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NATIONAL LAW CENTER

LAWRENCE E. MITCHELL  
PROFESSOR OF LAW

DIRECT (202) 994-0912  
FAX (202) 994-9811

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The Honorable Steven M.H. Wallman  
United States Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Dear Steve:

Thank you for sending along the materials provided to the Advisory Committee. Cathy Dixon had already sent me Background Paper No.1, and I called her to convey some of my thoughts on it. In this letter, I will further discuss some of those thoughts, but I will also discuss some particular concerns I have about Jack Coffee's memorandum, and especially its premise.

The driving concern underlying the idea of company registration clearly is the reduction of the cost to issuers of raising capital. This is an important and worthwhile concern, and the Commission already has, through integrated disclosure and the shelf registration process, made significant strides towards achieving that goal. At the risk of sounding somewhat like a securities fundamentalist, however, I think it is important to point out that this is not one of the primary goals of Federal securities legislation -- indeed it is only implicit in Section 2 of the 1934 Act which expresses the desire that such regulation as is mandated be "effective." Rather, the concern for reducing the cost of raising capital is both a legitimate policy concern in terms of enhancing market efficiency, the competitiveness of American industry and the overall success of our economy, and a political concern expressed by those who believe that Federal regulation interferes with individual and issuer autonomy. But it was not, and is not, one of the fundamental concerns underlying the creation and continuation of our securities laws. I stress this point at the outset because I think it is critically important to remember that you are dealing with legislation and regulation that is, first and foremost, consumer protection, and that the Committee not lose sight of this critical goal in its attempt to improve efficiency.

That having been said, I think that the idea of company registration has some merit. But the issuance registration process would need to be replaced by far greater emphasis on periodic reporting, and not just for its informational content. I am

concerned about preserving the prophylactic function of disclosure that, based on my own practice experience, is best realized in the registration process. Specifically while the Background Paper acknowledges the important role of staff comments and underwriter due diligence in ensuring the accuracy of disclosure (p.12), it ignores one of the main benefits thought to be achieved by disclosure, and that is ensuring the good behavior of corporate management. (Recall, for example, Brandeis's argument in Other People's Money.) The need to present extensive and detailed information not only about the issuer's financial affairs but of conflict of interest transactions and the like undoubtedly causes managers and controlling stockholders to think twice before engaging in such transactions, or at least to eliminate them prior to the public flotation of securities. It is my impression, at least, that the periodic disclosure process does not presently have this effect, both because of rather sloppy incorporation by reference of other materials into 10-Ks and because of the more limited distribution of detailed information (that is, filing with the Commission). It may well be that Annual Reports could be made to do this work, but I'm not sure that they do so under current practice. I suppose I continue to adhere to Bill Cary's view of securities disclosure as an important supplement to the governance requirements of state corporate law (which I recognize is an unfashionable view), but it is one that I think is important and to which the Committee should pay some careful attention. An excessive focus on facilitating efficiency in capital formation may well result in the loss of significant, if intangible, consumer protection.

Now to Coffee's point. His proposal is a fairly modest one, it seems, based on Rule 144A as it currently stands. But his premise, that of increasing the role of institutional investors in capital formation, has some potential problems. My main concern is with the steady concentration of corporate capital that Brancato has been tracing, and while it is a somewhat intangible concern, there are some more practical potential problems as well. In the first place, while Coffee is right that institutional investors as we know them were not significant players at the time of the adoption of the securities acts, he is in a meaningful way quite wrong. Individuals played some of the role that institutions now do, as Joel Seligman describes in the opening chapters of his history of the Commission. True, these individuals did not, as current institutions now do, aggregate the investment capital of millions of Americans. But by virtue of their ownership of much of American industry (and certainly our most important industries), they wielded much of the power institutions now potentially hold.

I have previously expressed my concern that this concentration of capital in institutions has the potential to foster short-termism in American business management (Vanderbilt Law Review, 1992, copy enclosed), and I won't bore you by rehashing that argument now. But there are real benefits to taking measures that further democratize, rather than concentrate, capital markets. Institutions, whether mutual funds, pension funds, or the like,

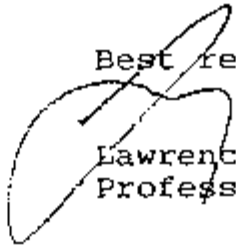
have their own relatively narrow set of goals and incentives to accomplish them. Of course these goals really boil down to the maximization of current returns (including growth in capital value). But the human beings who are the beneficiaries of these institutions, who are themselves potential players in the market, do not have such a limited world view. To take a simple example, while the General Motors pension fund has the goal of increasing its wealth and its ability to make required distributions, the workers who are the potential beneficiaries of that fund probably most care about keeping their jobs. This is not a value that is likely to get reflected when fund managers attempt to influence management. While any particular goal such as this one might not be reflected in corporate governance in any particular case, the dilution of concentration of ownership might have the effect of at least avoiding an unduly narrow market focus. At a minimum, it would free managers from the pressure of a particularly strong interest group with a very narrow interest.

We know that dispersed ownership has problems too, particularly in terms of monitoring corporate management. But I do not believe that the solution is to encourage concentrated ownership. One might argue that the liberalization of Rule 144A would enhance dispersion by permitting freer distribution of privately placed securities. But since many of these transactions could be expected to be inter-institutional, I'm not sure that this is the case. It would, however, create incentives for tighter relationships between issuers and institutions that I am concerned would in the long run increase the concentration of ownership that so worries me. Finally, and particularly in light of these close relationships, I would think that the insider trading rules and Rule 10b-5 ought to be significantly strengthened before creating a greater role for institutions in the capital formation process.

I realize these thoughts are somewhat general, and if you think it would be useful would be happy to make them somewhat more concrete. While general, however, I think that they address important policy concerns that seem to be missing from the Background Paper and from Jack's memo.

Please don't hesitate to call if you'd like to talk further, or if you'd like me to do some further work.

Best regards,



Lawrence E. Mitchell  
Professor of Law