Address by

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At the outset I wish to thank your Chairman for this opportunity to revisit beautiful San Francisco. I must also hasten to confess that I am not prepared to live up to the advance billing--I bring you no revelations concerning a new approach to old problems at the Securities and Exchange Commission. Indeed, while familiar problems have not moved off-stage, our principal concerns this past year have arisen from, and in coming years will undoubtedly be related to, a host of new problems and to older problems in new clothing.

Preliminarily, I should like to give you a brief accounting of our accomplishments, not to prove to you that the taxpayer is getting his money's worth, but to provide the context within which my remarks should be considered.

During the fiscal year ended June 30, 1962, the Commission processed 1844 registration statements under the Securities Act of 1933, an all-time high and more than twice the 810 statements disposed of during fiscal 1958. Ninety-five new investment companies registered under the Investment Company Act of 1940 during the past year as compared with 42 new companies in fiscal 1958. We referred 64 cases to the Department of Justice for criminal prosecution, more than four times the number referred in fiscal 1958. Other enforcement activities continued at extraordinarily high levels. Approximately 88 injunction actions for violations of the securities laws were filed last year, 121 administrative proceedings were instituted under the Securities Act of 1933 and the Securities Exchange Act of 1934 alone and approximately 555 investigations into possible violations of these acts were opened.

Although these statistics do not reach all areas of Commission responsibility, they reflect the vigor with which the Commission and its staff has, under the leadership of Chairman Cary, undertaken to meet an ever-rising workload, to reduce and, hopefully, to eliminate backlogs and delay. Because it is an aspect of our work with which most of you may be familiar, I shall mention only, by way of illustration, the sharp reduction effected, under trying circumstances, of the time required for the processing of registration statements for new issues.

For the longer term, these figures point up the changes which have occurred in the securities markets during the decade of the 1950's. The spectacular increases in the volume of trading, in the number of new public issues, broker-dealers and their salesmen, in the size and number of investment companies, and in public participation in our capital markets have raised questions whether existing securities legislation, as implemented and supplemented by the rules and procedures of the Commission and of certain other organizations, are adequate to meet the burdens and challenges of the 1960's.

The Commission will shortly submit to the Congress an elaborate study, by the Wharton School of Finance and Industry, of certain effects of the great growth of mutual funds in the past two decades. We are now studying this report to determine what lessons it has for us and for the industry. I am sure that others, concerned with the protection of investors and with the further development of mutual funds as an investment medium and as a source of capital, will find the study important and provocative.

Early in the year, the Commission published a staff study of Puts and Calls and their place in the securities markets. In January, the Commission issued a report of an investigation of the American Stock Exchange. This led to a major reorganization of that Exchange and to the adoption of a new constitution, and of new rules and procedures, designed to deal with problems discussed in the report and otherwise to improve the operations of the Exchange.

Substantive questions pertaining to the distribution and trading of securities, the recruitment and training of salesmen, the organization and operation of important market mechanisms, and a number of other matters related to those questions and to the earlier studies mentioned, are currently under study by a special staff of the Commission pursuant to authority of a Joint Resolution of the Congress. Our staff is engaged in various stages of fact gathering and evaluation and will not be prepared for some months to report its findings and recommendations. A discussion of these must, therefore, await a future date and another forum.

You should now be persuaded that the Commission is going through a period of intense study and reassessment. We have not felt, however, that the development of policy and the assumption of other regulatory responsibilities should await completion of these studies. The past year has been marked by the development of many new rules and the reconsideration of old ones, the adoption and publication of important statements announcing new or revised policy or statutory interpretations of general interest to industry and to the professions practicing before the Commission, and by the articulation, in particular cases, of the Commission's understanding of relevant statutory standards and requirements.

Not all of these actions have been free of controversy. I think it fair, however, to suggest that each has contributed to a wider understanding of relevant requirements or, at least, of the Commission's views as to those requirements. Chairman Cary's address to the Section of Corporation, Banking and Business Law yesterday, and the panel discussions which followed, demonstrated the value of these actions by the Commission in stimulating interest in and discussion of the problems, old and new, with which you and we must wrestle nearly every day.

So much for our activities during the past year. With your permission I should like now to turn to certain problems which are not peculiar to the S.E.C. and concerning which criticism is shared by many of the "independent" commissions as well as the executive departments which perform, to an increasing extent, rule-making, licensing and adjudicatory functions.

Ten years ago, the late Mr. Justice Jackson noted that "The rise of administrative bodies probably has been the most significant legal trend of the last century and perhaps more values today are affected by their

decision than by those of all the courts . . . ." 1/ Many of you would add that his remarks are even more timely today. Granting that there may be contraction in some regulatory areas, the growing complexity and interdependence of our own and other economies, the concentration of power incident to the increased size of individual business institutions, and the burdens attendant on a widening of international responsibilities foreshadow a continuing and significant role for administration regulation.

During the past year, I have been privileged to participate in a provocative and invaluable experience--the work of The Administrative Conference of the United States. 2/ Established on April 13, 1961, by an Executive Order of the President, and sparked by the Chairman of its Council, Judge E. Barrett Prettyman, recently retired from a distinguished career on the Court of Appeals of the District of Columbia Circuit, the Conference is composed of 85 members, including its Council, drawn from government, business, the professions, and the academic world on the basis of their broad experience and keen interest in the administrative process.

In committee and council meetings, and in plenary sessions, the Conference is attempting to generate possible solutions for the vexatious and continuing problems involved in the conduct and expedition of administrative proceedings, internal delegation of authority, separation of functions, the role of the hearing examiner, ex parte communications and many other matters. The final report of the Conference, which is to be submitted to the President in December of this year, should provide some yeast for the fermentation necessary to maintain a vital and efficient administrative process. More important, perhaps, is the possibility that the Conference will serve as the forerunner of a permanent organization to provide continuing study and suggestions for the betterment of administrative procedure and organization in a manner roughly similar to the way in which the Judicial Conference serves the federal court system. 3/

The Conference had its genesis in, and its work is being conducted against a background of, dissatisfaction with administrative agencies. The criticisms reflect conflicting philosophies. Some charge that the agencies have abandoned the public interest and become captives of industries they are supposed to regulate. Others say that administrators are guided either by outmoded concepts or by excessive zeal and that their activities often serve only to stifle the growth of vital sectors of the economy. These points of view find a common meeting ground in complaints against delay too frequently characteristic of the administrative process. 4/

1/ FTC vs. Ruberoid & Co., 343 U.S. 470, 487 (1952) (dissenting opinion).

2/ If you will pardon a personal aside, I should also mention that, during the past year, I found myself in the center of a controversy which has added a new chapter in administrative law.

3/ I should pause at this point to announce that all of you are cordially invited to attend a panel discussion on the work of the Conference to be conducted at 10:00 a.m. tomorrow at the Sir Francis Drake Hotel.

4/ Recent efforts to award a gold medal to Dr. Frances O. Kelsey of the Food and Drug Administration suggest that, in some situations, a lack of expedition is not always deemed to be contrary to the public and private interests involved.

A more fundamental criticism rests on the view that the agencies have demonstrated an inability to develop and to apply cohesive and consistent regulatory policies from which can be evolved standards sufficiently definite to allow a reasonable measure of predictability and certainty in the administrative process. The failure of the agencies to make more definite and certain the broad statutory policies under which they operate, it is argued, has impeded the commitment of capital and other resources necessary for economic growth, rendered inefficient the internal administration of government, created an appearance of arbitrariness in administrative decisions and made the agencies susceptible to improper pressures which threaten their independence and integrity. 5/

It is undoubtedly true that, in many areas of regulation now treated only on an ad hoc basis, administrators can and should formulate consistent policies and develop more predictable patterns of regulation. But the quest for certainty should not, I believe, be satisfied at the expense of informed and responsible flexibility. We ought not forget that the reason for substituting the administrative process for the more formal process of traditional judicial systems was the view that solution of the many faceted and ever-changing problems, involved in applying a general statutory standard to an increasingly complex world, required concentrated and continuous study, a task for which the courts were unsuited. 6/ It was supposed that the familiarity so developed would provide flexibility by adjustment of policy, interpretation or procedure to deal not only with the many different problems presented, but also with changes wrought by technological advances.

We must be careful lest the search for ultimate certainty and predictability rob the administrative process of the vitality and viability essential to meet the challenges of a rapidly changing world. Detailed statutes or rules, originally well-conceived to meet existing situations, often become encrusted with tradition and, in time, ill-adapted to the changes wrought by the fast pace of industrial and social development. I am sure that many of you have been faced with tax problems which have arisen solely because of attempts to reach ultimate certainty by what has been described as "The Sanctification of the Statutory Solution." 7/ It has been

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5/ Redford, National Regulatory Commissions,--Need for a New Look (1959); Friendly, The Federal Administrative Agencies: The Need for a Better Definition of Standards, 75 Harvard L. Rev. 863 (1962); A Look at the Federal Administrative Agencies, 60 Col. L. Rev. 429 (1960).

6/ "To a large degree they [administrative agencies] have been a response to the felt need of governmental supervision over economic enterprise--a supervision which could effectively be exercised neither directly through self-executing legislation nor by the judicial process." F.C.C. v. Pottsville Broadcasting Co., 309 U.S. 134, 142 (1940) (Frankfurter, J.).

7/ Cary, Reflections Upon the American Law Institute Tax Project and The Internal Revenue Code; A Plea for a Moratorium and Reappraisal, 60 Col. L. Rev. 259, 265 (1960).

suggested that such solutions sometimes have a tendency to produce precisely the effect sought to be obviated. As Professor Brown has put it, ". . . as elaboration of the statute seeks certainty and to avoid administrative responsibility, its very complexity calls for an ultimate surrender to administrative discretion." 8/

Demands for certainty have been accompanied by attempts to achieve uniformity in administrative practice within familiar judicial molds. Again, an attempt to confine a process, deliberately withdrawn from the judicial arena and unsuited to it, may serve only to defeat the aims of its sponsors. Those of you who have had occasion to appear before more than one of our federal regulatory agencies must have been struck by their widely differing nature and functions. While certain common procedural requirements are susceptible of, and should receive, more uniform treatment, the problems involved in rate-making, in awarding monopoly air rights, in revoking a broker-dealer registration or in authorizing changes in the capital structure of a large enterprise have little in common and provide little basis for a common framework. To encompass the full range of the administrative process within detailed and undifferentiated rules of procedure would afford administrative agencies and practitioners no latitude for the use of their specialized experience to achieve fairer results by simpler methods. Such proposals have a large potential for unnecessary delay and complexity. 9/

The barrage of criticism has tended to obscure the fact that, in most cases, administrative agencies have implemented a broad and indefinite statutory standard with rules, policies and procedures which provide a workable blend of predictability and flexibility, and that refinements and improvements are constantly being achieved. Innumerable examples of effective action by other agencies can be cited. I will limit myself, however, to illustrations based upon my own experience at the S.E.C.

Sections 6 and 7 of the Public Utility Holding Company Act of 1935 require S.E.C. approval for certain kinds of financing of registered electric and gas utility holding companies and their subsidiaries. The effect of these provisions is to confer on the Commission a large measure of discretionary authority over the capital and debt structures of such companies. While

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8/ Brown, An Approach to Subchapter C, 3 Tax Revision Compendium--Compendium of Papers in Broadening The Tax Base, 1619, 1620, House Committee on Ways and Means, 86th Cong., 1st Sess. (1959).

9/ It is noteworthy that, after considerable debate and exploration of all shades of opinion, The Administrative Conference has made recommendations, in such areas as finality and review of initial decisions by hearing officers, and ex parte communications, which would permit the agencies sufficient flexibility to develop procedures and codes best suited to the problems and needs recognized within their own areas of responsibility. I think it fair to note also, however, that the exposure of agency representatives to the rules, procedures and practices of other agencies of the government, as well as to the experience of those who practice before them and to the scholars who have made the administrative process a lifelong study, has already modified parochial points of view regarding the use or adaptation of procedures found effective elsewhere. This may well be one of the great achievements of this and any continuing Conference.

the Commission's jurisdiction in this area, contrary to Parkinson's law, has gradually receded as the great holding company systems constructed during the 1920's and 1930's have completed the reorganization process contemplated by Section 11 of the Act, the Commission still retains jurisdiction over one fifth of the electric and gas utility assets in the United States aggregating $12 billion in value.

Recognizing that an unbalanced capital structure and an inadequate equity cushion were prime causes of the grave financial distress suffered by the utility holding companies in the 1930's, the Commission in the landmark case of El Paso Electric Company, 8 S.E.C. 366 (1940) enunciated the so-called 50-25-25 policy, i.e., that long-term debt should not exceed 50 per cent of total capitalization and surplus and that common stock equity should not be less than 25 per cent. Although this policy was generally adhered to for the next twelve years, it was applied with modifications justified by the particular needs and financial condition of each individual company. In 1952, the Commission took note of the improved condition of the industry and, in the Eastern Utility Associates case, 34 S.E.C. 390, adopted the so-called 60-10-30 policy which permitted debt financing up to 60 per cent of total capitalization. More recently, in the Kentucky Power Company case, Holding Company Act Release No. 14353 (1961), the Commission approved a financing which raised the long-term debt ratio to 65 per cent, retaining, however, the 30 per cent minimum equity stock requirement.

I recite this history as an instance of the orderly development, through the decisional process, of standards which are definite and predictable and yet sufficiently flexible to meet the changing needs of the industry and the particular circumstances of individual enterprises. Continuing exposure of the Commission to the financial requirements and the problems of a growing industry provides for change and adjustment to meet them on a basis which affords, at the same time, necessary protection to investors and consumer interests.

The rules governing the solicitation of proxies provide another and somewhat different arena for evaluation of the criticisms directed against the administrative process. Under Section 14(a) of the Securities Exchange Act of 1934, it is unlawful to solicit proxies with respect to any security registered on a national securities exchange "in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors." Similar rule-making authority, as well as authority to issue orders in individual cases, with respect to the solicitation of proxies from security holders of registered holding companies and their subsidiaries is contained in the 1935 Act. A more sweeping grant of authority or, as some might have said, a more disturbing instance of "delegation run riot," could scarecely be imagined. 10/

10/ In discussing a similar broad delegation of authority the Supreme Court said in the Pottsville Broadcasting Co. case, supra fn. 6, p. 4, that "While this criterion is as concrete as the complicated factors for judgment in such a field of delegated authority permit, it serves as a supple instrument for the exercise of discretion by the expert body which Congress has charged to carry out its legislative policy." (309 U.S. at 138)

But the record shows that the Commission has moved with great restraint, and yet with deliberate speed, in this complex and sensitive area which affects a broader spectrum of the nation's larger corporations than most other provisions of the federal securities laws. In six major and comprehensive revisions, the proxy rules have developed into what has been termed the Commission's most effective disclosure tool. They have compelled the furnishing to shareholders of the information and procedural safeguards necessary to informed and effective exercise of their corporate franchise, provided them with a mechanism for democratic expression of views with respect to company policy, and afforded the Commission and the parties a measure of control in the often frenzied climate of proxy contests. No less important, however, is the fact that the proxy rules, and the informal procedures under which they are administered, have provided an effective means of achieving a reasonable degree of certainty of compliance with statutory requirements.

I might mention another field in which the Commission has developed detailed rules designed to provide a fair measure of certainty. Those of you familiar with the techniques of securities distribution will agree that the line between manipulation, which is unlawful, and stabilization, which is deemed necessary to orderly distribution, is at times a shadowy one. For almost two decades it was felt that the promulgation of rules providing clear lines of distinction was impossible or, at least, so difficult as to be discouraging. Nevertheless, the experience acquired by the Commission in dealing with these problems on an ad hoc basis ultimately made possible the adoption of rules which, albeit complex, do provide guidance even to the expert in this very difficult field.

Rule-making, however, has its limitations. Rules are thought to be most useful when they provide precise definitions and standards. While these aims, as I have noted, frequently are achieved, many questions arising under the securities and other laws, although of a recurring nature, are not susceptible to the precision of language, and certainty as to effect, demanded by some. Moreover, as I have already noted, serious questions have been raised whether attempts at such precision are in the best interests of all concerned. Nevertheless, the Commission has considered that, to the extent possible, it should provide general guidance to those subject to its jurisdiction. It has been a long-established tradition at the Commission to issue statements of policy and interpretative opinions on many questions of wide interest. This practice has continued and, indeed, been accelerated during the past year. They have run the gamut from equity funding and the duties of broker-dealers to certification by independent accountants in new audits.

Some of you in attendance at the symposium conducted yesterday by the Section on Corporation, Banking and Business Law may have noted that these efforts are not wholly free of criticism. Unfortunately, the securities statutes are studded with provisions which give rise to interpretative questions not susceptible to meaningful generalization. These can only be

answered by an examination of the particular circumstances of each case. Examples with which most of you are familiar include questions of control and investment intent for the purpose of compliance with the registration requirements of the Securities Act, and the question of what constitutes a material fact required to be disclosed in documents filed with the Commission or transmitted to security holders. The Commission has always been sensitive to requests for assistance from persons who seek to comply with relevant requirements and to avoid violations which may trigger enforcement action by the Commission or bring crushing civil liabilities. A variety of informal administrative techniques and procedures have been fashioned to provide such guidance. Pre-filing conferences with members of the staff are frequently conducted in cases where special problems might unduly delay the processing of the materials filed and disrupt the time schedule for the distribution of new issues. After the filing of the registration statement, the well-known letter of comment has proved to be an effective method for transmitting the staff's suggestions and comments as to deficiencies in the required documents where it appears there has been a bona fide effort to comply with the disclosure requirements. It is only when a registration statement appears to be conceived in fraud, or drafted in disregard of the statutory requirements, that the staff's cooperative endeavors are replaced by the formal proceedings contemplated by the statute to test its accuracy or adequacy.

Similar informal procedures, affording easy access to the Commission's staff and, indeed, to the Commission itself, characterize administration of the proxy rules. This is an activity in which promptness of agency decision and action is of paramount importance if corporate proxy machinery is to function in an orderly fashion and compliance with the regulatory requirements is to be effectively enforced. The Commission's performance under the proxy rules--a context in which time is seldom sufficient for exhaustive investigation and deliberation--is a prime example of the capability of the administrative process to operate with rapidity and decisiveness to carry out a significant regulatory function.

Apart from these informal procedures employed in the processing of material required to be filed with the Commission under all of the statutes administered by it, the Commission's staff each year, in its central and regional offices, issues thousands of interpretative opinions to industry representatives and to other members of the public. Some of these are given over the telephone when the urgency of the question requires it; many emerge from extensive face-to-face discussion; others have the status of the familiar no-action letter in which the staff indicates that, on the basis of stated facts, it will not recommend that the Commission object to the proposed transaction. Relatively simple and routine interpretations are rendered by staff attorneys, accountants and analysts. More novel or complex questions receive serious consideration by the Chief Counsel and the Director of the appropriate Division as well as by the Commission's General Counsel and Chief Accountant. Many are brought to the attention of, and cleared through the

Commission itself. Some of you may have noted that S. 2135 is moving up on the legislative calendar. When enacted into law, this bill will, by providing the Commission with power to delegate certain of its authority, make possible the development of additional procedures designed to expedite the flow of work and to permit the Commission to devote its energies to important policy matters.

Despite their obvious utility, it has been suggested that these informal procedures be subjected to a high degree of judicialization. Many of these procedures, developed to provide guidance with regard to matters within the Commission's jurisdiction, would be subjected to requirements now applicable to adjudicatory proceedings. Some of these proposals are so broad, for example, as to suggest that informal opinions in particular matters, made upon request of interested persons, as well as general interpretative releases and statements of policy, would be subject to prior notice and opportunity for hearing or comment, with an ultimate right of appeal to the courts.

It is submitted that such formalization would hamper the efficiency of administrative agencies and would not be in the public or private interest. Informal advisory opinions do not determine private rights and obligations. Nevertheless, if circumscribed by the procedural requirements of formal adjudication or rule-making, the agencies could no longer permit "spot" interpretations in particular cases by members of the staff. Each proposed interpretation would travel a many-runged ladder of review for careful consideration by high staff officials as well as by the members of the agency. Precision of language and detailed statements of rationale would be imperative, if misplaced reliance by the public and misconstruction by the courts is to be avoided. Where delayed decision too often is no decision at all, and unprecedented workloads have already created intolerable strain, the path toward efficient administration would be lost in a swamp of procedural complexity. 11/

Informal procedures such as those employed by the S.E.C. have been termed the "life blood of the administrative process" 12/, and the Commission is proud of its pioneering role in their development. Its efforts in this regard have also received favorable comment in the report of a Task Force of the second Hoover Commission 13/ and in the more recent Landis Report. 14/

11/ In the Pottsville Broadcasting case, supra, fn. 6, p. 4, the Supreme Court stated that (309 U.S. at 145): " . . . differences in origin and function preclude wholesale transplantation of the rules of procedure, trial and review which have evolved from the history and experience of the courts . . . [Administrative agencies] should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties. [footnote omitted]"

12/ Final Report of the Attorney General's Committee on Administrative Procedure (1941), pp. 58-59.

13/ Commission on Organization of the Executive Branch of the Government, Task Force Report 4 on Legal Services and Procedures (1955) at pp. 189, 191.

14/ Landis, Report on Regulatory Agencies to The President-Elect (S. Comm. Print 1960) at p. 46.

So far as I know, they have been widely applauded by industry and by the securities bar, for they have engendered a healthy spirit of cooperation between the regulators and the regulated by fostering understanding of each other's problems and goals and by reducing the friction between the public and private interests involved. And they have worked well without danger to the orderly development of substantive and administrative law and procedure. They merit not cumbersome restriction but careful examination by those interested in minimizing delay, increasing certainty, and vitalizing flexibility in the administrative process. In my view, the utility of the administrative process will be heightened to the extent that administrators are encouraged to introduce, without sacrifice of any basic right of any person affected, greater flexibility and less, rather than more, rigid procedures in the performance of their responsibilities.

I have described some of the techniques used at the Commission. It is recognized that other agencies, unlike the S.E.C., are subject to special and difficult problems arising not only from restrictions found in their organic statutes but also from the demands of conflicting private interests for limited, in some cases exclusive, franchises of great economic value. Nevertheless, many of the practices which have proved so effective at the S.E.C. are mirrored in other agencies in procedures developed through years of trial and error and dedicated concern for efficient administration of law. Undoubtedly much room for improvement remains. Yet, if the administrative process is to meet the challenges of heavier loads and unanticipated needs, it should not be stifled by attempts to achieve procedural uniformity, for the sake of uniformity itself, or compelled, in the interest of absolute certainty and predictability, to relinquish reasonable freedom to experiment. Indeed, the criticism which should give most concern to administrators, and to others interested in good government, is that not enough courage imagination or time has been allocated to the development of new techniques and policies or the modification of old ones, to meet the demands of changing times and fresh problems. While ever-mounting burdens of day-to-day work and the almost inevitable lag between personnel requirements and budgetary provisions have contributed to this result, blame cannot fairly be attributed to these factors alone. 15/ Correction of these faults should be our common aim.

15/ In this connection, mention should be made of one difficult problem we face at the S.E.C. and which, I believe, is common to many other agencies--the retention of a "middle" staff, that is, persons who have been with the Commission more than three and less than fifteen years. Indeed, this is a problem of all government. While we have little difficulty in attracting excellent young people, the greener pastures of private industry induce many to leave us after they have enjoyed a brief post-graduate education. This places a special burden on senior employees and affects our ability to do our jobs effectively. Unnecessary formalization of techniques, which have proven to be useful and expeditious, would aggravate this problem.

It must be recognized, however, that flexibility has its limitations. I will conclude my remarks with an illustration of the danger in carrying it too far. Mr. Cooper has told you that I plan to go abroad soon. In reviewing some literature about a country I intend to visit I came across the following item:

"A resident sent in an application for a telephone together with a doctor's note to obtain priority on medical grounds. In due course she was advised that a priority had been granted and that a telephone would be installed with a minimum of delay. After a month passed, the applicant wrote, complaining of the delay. She received a terse mimeographed reply stating that the request had been received and rejected. Outraged, she made her way to the official whose signature appeared on the letter and demanded an explanation. 'There's nothing to get excited about,' explained the official calmly. 'You'll have your phone next week. It's just that we ran out of the mimeographed letters confirming installations and we're using the rejection form instead for the time being.'"