

An Address

by

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Most of the talks which I have been giving to groups here and there have fallen into the category of literary composition known as "exposition." They have consisted largely of statements about specific plans, techniques and problems. Today I would like to be a little more general and philosophical.

In the operation of that great complex machine of business enterprise in corporate form, you as corporate secretaries and we as commissioners are in a sense technicians. We each have our separate and distinct responsibilities in keeping the machine running the way the law intends it to run. And you know and we know that occasionally there are those about the shop who want to run the machine in a way that the instruction book says it should not be run.

Metaphors and analogies are always misleading, of course. What I am trying to say is this. Operation of the corporate form of enterprise calls for the collaboration of many types of talents. It needs imagination and daring in the matter of engineering, production and selling. It needs judgment, analytical ability and integrity, and perhaps the gift of prophecy in the matter of financing. It needs administrative skill and a warm human understanding in handling the multiple problems of personnel. But it also needs people whose primary responsibility is to see to it that the game is played according to the rules, and that's where we fit in. And by the word "we" I mean you, your corporate counsel, your corporate controllers, the independent accountants, on the owner-management side and regulatory commissions on the government side.

What I have said is more than a cliché. The effectiveness with which we accomplish our respective tasks is enhanced or diminished as we appreciate or fail to appreciate our relation to the whole scheme of things. Consequently, I want to discuss in still more detail your duties and ours in the operation of our corporate system.

Let me remind you first that the corporation is an artificial entity. It is a creature of the state, having no existence apart from that which is breathed into it by operation of law. Since the law is the parent of its corporate creature, it is not to be wondered at that the law hedges corporate enterprise about with more rules than it does individual activity.

Corporations are empowered to do only what the law says they may do. Their directors have duties as to good faith and prudence. Their property must be handled with due regard to the rights of creditors and stockholders. Their relations to one another must be subject to some control. To implement these general principles, many detailed rules and techniques have been developed.

The system of corporate enterprise has worked, perhaps better in the United States than anywhere else, but there have been some anxious moments. To keep it working there has evolved over the years a complex scheme of legal controls. These controls have related, among other things to:

- (a) formal requisites as to organization,
- (b) limitation of corporate power,
- (c) duties of officers and directors as to good faith and prudence,
- (d) duties and limitations, both of the corporation and its management, in connection with financing,
- (e) rules relating to consolidations, mergers and other combinations of corporations,
- (f) regulation of both restraints of competition and practices creating ruinous competition, and
- (g) regulation of bankruptcy and reorganization.

Some of these matters are regulated by state law; some by Federal law, some by both. Some of the legal principles governing corporations have their origin in the common law. In the early days of corporate enterprise, some of the limitations on corporate activity were more severe than they are today. The laws of many states once did (and some laws of some states still do) forbid corporations to be organized for more than one purpose. Time was when no corporation could own the stock of another corporation or reacquire

any of its own stock. The ability of corporations to affect the rights of existing security holders by recapitalizations, reclassifications, mergers and consolidations was once more limited than it is today. The relaxation of some of these restrictions created problems which in turn caused the imposition of other limitations. For example, the extension to corporations of the right to acquire stock of other corporations provided an opportunity to create holding companies and investment companies. Now we have a Public Utility Holding Company Act and an Investment Company Act. And as you know the subject of bank holding companies has been under discussion in Congress for years.

If we look back objectively over the last century and a half and examine what has taken place in the legal regulation of corporate enterprise, we conclude that the American people, organized in Federal system of state and national sovereignty, have in fact been almost continuously engaged in a process of building up gradually legal techniques to solve as they arose, the long series of specific problems which arose as the American economy expanded and became more complex.

First we had corporations by special act of state legislatures. Then we had what now appear to be rather rudimentary general corporation laws which quickly became encrusted with amendments. Then more modern corporation laws were devised, some of them designed to attract corporations to particular states, others designed to codify what had become accepted legal principles. The effect on public interest of corporations engaged in the operation of public utilities resulted in the enactment of the Interstate Commerce Act and its amendments, many state public utility regulatory acts, the Federal Power Act, the Federal Communications Act, the Civil Aeronautics Act. The interstate character of the consequences of corporate activity and the growth of large business combinations called forth the Sherman Antitrust Act, the Clayton Antitrust Act, the Federal Trade Commission Act and the Public Utility Holding Company Act of 1935. Abuses in the raising of capital called forth the state "blue sky" laws but the activities those laws sought to control were interstate and that fundamental economic fact necessitated the enactment of the Federal Securities Act of 1933 and the other laws administered by the Securities and Exchange Commission.

I mention these things which are as well known to you as to me as background material. I mention them also because the very tracing of this development will recall to your mind that the evolution of corporate enterprise and of the legal techniques which control it has been relatively constant and has always been accompanied by resistance, dispute and controversy. That last fact is important. People do not rise up and argue about things in which they are not interested.

People, and I mean people generally not just those directly involved, are interested in making our system of corporate enterprise work because they know that the United States has grown economically strong and great under that system. Moreover, in today's state of technological advance, material life as we know it today - automobiles, airplanes, washing machines, newspapers and television - cannot go on without large aggregations of capital at work to keep it going. The corporation is the agency which gathers together and administers the capital. The only alternative agent would be the state. Think about that for a while, if you have any idea that making our system of corporate enterprise work is not a subject of supreme public interest.

Public opinion - articulate public opinion - on the subject of private corporate enterprise ranges all the way from the "no controls - leave everything to management - tell the investor what you think he should know" school of thought to the school of thought that would socialize all major enterprise. The critics of our present corporate system are naturally motivated by their ultimate objective, whether it be unregulated freedom on the one extreme or socialism on the other. However, I submit that the vast majority of criticism is, and historically has been, directed to making the system work better, to correcting actual or potential abuses and to adapting the system to the problems of the times.

The attacks on corporate enterprise generally fall into three categories: (1) attacks on size or monopolistic tendencies; (2) attacks on abuses in the raising of capital; and (3) attacks on abuses by management.

The Federal anti-trust laws and the common law on restraint of trade deal with the subject of monopoly and restraint of competition. I am not going to discuss those subjects. The

Federal securities laws and the state "blue sky" laws deal with abuses in the raising of capital. There is a cross-crossed pattern of Federal and state statutory regulation as well as a considerable body of common law concerning the relations of management to the corporation and to its stockholders and creditors. The fact that the law, both with respect to the problems of raising capital and the regulation of management, is both Federal and state, raises, of course, innumerable problems and complexities.

And so we come to this. You as corporate officers and we as regulators are trying to keep in working order a system that is very complex, very important - a system which is constantly under attack, and constantly called upon to justify its existence and which must continue to justify its existence in order to survive. Both the complexity and the importance of the problems with which we deal are a challenge to the best in all of us, to the owners, the management and the law enforcement agencies.

It is easy to talk in broad generalities about concepts such as "corporate democracy", "adequate disclosure", "sensible regulation", and even "no unnecessary red tape". It is when we get into specifics that the difficulty begins. Is a certain proposal a proper subject for action by security holders under the laws of the issuer's domicile so that such a proposal should be included in management's proxy material? What if there are no cases or specific statutory provisions on the subject?

Where shareholders are asked to approve a classification of directors - the so-called stagger system - what information are they entitled to have as to the effects of such a system on the results intended to be achieved by cumulative voting? In order that the investing public may be adequately informed by financial reports, how much uniformity in accounting treatment should the Commission insist upon? In connection with enforcement of the liability of insiders for short-swing trading profits, how simple and understandable can the reporting rules be made without creating loopholes for circumvention of the law?

If a deal is negotiated between the parties at arms' length, can the Commission make a statutory finding of fairness without independent investigation? How much information should a company furnish and with what frequency to enable the market to evaluate its securities?

I mention those few things simply to illustrate that the problems in the legal control of corporate enterprise, whether seen from the viewpoint of management or from the viewpoint of the regulatory agency, are not only legion but also difficult.

Sometimes the multiplicity of individual problems tends to destroy the perspective both of Commissioners and staff. I am sure that in your day-to-day work you occasionally feel as we do the need to climb a hill to get away from details and get a view of the job as a whole.

This job which you have and which we have - the job of keeping corporate enterprise in compliance with legal limitations and legal requirements - is not easy. We can sense, and I am sure you can sense from time to time, an attitude on the part of many two-fisted corporate executives which could be expressed in the words "Go away; don't bother me".

But it's our job not to go away. The laws which our Commission administers were enacted to deal with real problems and they have not been substantially amended since their enactment. The people and the Congress have accepted the basic approach represented by those laws. Registration statements, proxy statements, annual reports are part of a firmly established procedure to provide the investor with information as to the enterprise in which his money is invested and as to the stewardship of its management.

It is our job to see that those instruments are truly informative and not merely media for genial expressions of optimism. Our political democracy and our free press both testify to a belief that an organization of people does best when the people who compose it know the facts. The full disclosure concepts of the several securities laws were received in the beginning with grave misgivings. But who can urge today that the duty to disclose has either seriously interfered with the raising of capital or hampered management in developing the economic potential of the enterprise it administers. Of course, it's the duty of the Commissioners not to become worshipers of paper for paper's sake. We are doing our best to keep our work meaningful.

Neither can most other regulators be expected to go away. The present system of corporate regulation has evolved as a result of response to the challenge of real problems.

And it is your job not to go away. You in effect must know legal requirements and limitations; you must understand them; you must interpret them to others; and impress others with their importance; and you must see that they are observed and carried out.

All of that is a big job. Let's break it down a little. Think of the techniques which you must establish and keep in operation merely to assemble and report information: reports under state corporation laws; reports under "blue sky" laws; registration statements under the Securities Act of 1933 and reports under the Securities Exchange Act of 1934; reports to stock exchanges; reports as to security holding of officers and directors; information includible in a proxy statement. It was always a source of wonderment to me when I was practicing law and doing work in corporate financing, that a good corporate secretary could respond so quickly to demands for specific items of information.

Moreover, a corporate secretary is vested with responsibilities for maintaining proper corporate procedures - adequate notice, adequate minutes, proper execution of documents. Oftentimes that isn't easy. Demands for haste and informality, sometimes necessary, sometimes capricious, happen in the best regulated corporate families. I was thinking of that sort of thing when I spoke of impressing others with the importance of legal regulations.

I am not repeating these things merely as a list of the types of paper work you have to do - you could probably add much more to the list. I remind you of these things simply as illustrative of the importance of your part in keeping corporate enterprise in compliance with limitations and requirements which the law imposes. Management relies on you for the day-to-day check on its own discharge of its legal responsibilities. You are a vital part of the mechanics by which management gives an account of its stewardship. It is through you in great measure

that management discharges its common law and statutory duties of disclosure. In the performance of your work, of course, you must make use of the talents of lawyers and of accountants and business machines but to discharge your duties adequately, you must be broadly informed as to the formal requisites of corporate procedure and trained in a multiplicity of administrative techniques.

Your work well performed is, of course, not merely an element in the fulfillment of the abstract legal responsibility of the corporation and its management. It is a substantial element in guarding against action or inaction which might subject management to statutory or common law liability. After all the secretary and, of course, the general counsel, should between them provide the alertness and judgment to prevent both nonfeasance and misfeasance.

I say these things not as a lecture and certainly not as an illustration of any powers for original thinking. I say them because a reminder of the importance of one's responsibilities and of their relationship to the general scheme of things sometimes serves to maintain perspective and to increase the joys and rewards of going about one's daily duties.

I say these things, too, because of an understandingly human desire on my part for you to see that we in Government also have an important part to play in making the system of corporate enterprise work. To return to a thought I mentioned near the beginning of my remarks - The Corporation is a creature of the law. It must, therefore, have its powers, duties, procedures and liabilities prescribed by the law. The law must be administered by the agencies of Government - in the United States, both Federal and state. It is a part of your job to see that your respective enterprises are operated in accordance with law and it is our job to see that you do that part of your job.

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