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News Release

Address

to the

Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association

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"... APPROPRIATE IN THE PUBLIC INTEREST"

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In a recent letter to the Commission, Professor Loss -- the acknowledged Sage of this Committee and of the federal securities Bar generally -- stepped aside from the arguments he was putting forward in his client's particular cause and, in a sad and studied paragraph, raised an issue fundamental to the functioning of the Agency whose pantheon he has so long and learnedly graced: How does the Commission, in 1991, fulfill its statutory obligation to conduct the public's business in the public eye, and, once having taken action in public or having disclosed action to the public, to what extent does the Commission, in 1991, honor the public's right to rely on the policies made or implicit in those actions. I characterize this issue as fundamental, on the basis of observing the Commission over more than a quarter century of securities law practice and more than 5-1/2 years as an SEC Commissioner, because I know of no issue that better gauges whether a government agency is continuing to act primarily in the interests of the public for whose benefit it was created (as opposed to serving and protecting, first and foremost, itself).

Professor Loss has given me permission to quote from that portion of his letter, as the introduction to and summation of the statement of my opinion on this issue. He wrote:

I have no way of knowing whether the [30-plus-year-old public statement that he had cited elsewhere in his letter] still reflects Commission policy. But I know of nothing the Commission has since said to indicate such a basic change. That is to say, any development so fundamental in the Commission's administration of the statute ... should be publicly announced. If the citizen must cut square corners in dealing with the government, the government must be no less scrupulous in dealing with its citizens. (emphasis added)

Professor Loss' wistful recollection of the Agency's erstwhile pride in being openly and self-confidently "scrupulous" in dealing with its regulated and otherwise-affected "citizens" catalyzes into public speech today my ever-stronger reaction against the Breeden Commission's views of its limited responsibility for its public actions and my ever-surer antipathy to the Breeden Commission's practices of avoiding action in the public's eye whenever possible and of utilizing every available avenue to cloak non-public action from the public's review. Professor Loss' recollection also goads whatever lash my words can summon against my own, and your, continued acquiescence that those views and those practices be allowed to persist unchallenged.

At the outset, let me define "the public" to whose interests, in my view at least, the SEC is statutorily mandated

to be faithful. Perhaps the phrase "the capital-markets-related world" conveys the proper scope. Not just (although including) the President and concerned officials of the executive branch along with Congressmen, Senators and Congressional staff members with relevant responsibilities (what might be called "the Washington public"), but, as well, the full portion of 200,000,000 Americans affected for good or ill by the SEC's exercise of administrative authority: investors (individuals and institutions, professionals and customers), those who provide and service markets and market-related facilities, the human beings who work for, manage or direct the myriad of registered and regulated enterprises, the independent professionals who render law, accounting, appraisal or engineering services to registered and regulated persons -- and I'm sure I've left some out. A broad "public", encompassing even those benighted souls who are, or are in danger of being, accused of securities law violations (lest we forget that an SEC complaint or order for proceedings does not equate to a Circuit Court affirmance of liability, civil or criminal). They are all among the "citizens" with whom, in Professor Loss' word, the Commission must be "scrupulous".

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Now, what is the present SEC attitude to conducting that public's business in the public eye? In a phrase: avoid it if there's any excuse. Unlike speeches by Chairman Breeden to applauding audiences, public Commission meetings -- even though conducted as a species of press conference -- have the glimmering potential for real discussion, for exploration of issues from a previously-unconsidered viewpoint, even for persuasion and change of position. They are always rather time-consuming, at a time when so many other matters of consequence to the Agency (new office quarters, new propositions to Congress, new empowerments imitatable from other regulators, new requests by foreign governments for legislative assistance, new jurisdictional possibilities -- all adaptable to the augmentation of the Agency's status in the eyes of its within-the-Washington-beltway audience) await the Chairman's personal review and revision. Public meetings are a bit dangerous, in that they require careful direction lest a process of Commissioners asking questions publicly, suggesting corrections publicly, and sometimes even disagreeing publicly and stating the reasons for doing so in formal dissent, undermine the stage-set designed for announcing, to the press and the public, the Commissioners' ratification of the Chairman's prior decisions. They are therefore rather sloppy, as compared to the efficiency that flows from complete control of the Commission's agenda (including the capability to dictate changes in proposals submitted for Commission consideration even when those changes are dictated as the Commissioners and members of the public await the gavel for a meeting) and from full discretion over the calendaring of all Commission discussions (whether the particular matter has been

under consideration for twelve months or twelve hours and whether the relevant materials or the meeting time have been made available to the other Commissioners ten days or ten minutes before the discussion), all of which have recently accreted to the Chairman.

When public meetings <u>are</u> held, the first mechanism of control (long antedating Chairman Breeden, I should note) is that, unlike at meetings of other financial regulators, only a precis of the matters to be discussed is available for anyone but the Commissioners and the proposing staff. The role of public and media attenders at the SEC's "public" meetings is solely to eavesdrop on the colloquy between staff and Commissioners (even if one of them happens to be the only person in the room with sufficient knowledge to answer a particular question being posed) and to try to intuit the particular subject of any colloquy being overheard. The changes from final draft to published copy apparently might give insight for subsequent interpretation -- as if that isn't precisely a purpose of public attendance.

As an additional control mechanism, Chairman Breeden recently declared that he had promulgated and would enforce a new "rule", namely, that the Secretary's office is "directed to publish, no matter what," each release adopted by the Commission, by five o'clock on the afternoon of the Commission's public discussion and vote. The Commissioners were specifically alerted to prepare any dissenting statements before the vote was taken. This new "rule", if implemented, would reduce to a bare minimum the possibility of post-meeting correction and revision, in response to discussion by Commissioners at public meetings, which, despite Chairman Breeden's contrary assertion, neither "defeats the purposes of the Sunshine Act" nor "defeats the purposes of the processes of the Commission." Quite the opposite, it would be Chairman Breeden's arbitrarily-declared new "rule" that would defeat both those purposes, spaying the function served when Commissioners ask questions publicly and suggest changes publicly, degrading the public meetings, and robotizing the other Commissioners.

To avoid these problems, of course, it is easiest of all to circulate matters, that normally require a public meeting, for determination by consent in writing without a meeting -- and the more clogged the funnel of Commission action awaiting the Chairman's personal approval, the more justification can be adduced by affected staff and regulatees for non-public action simply to get the matter done. And it is nearly as easy to take advantage of the various "may"s and "likely to"s and "illustrative"s in Subpart I of Part 200 of the Code of Federal Regulations to justify a non-public Commission discussion of proposed amicus positions no matter how broadly applicable the proposed positions may be (including amicus positions going to issues explicit in a pending rulemaking proceeding), or of

proposed assertion of quasi-adjudicative jurisdiction even where prior orders have taken a contrary position, or of legislative proposals that could have a bearing, however tangential, on one or more pending enforcement proceedings. Regardless of the general mandate of the Sunshine Act or the intent of its drafters, at the present SEC its effect is to prevent more than two Commissioners from private discussions unknown to the Chairman, the General Counsel, and the Divisional Directors, but its provisions are not allowed to interfere with a determination by the Chairman, the General Counsel and the appropriate Divisional Director that the Commission should consider and adopt policy positions of general applicability without the hindrance and restraint of public observation.

Second, what <u>is</u> the present SEC attitude toward making available for the public's review the Agency's non-public actions? (Let me make clear that I do <u>not</u> include here the conduct by the Enforcement Division of investigative, prosecutorial and litigative functions, as contrasted with general case-transcending policy guidance given by the Commission to that Division, or with issue analysis and discussion done to assist in performing the Agency's legislatively-mandated and judicially-encouraged role as interpreter of the federal securities laws.) In a phrase: assert every statutory barrier and every common law privilege that can be made relevant. The litany of examples leaves me half-crying, half-laughing.

- Screening profiles developed by the staff to aid in determining when to give full review to 1933 Act filings must be protected at all costs. The explanation: some registrant may, somehow, inappropriately avoid review by wriggling through the screen -- as if the purpose of review was to trap the registrant rather than to test and, if proper, to expand disclosure for the benefit both of the investor and the registrant. (How many of you, alumni of the Division of Corporation Finance, already know the structure if not the details of the screens?)
- A memorandum of advice to the Commission from the Office of General Counsel, prepared in a matter that was decided seven years ago, referred to and quoted from by Commissioners in public meetings, and asserting a position that I believe has now been changed, may not be publicly released, even to the author of the memorandum. The grounds: a combination of the deliberative process privilege, the attorney-client privilege, and the attorney work product privilege -- all as to a matter interred these seven years by a Chairman and Commissioners none of whom survives at 450 Fifth Street today.

- A Commissioner may not insist that his or her, or their, disagreement with the majority on a Commission amicus brief be noted for the Court. (Presumably every federal Court believes that all SEC decisions are unanimous.) The reason: there is no rule or practice affirmatively specifying that this can be done, and the Chairman and General Counsel are by hypothesis in the majority (or there wouldn't be a brief).
- In response to Freedom of Information Act requests or discovery demands in litigation, no shield is asserted more broadly than the inter- and intra-Government privilege. It is, I think, both because no one seems to know quite where that privilege begins or ends, and because its assertion conjures up the fear of restraints on the performance of their appointed tasks by government employees, that the mere incantation of that privilege is a surefire winner every time.
- An absence of articulated policy in any arena is, of course, to be denied -- except (as when representatives of this Committee pressed for guidelines for administration of the new Remedies Act) where the Chairman brooks no policy other than the pliancy of case-by-case development. Equally to be denied is the existence of articulated policy when that policy would likely rouse Congressional or media criticism -particularly where the policy is designed to anneal the Commission against the erosion of case-by-case development. And, of course, the inconsistency between those two, and the unifying decisional motive that leads to such conflicting results (namely, the selfprotection of the Agency against the superior capacity of the public to absorb and adapt to regulatory policy once known, and against the within-Washington perception of having been outflanked or coopted), are to be denied as well.
- Last, decisional results that are made in non-public processes on the basis of policy factors that are imponderable -- the ubiquitous notion, for example, that investor confidence will be undermined by anything from the use of permissible (but disfavored-by-the-Agency) corporate charter provisions to pricing formulae that actually require investment managers to analyze value and risk -- are swathed in bureaucratic process and jargon so that the core decision is protected both by camouflage and by market timing. (Who among you represents a registrant that can outwait the SEC?)

If these examples suggest to you a we-versus-them mindset, what I want to remind you is that the "we" is not -- or at least is not supposed to be -- a human individual subject to procrastination, self-protection and ambition, and is not a for-profit enterprise measured by its increase in sales or production units or rank-within-industry year by year, but that the "we" is rather a government agency created, funded and continued by the elected representatives of the citizenry to be an impartial regulator for the public's benefit, and the "them" is the members of that very same public disaggregated into individuals.

Third, what <u>is</u> the present SEC attitude toward the public's reliance on the Agency's public actions, <u>i.e.</u>, toward the SEC's own responsibility for those actions? In a phrase: disclaim reliability whenever possible.

- In the rulemaking process, it is clearer than ever (certainly clearer than when it was first stated publicly two or three years ago) that no staff description or response in a public meeting to a Commissioner's question about a rule proposal puts an interpretative gloss, that can be relied on by the public, on the release text or rule text being discussed.
- Similarly, in the consideration of legislative proposals at a Commission public meeting, not only what the staff describes as the meaning of the draft legislation but what the Commission itself states as to its intentions cannot be relied on -- even if enacted by Congress, without comment, and subsequently signed into law by the President, without comment, in the very words submitted. Chairman Breeden has said that what matters is not what was publicly expressed as being the Commission's collective intention when the legislation was sent up to Capitol Hill but what was in the heads of the legislators (although unexpressed) when they voted on the legislation.
- As to policy decisions, though a majority of renegade Commissioners may, very rarely, force the hand of the Chairman and the Divisional Director to commit to a policy review (as with respect to the Commission's role in bankruptcy proceedings under the 1978 Act) or, even more rarely, to accept an unwanted result (as with respect to the information requirement of Rule 144A), no one should ever rely on or even expect action to effectuate that commitment since, given the Chairman's opposition, the staff will not resubmit the matter until at least some of the renegades have been replaced—and no one else among attenders or commenters is in a position to intervene.

- As to testimony rendered before Congressional Committees, most current testimony is in process of preparation and change to the very last minute, so that the formal proposal and justifications submitted for the hearing record are likely to have evolved well beyond any version "approved" by the Commissioners and may or may not convey the true thrust of the stillsubsequent oral presentation by the Chairman at the hearing itself. While, therefore, the written testimony affords insight into matters not discussed at the hearing, only the hearing transcript evidences positions to which the Chairman (and therefore the Commission) is actually committed. You will understand why I have been amazed (and have expressed my amazement "on the record") that the Breeden Commission should treat the rendering of legislative testimony in a manner that belittles the process, as if to say that these appearances are pure exercises in dramatics for the Congressional stage -- to which I have received the response that that's generally what these appearances in fact are.
- And as to no-action letters (a different species of public action but public action nonetheless), let me put it to you short and clear: you can -- nay, you must -- take into consideration in advising your clients any staff no-action or interpretive position (written or oral) that rejects a proffered argument or position reasonably close to your own, and you can reason from it to your disadvantage (that is, respond to its implications). But only at your peril can you take into your consideration, and reason to your advantage from, a staff position accepting a similar argument or position. And the more high-profile the staff letter in question, the more peril you assume. That's a kind of reliability, I suppose, but limited to the negative direction only.

In sum, the Breeden Commission will not allow the public's attendance, or the Commissioners' participation, in Sunshine Act meetings to be consequential, and will minimize in every possible way the extent and circumstances of public reliance on the Agency's other public actions.

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We reach, then, the questions, "Why does the Commission, in 1991, after nearly sixty years, now think and act this way?" and "What difference does it make?"

I've come to the conclusion that there are four interrelated answers to the question, "Why?"

One answer is psychological in nature: the Agency is institutionally fearful of being committed today to any position that may be too narrow, too exact, too meager to accommodate the ambitions that the Agency adopts as in its interest tomorrow. That's not atypical of federal regulatory departments and agencies, but it does symptomize a loss of vibrancy, of self-confidence, of assurance that the SEC does its job very well today and is in no danger of losing the capability to continue to do that job very well tomorrow.

One answer is managerial: every organization absorbs and reflects the attitudes and practices of its leader.

One answer is professional: neither regulatory agencies nor staff nor even Chairmen venture into waters of this depth and murkiness without lawyers' approval. What has happened over the years (as best I can determine), traceable not to any one individual or group but simply to the never-arrested accretion of practice and the normal human conviction of the correctness of the positions espoused by one's self and one's colleagues, is that the Office of General Counsel rarely any longer exercises the ability -- required of each of you, and of every private lawyer -- to function sometimes as counsellor, neutrally assaying the law, and sometimes as advocate, crafting the best available arguments out of the law. In questions arising under the Administrative Procedure Act, in consideration of self-regulatory organization rule proposals under Section 19 of the Exchange Act, in analysis of interpretive issues bearing on proposed enforcement actions ranging from highly technical broker/dealer financial responsibility violations to matters of constitutional dimension being brought to the Supreme Court -- in public meetings and in closed meetings -- the Commission's legal advisers have almost without exception been advocates for the arguments put forward by the particular Division and approved by the Chairman. I mean "advocates" in the full sense of the old Code of Professional Responsibility -- advocates pressing rather than evaluating arguments, advocates belittling rather than searching for relevant contrary material, advocates reporting on my heresies when I sought assistance in analysis. As just one instance, I recently asked the Office of General Counsel for a written opinion to me and the other Commissioners to support a position with broad precedential sweep as to which I had grave concerns. Having specified both the requirement of an "opinion" and my status as a "client", I received a memorandum of law written in the style of "it can be argued ...", concluding "we believe ... that the Commission may now, under appropriate circumstances, lawfully [act] " although "in a proceeding in which judicial review was sought the result could be uncertain", and followed by a verbal explanation that, unlike in a law firm, such

a memorandum provided the "opinion" I had requested. Not one of you would <u>dare</u> to proffer either the opinion or the explanation! I should have been told "we cannot render such an opinion", but the institutional position, once taken, <u>had</u> to be supported. Hear me well: when the Commission receives from its advisers only advice favorable to the positions being proposed before it, it has become prisoner to its own advocacy -- and you and I and <u>all</u> the public are the victims.

The final answer is philosophical: the Breeden Commission has repressed, once again, the constant, nagging and crucial restraint that "comes with the turf" of federal independent regulatory agency status, namely, that the Agency is a creature of legislation with only the limited authority specifically granted by the elected representatives of the public, and that there therefore is, and always will be, a distinction between its own interests as such creature and the interests of its creators — "the public interest" that it is mandated to serve. (I find it particularly odd to have to remind government officials of that in the third year of the presidential administration of the man whose name is linked to the Report of the Task Group on Regulation of Financial Services.)

When I turn to the question, "What difference does all this make?", I put to you, zealously and angrily, that it makes a great deal of difference.

I don't doubt that the SEC has, and ought to have, a deepbred feel for the propriety of its statutory mandate, its reason for being. High standards of disclosure, particularly with respect to the embarrassing matters that are best disinfected by disclosure; thoroughgoing regulation of professionals in the securities industry for the benefit of customers who place their trust in the honesty and integrity of those professionals; careful public-utility-type regulation of any aggregation of public funds for investment in instruments that fall within the broad definition of "securities"; and dedicated enforcement of all the laws and rules -- that's what the SEC is, and should be, all about. Nor do I doubt that the SEC is composed of top-notch, hard-working, concerned human beings who, having been weaned on the importance of proper fulfillment of the Agency's statutory mandate, do carry the notion, implicitly or explicitly, that in the financial and investment arenas they are doing the Lord's Most of what the SEC does is therefore done with a will, with a verve and with a responsibility that has for 57 years kept the Agency at the forefront of federal regulatory agencies in effectiveness and in competence.

As is likely to happen in such a situation, however, an element of stiff-necked righteousness and regulatory ambition tends to creep into the responsible doing of the Lord's work. At the SEC, if the need for disclosure, or the need for regulation,

or the elements of a violation, are so clear to the Agency, how can there be any disagreement? And what venal motives must be attributed to that disagreement? And what is to be done about the need, equally clear to the Agency, for disclosure or regulation just a bit beyond the SEC's reach? Who could fill that need better than the SEC? And, again, how can there be any disagreement?

As is also likely to happen in this context, there tends to develop a sense of "sole source": with all the knowledge the Commission has, with its undoubted purity of motive, and with disagreement by outsiders evidencing their less-than-100% commitment to the right, the true and the just, doesn't it stand to reason that only what originates from within the Agency is likely to be correct, and that (by contrast) what originates elsewhere must be suspect if not venal?

And as is also likely to happen to human beings and human institutions everywhere, it tends to become anathema to consider (much less publicly or privately admit) that some prior course of action was a mistake. The distant past alone, graced by the anonymity that comes with the passage of time, can be reassessed. At the SEC, it can now be admitted that it probably would have been wiser not to take extreme advocacy positions in Continental Tobacco and in Dirks, even though the lower courts encouraged the Commission to do so. But as to CTS (particularly CTS) or the American Bankers' Rule 3b-9 case, oh no!! The Agency embarked on the course, the course was justified by its mandate broadly construed, and the Agency had to stay the course through to the finish line.

The only effective barrier, the only meaningful constraint, on the Commission is the constant insistence that the public be the master, not the servant, of the regulatory agency created in its name and for its benefit. Fulfilling the obligation to conduct the public's business in the public eye and honoring the public's right to rely on the policies made or implicit in those actions are the best gauges of the effectiveness of that insistence, in keeping the Commission from confusing its own interest with the public interest, in keeping the Agency from subverting the relationship between itself and those whom it was created to serve. So the difference that is made when the Agency seeks to avoid action in the public's eye, when it seeks to cloak non-public action from the public's review, when it seeks to minimize responsibility for its public actions, is the erosion of that effectiveness, the diminishment of that insistence, the gradual reversal of master-servant roles between the public and a federal government agency created by and for the public.

I have tried to be insistent from inside the Agency, without much success. I have been the wrong person, at the wrong time, with the wrong ways of going about persuading people on that

fundamental issue. I indict myself on that count, among others. You have not yet been insistent from outside the Agency, perhaps because the extent of the erosion is not as visible from outside, perhaps because of the press of daily responsibilities and the clear desirability of remaining on good personal terms with Agency personnel, perhaps because you simply disagree. But I put it to you that a great deal is at stake here, and that the responsibility lies not solely but heavily on the organized private Bar -- on this Committee, on you. You are the professionals trained not only in the securities law but in constitutional law and its 20th Century progeny, administrative law. You are the organized guardians of the legal system on which all Government in our nation rests and on which the cohesion of our national society depends.

The essence of constitutional government and of the constitutional exercise of elements of executive, legislative and judicial power, delegated to independent federal regulatory agencies like the SEC, is accountability. When the Commission seeks to avoid action in the public's eye, when it seeks to cloak non-public action from the public's review, when it seeks to minimize responsibility for its public actions, the resulting reduction in its accountability goes to the heart of our law, of lawyers' responsibility generally, and of this Committee's function in particular.

Although I am the lame duck Commissioner (perhaps <u>because</u> I am the lame duck Commissioner), I therefore call on you to take up the defense of <u>all</u> of us as citizens -- to strive toward acknowledgment by the Commission that it <u>is and ought to be constrained</u> (a phrase evidencing both responsibility and pride) to weigh heavily and affirmatively, in <u>all</u> its deliberations, the interest of the public in observing and relying on what the Commission does and in holding the Commission accountable to the public for its actions.

You counsel your clients daily to make disclosure, to comply with regulatory requirements, to be cooperative with the Commission's staff, to "cut square corners" in dealing with the Commission. You have at least an equal obligation, professional and societal, to insist that the Commission (in Professor Loss' felicitous phrase) "be no less scrupulous in dealing with its citizens."