBLIC CORPORATIONS ARE REQUIRED BY THE ACT TO MAKE AND KEEP BOOKS, RECORDS AND ACCOUNTS WHICH, IN REASONABLE DETAIL, ACCURATELY AND FAIRLY REFLECT TRANSACTIONS AND DISPOSITIONS OF THE ASSETS OF THE ISSUER.

IN ADDITION, SUCH COMPANIES ARE REQUIRED TO DEVISE AND MAINTAIN A SYSTEM OF INTERNAL ACCOUNTING CONTROLS SUFFICIENT TO PROVIDE REASONABLE ASSURANCES THAT TRANSACTIONS ARE EXECUTED AND RECORDED IN ACCORDANCE WITH MANAGEMENT AUTHORIZATION AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES.

IN THIS INSTANCE, DISCLOSURE LED TO GREATER REGULATION BECAUSE IT WAS FELT THAT DISCLOSURE WAS NOT SUFFICIENT TO CONTROL THE TYPE OF CORPORATE MISCONDUCT DISCOVERED IN CONNECTION WITH THE FOREIGN PAYMENTS AREA. LEGISLATION REGARDING BRIBERY AND OTHER RELATED PAYMENTS WAS A REACTION TO CONDUCT WHICH PEOPLE FELT WAS OFFENSIVE TO THE FREE ENTERPRISE SYSTEM, EVEN THOUGH SUCH PAYMENTS MAY NOT BE REGARDED AS ILLEGAL OR IMMORAL IN FOREIGN COUNTRIES.

I AM TROUBLED THAT AMERICAN CORPORATIONS HAVE FOUND IT NECESSARY TO RESORT TO MAKING SUCH PAYMENTS IN ORDER TO SELL THEIR GOODS. IN A SOUND BUSINESS SYSTEM, PRODUCTS SHOULD BE SOLD ON THE BASIS OF QUALITY AND PRICE RATHER THAN BRIBES OR KICKBACKS. THE EXPOSURE OF THE SENSITIVE PAYMENTS PROBLEM INDICATES TO ME THE EXISTENCE OF SERIOUS ECONOMIC AS WELL AS ETHICAL PROBLEMS AT THE HEART OF OUR LARGE PUBLIC CORPORATIONS. WHETHER THE BEST SOLUTION TO THOSE PROBLEMS WAS NEW LEGISLATION IS THE KIND OF QUESTION I WANT TO RAISE IN YOUR MINDS TONIGHT. THE SEC STRONGLY SUPPORTED THIS LEGISLATION SO IT WOULD BE UNSEEMLY FOR ME TO QUESTION ITS WISDOM.

MOREOVER, I BELIEVE THAT THE INTEGRITY AND RELIABILITY OF THE BOOKS AND RECORDS OF OUR PUBLIC CORPORATIONS IS ESSENTIAL TO THE ADMINISTRATION OF THE SEC'S FULL DISCLOSURE SYSTEM, BUT WE SHOULD BE WARY OF IMMEDIATELY REACTING TO PERCEIVED ETHICAL DEFICIENCIES IN CORPORATE BEHAVIOR BY PASSING A LAW, PARTICULARLY WHERE THAT LAW ARTICULATES A MORAL STANDARD WHICH MAY NOT BE WIDELY SHARED.

III. COMPETITION AS AN ALTERNATIVE TO REGULATION

ANOTHER ALTERNATIVE TO GOVERNMENT REGULATION AS A MEANS TO REGULATE CORPORATE CONDUCT WHICH IS GAINING INCREASED POLITICAL POPULARITY IS COMPETITION. IN 1975 CONGRESS EXTENSIVELY AMENDED THE SECURITIES EXCHANGE ACT OF 1934 SO THAT THE SEC WOULD HAVE TO CONSIDER THE COMPETITIVE EFFECTS OF ITS REGULATIONS.

FOR OVER 180 YEARS -- SINCE THE 1792 BUTTWOOD TREE AGREEMENT FOUNDING WHAT IS TODAY THE NEW YORK STOCK EXCHANGE -- THE SECURITIES INDUSTRY OPERATED UNDER A FIXED COMMISSION RATE SYSTEM. THAT IS, STOCK EXCHANGE RULES SET MINIMUM COMMISSION RATES THAT MEMBERS HAD TO CHARGE THEIR CUSTOMERS FOR EXECUTING STOCK PURCHASES OR SALES ON THE FLOOR OF THE EXCHANGE. THE FIXED RATE SYSTEM WAS SO INGRAINED IN THE INDUSTRY THAT WHEN CONGRESS ENACTED THE FEDERAL SECURITIES LAWS IN THE 1930'S, IT SPECIFICALLY RECOGNIZED THE FIXED RATE STRUCTURE AND GAVE THE SEC OVERSIGHT AUTHORITY TO ENSURE THAT THOSE RATES WERE REASONABLE. IN CONCEPT, WITH RESPECT TO COMMISSION RATES, THE SEC ACTED NOT TOO DIFFERENTLY FROM A PUBLIC UTILITY RATE REGULATOR.

THE QUESTION OF WHETHER SUCH A RATE STRUCTURE AMOUNTED TO PRICE FIXING IN VIOLATION OF THE ANTI-TRUST LAWS WAS ANSWERED BY THE SUPREME COURT ONLY THREE YEARS AGO. THE COURT SAID IT DID NOT BECAUSE OF THE COMMISSION'S AUTHORITY TO REGULATE THE REASONABLENESS OF COMMISSION RATES.

THE COMMISSION, HOWEVER, FOUND THE TASK OF REGULATING THE REASONABLENESS OF COMMISSION RATES INCREASINGLY DIFFICULT IN A CHANGING INDUSTRY WHICH BORE LITTLE RESEMBLANCE TO PUBLIC UTILITIES. BETWEEN WORLD WAR II AND THE EARLY 1970'S THE PUBLIC FLOCKED INTO THE SECURITIES MARKETS AND FINANCIAL INSTITUTIONS INCREASINGLY CAME TO DOMINATE THOSE MARKETS. GREATER PARTICIPATION IN THE MARKETPLACE GENERATED COMPETITION FOR COMMISSION BUSINESS AND LED TO DIVERSIFICATION OF THE FINANCIAL COMMUNITY TO ACCOMMODATE THE INVESTING NEEDS OF ALL PARTICIPANTS. IN ADDITION, TRADING VOLUME INCREASED TREMENDOUSLY. THESE DEVELOPMENTS NECESSARILY LED TO CHANGES IN THE WAYS SECURITIES WERE TRADED, AND MADE IT DIFFICULT TO DETERMINE A REASONABLE FIXED COMMISSION RATE.

FIXED COMMISSION RATES (BASED ON A SET COMMISSION PER SHARE NO MATTER HOW LARGE THE TRANSACTION) DID NOT ADEQUATELY TAKE INTO ACCOUNT COSTS ASSOCIATED WITH EXECUTION OF SECURITIES TRANSACTIONS. SINCE VOLUME DISCOUNTS WERE NOT AVAILABLE, "ECONOMIES OF SCALE" WERE NOT RECOGNIZED. THUS, BROKER-DEALERS REAPED GREAT PROFITS FROM LARGE TRANSACTIONS WHICH WERE DISPROPORTIONATE TO THEIR COSTS IN EXECUTING SUCH TRADES.

WITHOUT PRICE COMPETITION, COMPETITION FOR BROKERAGE BUSINESS OCCURRED BY PROVIDING INVESTORS ADDITIONAL SERVICES OR BY VARIOUS REBATIVE SCHEMES. UNDER THE CIRCUMSTANCES THE FIXED RATE STRUCTURE LED TO ECONOMIC DISTORTIONS AS TO ACTUAL COST, TO VARIOUS CONFLICTS OF INTEREST, TO INEFFICIENCIES IN THE WAY BROKERAGE FIRMS OPERATED AND TO AN INABILITY OF THE SECURITIES INDUSTRY TO APPROPRIATELY RESPOND TO DEMAND ON A PRICING BASIS.

FIXED RATES ALSO CONTRIBUTED TO MARKETPLACE DISLOCATIONS. LARGE INSTITUTIONAL INVESTORS ENGAGED IN VARIOUS SCHEMES TO AVOID OR CIRCUMVENT THE HIGH COMMISSION RATE BY EXECUTING THEIR ORDERS AWAY FROM THE PRIMARY MARKETPLACES. THIS, IN TIME, CAUSED FRAGMENTATION OF THE MARKETPLACE AND PRESENTED OBSTACLES TO THE DEVELOPMENT OF A NATIONAL SECURITIES MARKET SYSTEM.

FINALLY THE SEC FOUND ITSELF INCAPABLE OF EFFECTIVELY REGULATING COMMISSION RATES. THE NATURE OF BROKERAGE AND OTHER FINANCIAL SERVICES PROVIDED BY THE BROKER-DEALER COMMUNITY CREATED IMMENSE DIFFICULTIES IN ALLOCATING COSTS, CAPITAL AND REVENUES IN ORDER TO DETERMINE A REASONABLE FIXED RATE. MOREOVER, COMPETITION ON THE BASIS OF PRICE HAD A STRONG POLITICAL APPEAL. THE FAILURE OF THE SEC TO DEVISE A REASONABLE RATE STRUCTURE LED TO A CONSENSUS THAT COMPETITION WOULD BE PREFERABLE TO GOVERNMENT REGULATION. THE COMMISSION THUS DETERMINED THAT UNDER THE CIRCUMSTANCES THE FREE PLAY OF COMPETITION COULD PROVIDE A LEVEL AND STRUCTURE OF COMMISSION RATES WHICH WOULD BETTER SERVE THE INTERESTS OF THE INVESTING PUBLIC, THE SECURITIES INDUSTRY, THE NATIONAL ECONOMY, AND THE PUBLIC INTEREST THAN ANY SYSTEM OF PRICE FIXING WHICH WE COULD DEVISE AND ENFORCE.

ON MAY 1, 1975, THE COMMISSION BY RULE ABOLISHED THE FIXED COMMISSION RATE STRUCTURE AND ON JUNE 4, 1975, THE CONGRESS DID THE SAME BY STATUTE. THE IMMEDIATE IMPACT OF UNFIXING HAS CAUSED A LOSS OF THE ARTIFICIAL PROFITABILITY IN THE INDUSTRY AND THE FINANCIAL FAILURE OF MANY FIRMS WHICH COULD NOT SURVIVE IN A COMPETITIVE ENVIRONMENT. COMMISSION RATES ALSO HAVE CHANGED TO MORE ACCURATELY REFLECT THE ACTUAL COST TO EXECUTE TRADES.

THE SECURITIES INDUSTRY IS STILL ABSORBING THE IMPACT OF THE UNFIXING OF COMMISSION RATES. MANY FIRMS ARE REACHING OUT FOR NEW AREAS OF PROFITABILITY AND NUMEROUS MERGERS HAVE RESULTED IN A CONCENTRATION IN THE INDUSTRY WHICH I AND MANY OTHERS FIND UNDESIRABLE. SOME HAVE EXPRESSED THE FEAR THAT THIS NEW CONCENTRATION WILL IMPEDE COMPETITION MUCH AS THE FIXED COMMISSION RATE STRUCTURE DID. BUT IT IS MY VIEW THAT THE COMMISSION AND THE CONGRESS MADE A CORRECT REGULATORY DECISION IN UNFIXING COMMISSION RATES AND WE WOULD HAVE TO THINK LONG AND HARD BEFORE RETURNING TO RATE-MAKING IN THE SECURITIES INDUSTRY.

YOU MAY BE WONDERING WHAT MY ANALYSIS OF COMPETITION AS A SUBSTITUTE FOR REGULATION HAS TO DO WITH BUSINESS ETHICS. ALTHOUGH THE PRESSURES OF COMPETITION CAN LEAD TO IMPROPER BEHAVIOR, AS SHOWN BY THE ILLEGAL AND QUESTIONABLE PAYMENTS CASES, I BELIEVE THAT A COMPETITIVE ENVIRONMENT IS GENERALLY MORE CONDUCTIVE TO RESPONSIBLE BUSINESS BEHAVIOR THAN AN ENVIRONMENT CHARACTERIZED BY REGULATORY CONTROLS.

AS THE SEC'S EXPERIENCE WITH FIXED COMMISSION RATES INDICATES, COMPETITION CAN BE A MORE EFFECTIVE MONITOR OF BUSINESS CONDUCT THAN INEFFECTIVE GOVERNMENT REGULATION. I WOULD SUGGEST THAT WE SHOULD CONSIDER THE REGULATORY IMPACT OF COMPETITION ITSELF ON BUSINESS CONDUCT BEFORE ENGAGING IN THE EXERCISE OF REGULATORY AUTHORITY TO DEAL WITH THE ILLS OF OUR BUSINESS COMMUNITY.

IV. CONCLUSION

IN A RECENT ARTICLE IN THE NEW YORK TIMES, PROFESSOR DAVID J. ROTHMAN DISCUSSED THE ATTITUDE OF "A NEW GENERATION OF REFORMERS" WHICH IS "CHALLENGING THE IDEAL OF THE STATE AS PARENT." PROFESSOR ROTHMAN HAS ANALYZED THIS SHIFT FROM PREVIOUS LIBERAL THINKING AS FOLLOWS:

"THE COMMITMENT TO PATERNALISTIC STATE INTERVENTION IN THE NAME OF EQUALITY IS GIVING WAY TO A COMMITMENT TO RESTRICT INTERVENTION IN THE NAME OF LIBERTY. OUR PREDECESSORS WERE DETERMINED TO TEST THE MAXIMUM LIMITS OF THE EXERCISE OF STATE POWER IN ORDER TO CORRECT IMBALANCES. WE ARE ABOUT TO TEST THE MINIMUM LIMITS OF THE EXERCISE OF STATE POWER TO ENHANCE AUTONOMY." NEW YORK TIMES
MARCH 7, 1978.

ACTUALLY, THE CONTROVERSY BETWEEN WHETHER INDIVIDUAL RIGHTS OR SOCIAL NEEDS ARE ENTITLED TO GREATER PRIORITY IS NOT NEW. AGAIN, I WOULD RETURN TO THE DIFFERENCES IN OPINION BETWEEN JUSTICES DOUGLAS AND BRANDEIS. WHEN WILLIAM O. DOUGLAS PROPOSED A REGULATORY AGENCY FOR BUSINESS IN 1934 HE URGED THAT WE SHOULD HARNESS THE INSTRUMENTS OF PRODUCTION "FOR THE ANCIENT PURPOSE OF SERVICE IN THE SENSE OF THE PUBLIC GOOD."

HOWEVER, HE RECOGNIZED THAT "ULTIMATELY THIS MAY RUN TO FASCISM OR SOCIALISM." THIS WAS A RISK WHICH ONE LIBERAL WAS THEN WILLING TO ACCEPT IN ORDER TO RESPOND TO THE NEEDS OF THE NATION.

LOUIS D. BRANDEIS, ON THE OTHER HAND, IN A LETTER WHICH HE WROTE IN 1922 STATED:

"REFUSE TO ACCEPT AS INEVITABLE ANY EVIL IN BUSINESS (E.G. IRREGULARITY OF EMPLOYMENT). REFUSE TO TOLERATE ANY IMMORAL PRACTICE... BUT DO NOT BELIEVE THAT YOU CAN FIND A UNIVERSAL REMEDY FOR EVIL CONDITIONS OR IMMORAL PRACTICES IN EFFECTING A FUNDAMENTAL CHANGE IN SOCIETY (AS BY STATE SOCIALISM). AND DO NOT PIN TOO MUCH FAITH ON LEGISLATION. REMEDIAL INSTITUTIONS ARE APT TO FALL UNDER THE CONTROL OF THE ENEMY AND TO BECOME INSTRUMENTS OF OPPRESSION."

PART OF THE DIFFERENCE OF OPINION BETWEEN THESE TWO THINKERS, BOTH OF WHOM HAD AN IMPORTANT IMPACT ON THE SEC, WAS THE TIMES IN WHICH THEY WROTE. TODAY IS A NEW TIME, WITH NEW PROBLEMS. IN THE PAST, OUR SOCIETY HAS PUT A PREMIUM ON PRODUCTION -- WHETHER IN THE FORM OF MORE PROFITS OR MORE LAWS. NOW WE RECOGNIZE THE NEED FOR CONSERVATION AND YET WE STILL REGARD UNEMPLOYMENT AS AN EVIL. THIS MEANS WE MUST MAKE DIFFICULT QUALITATIVE DECISIONS IN ORDER TO MAXIMIZE OUR SCARCE NATURAL, ECONOMIC AND HUMAN RESOURCES FOR THE BENEFIT OF EVERYONE. IN MAKING THESE DECISIONS, WE MUST GUARD AGAINST THE TEMPTATION TO IMPOSE REGULATORY CONTROLS AS A SUBSTITUTE FOR SOLUTIONS TO OUR BASIC ECONOMIC AND SOCIAL NEEDS.