SPEECH

of

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Speech of Judge John J. Burns, General Counsel of Securities and Exchange Commission, before The Security Traders Association, Cincinnati, Ohio, August 8, 1935.

Before I attempt the few serious observations which I propose to make this afternoon, without a great deal of relevance and consequently without much in the way of an excuse, I desire to relate a story which is illustrative of the liability provisions of both the Securities Act of 1933 and the Securities Exchange Act of 1934. All of us remember the great furor about the civil liability sections of the Securities Act. It was denounced as a barbarous exhibition of fanaticism by those who saw in it a sinister plot to destroy wealth and enterprise. It was just as passionately defended by crusaders whose zeal left no room for tolerance toward those who dared criticize the Act. In the cold sober light of afterthought, there appears little reason for all the turmoil. True it is that the amendments have been helpful from the point of view of those on whom the Act must operate, but by and large substantively there has been little if any extension of the ancient common law doctrine of liability for misrepresentation.

The civil liability sections of the statute, it is true, contain wording which on first reading might strike terror in the heart of a prospective respondent. Here are the words - "anyone who sells a security * * * by means of a prospectus or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they are made not misleading (the purchaser not knowing of such untruth or omission) and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known of such untruth or omission shall be liable" --

Such language is largely a restatement of the common law which imposed liability for misrepresentation and which recognized the principle underlying the Securities Act of 1933 that a half a truth may be a whole lie. Now for the story to indicate how truth in the wrong setting may be deceptive.

A few years ago the United States Supreme Court in the case of Buck v. Bell upheld the constitutionality of a Virginia statute providing for the sterilization of criminally insane. Mr. Justice Butler dissented, although he wrote no expression of his views. The majority opinion was written by the late beloved Justice Holmes, and I might add, with characteristic elegance and force. One line was very pithy, referring to the record of the case dealing with the Buck family, he said - "three generations of morons are enough". Professor Thomas Reed Powell of the Harvard Law School had an occasion to write a review of this case for a legal periodical and his half truth was as follows: "Mr. Justice Holmes said: 'Three generations of morons are enough', Mr. Justice Butler dissents."

I am anxious to appear more than routinely orthodox when I express my thanks for the opportunity of addressing you gentlemen this afternoon. This anxiety springs from a conviction that gatherings of this nature can contribute largely to the success of the law. I refer to the goodwill and spirit of cooperation which can be generated from such occasions. The law and the Administration should not be regarded as a great brooding omnipresence in the sky - a hostile alien thing to be resented as a plague - and to be observed only because one fears its sanctions, civil and criminal. If such is the regard for our statutes, we could not hope to survive. No student of the school of jurisprudence would put much faith in the permanent value of any statute dependent for its sanctions on fear alone. Valid sanctions are found to rest ultimately on the reasonableness of the legislation - on the wisdom of the law-maker. It has been the objective of the Securities and Exchange Commission and of its staff to prove to this Country that the Acts, subject to its control, were conceived in a spirit of reasonableness and are being administered in a wise and sympathetic manner.

It would take too long and would be of questionable advantage to dwell in detail upon the numerous causes and occasions which gave rise to the legislation entrusted to the care of the Securities and Exchange Commission. There was one reason given at the time the legislation was submitted which is seldom referred to but which is of the greatest importance. This reason for the legislation shows that the Securities Act of 1933 was partly, at least, a measure for recovery and was not essentially a punitive statute as has been so often asserted. The President specifically mentioned this objective of the legislation in his message on the Securities Act of 1933. He said:

"I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.

"In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.

"Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.

"There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

"This proposal adds to the ancient rule of caveat emptor, the further doctrine 'let the seller also beware.' It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.

"The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.

"This is but one step in our broad purpose of protecting investors and depositors. It should be followed by legislation relating to the better supervision of the purchase and sale of all property dealt in on exchanges, and by legislation to correct unethical and unsafe practices on the part of officers and directors of banks and other corporations.

"What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others."

To what extent the legislation has accomplished the statutory objectives is a matter of some dispute. I believe much good has been done. A thorough-going appraisal would involve an enormous amount of work, would probably be tiresome and would not be in good taste. Perhaps I should divert for a second and tell you of a letter I received yesterday from one of the most successful lawyers engaged in defending the crooked stock racketeers. He had written for a copy of our anti-fraud bulletin which is a service we make available to official and semi-official agencies engaged in the work of fraud prevention. I replied to him that the policy of the Commission was against extending the list and I added, in view of the number and character of his clients, to put his name on the list would require a most extraordinary interpretation of the words "fraud prevention". He wrote me and said, rather mournfully, that since the S.E.C. was established, the number of his clients had been greatly reduced.

To a large extent I believe the restoration of investment confidence has been accomplished. Out of the charges and counter-charges - the statistics and graphs;- out of all the explanations, logical, biological or economic, for the economic collapse of the security markets of a few years ago,- one fact remains unchallengeable - unaffected by the furor of controversy. The confidence of the investors was seriously impaired. In the ordinary course of events, the task of regaining this confidence would have been prolonged and tortuous, involving advertising propaganda and crusading of one kind or another. This task has been simplified and the objective of restored confidence brought closer to realization as a result of this Federal legislation. After all, the Act sought no more than a national control over the admitted evils in a great business affected with a tremendous public interest.

The security problems of this Country have increased in direct proportion to the growth of the corporate method of doing business. That this should be so is almost self evident. A piece of paper is the only physical thing that is transferred in the sale of a security and hence the opportunity for deception and overreaching is very great. With the amazing development industrially in this Country, accounting procedure was bound to grow in complexity and the handicap of the amateur investor was made evident.

In the beginning of English law, the corporation itself was a single thing. Centuries ago, Sir Edward Coke defined it in medieval terms. "A corporation" he said, "is invisible, unnatural, has no soul; neither is it subject to the imbecilities or death of the natural body". In short, a legal personality was created apart from the group. This person could act in a legal sense; could sue and be sued; own property and incur debt. Its members had limited liability and this privilege led to the gradual adoption of the corporate device for the business of this Country.

The corporate device has allowed the development of multiple ownership; that is, an indefinite number of people may own the assets of an enterprise through minute division of these assets into shares. From this multiple ownership, through the corporate device, has come one of the most striking phenomena of recent times, the separation of ownership and control and the consequent use of the management faction in the arena of our corporate life.

Under simple conditions, ownership implies the control of the thing owned. The development of the corporation, however, with its multiple shareholders, has made it possible for an individual to own without controlling, and to control without owning.

At the present time, under the corporate device, ownership means a legal title to assets which cannot be controlled by the individual, though he may, of course, exercise such control over the property by combining with other shareholders to form a majority of the voting stock. But, if the shareholder does not join the majority group, his title to ownership merely gives him the right to share pro rata in the profits and losses of the enterprise. The actual distribution of the proceeds depends upon the decision of the directors who legally control the business. Thus, more and more, the real position of the holder of ownership shares-- common stock --becomes that of a security holder who is almost divorced from the control of the property nominally owned, and whose main interest is in the allocation of earnings made to him by those in control of the business.

This division of functions which is characteristic of the modern corporation has had far-reaching consequences, as the evidence has shown. It means that control over the instruments and physical assets of production and distribution is passing from the property owner to centralized managerial groups. Those who direct the modern corporation are, more often than not, the owners of only a negligible portion of the company's stock. It follows that the returns from profitable management of the corporation affect them directly only to a relatively minor degree; on the other hand, the stockholder to whom the profits accrue has less and less to do with the direction of the corporation. The bearing of this separation of ownership from control on the whole concept of property and on the place of the profit motive in economic life is of very great significance.

Our national picture is noted for the great number of large enterprises. The separation of ownership and control has to a large extent made possible the emergence of the modern corporate giant. In order to finance these enormous enterprises, it became necessary to secure from the investing public the supply of capital. Naturally enough, the law was put to great strain to adjust the ancient wisdom of Lord Coke to modern times with corporate aggregations of wealth which in some instances exceed the total wealth of some of the states of the Union.

For instance, according to the most recent figures available there are over 675,027 stockholders in the American Telephone and Telegraph Company. Its total assets are over $4,977,054,686 and its gross revenues for last year were $887,545,237. Just a few more figures will indicate the nature of the problem. It is estimated that there are in this Country 425,990 corporations with total assets of over $280,082,922,861. Our statistics indicate that on the national exchanges of this country there are registered the securities of over 1900 companies.

The social implications from this development are serious, the diagnosis of the underlying factors difficult and the prognosis for future trends exceedingly hazy. The phenomenon is self-evident. From it flow certain obvious corollaries. In the first place, America has become a nation of investors. In the second place this great investing public deserves from society greater protection than has been furnished in the past. It is quite clear that the investing public should not be required to look for protection in the extra legal sanctions of ethical customs. The states many years ago came to grips with the securities problem through the passage of Blue Sky laws, and in many states these laws were effective to a large extent. But only recently has it been shown that state action, however well conceived is not enough. Because of the size and scope of enterprises, because of the inherent limitations on effective state action, and because of the interstate character of the problem, Federal intervention was inevitable. And so, in the light of the shocking revelations of what might be termed the insecurity of securities, and in order to give a firmer, sounder, saner basis to the business which you represent, in order to give new life to old fundamentals, in order to strike a new balance more favorable to the investing public, the Securities Act of 1933 was passed in May, two years ago, without a dissenting vote in either house.

You may be surprised that I should have the temerity to discuss with you any recent legislation, whether it be the Securities Act of 1933 or the '34 Act, called the Fletcher-Rayburn Act, or the Utility Bill of 1935 which, if it is passed, ought to be known as the Wheeler-Rayburn-Hopson Act. About this time, I suppose most of the staff of a New Deal agency is expected to be in a feverish panic because of the recent epidemic of unconstitutionalities.

We are glad to announce a very confident feeling of immunity. Incidentally, you will be interested to know that the only persons to date who have even suggested an attack on the constitutional basis of the Commission's action have been rogues whose fraudulent activities have been exposed by the Commission. Our confidence comes largely from the realization that this legislation is the culmination of a long continued demand that the powers of the National Government be employed to control the serious difficulties of securities distribution and trading.

The Commission is gratified by the attitude of friendliness and cooperation displayed by stock exchanges, brokers, dealers and underwriters. Not that we are deluded that the Acts or the administration thereof represent perfection, or for that matter that there has been one hundred per cent law observance by even the more respectable among you. But by and large the atmosphere has been pleasant and the Commission feels that its hopes for the future of the business and the investor are quite reasonable. Speaking generally, the unwarranted fears have been largely allayed, even in the minds of our most pessimistic critics, the Wall Street lawyers. Chairman Kennedy dryly observed that they are so meticulous and so cautious that he finds it difficult to understand how their clients can lose money. The lawyer critics are not now concerned with fretful predictions of impending chaos. All of this is forgotten in the rush of new business. Only recently one of the most outstanding figures in the financial world told a friend of mine that he would regard it as "calamitous" if either the Securities Act or the Securities Exchange Act were repealed or declared unconstitutional.

The problems of the Commission which would be of interest to you gentlemen are so numerous that one is required to select but a few for discussion at an affair like this. Commissioner Landis recently in St. Louis has discussed the difficulties which confront the smaller exchanges. Many of them have lost registrants to the New York Stock Exchange because the issuers having to file the same amount of information are desirous of securing the added prestige of a big board registration. This is a source of considerable worry to the Commission, but I am hopeful that a realistic solution will be forthcoming quite soon so as to preserve these institutions which can be great factors in protecting the public. I could talk at great length about the tremendous difficulties of Section 15 of the Securities Exchange Act of 1934 and the over-the-counter markets, but I do not regard a discussion of this matter as timely in view of the Commission's current study of the subject.

Out of the unusual activity under the Securities Act of the last few months have come some difficult problems and I would like to refer briefly to them for your interest and enlightenment.

By Section 8(a) of the 1933 Act a registration statement cannot become effective until 20 days after the filing thereof. The Commission has no power by rule, regulation or order to cut down this period. The Congressional intent was extremely clear to the effect that the twenty day period between filing date and the effective date was not to be shortened legally by any conduct of the Commission. You all know that during this twenty day period it is just as illegal to solicit purchases as if the security in question were not being registered. The definition of "sale" "sell" and "offer for sale" are so broad that they include any attempt or offer to dispose of or any solicitation of an offer to buy a security. It is not necessary that a dealer secure a firm commitment within the twenty day period in order to violate the statute. Any solicitation even if accompanied by the most solemn protests that the dealer seeks only an expression of opinion is violative of the spirit as well as the letter of the law.

We know only from hearsay that the practice of "jumping the gun" is widespread. We have received many complaints but few have the courage to give us the factual data. The executives we have talked with informally, purport to be deeply concerned over the complaint that this practice is common. They point to instructions which have been issued by them against any such misconduct under the penalty of discharge should a salesman be caught. Yet the evidence is overwhelming that the twenty day period is being ignored. Only a week ago the New York Times financial editor stated: "The practice of 'jumping the gun' in the marketing of new securities issues has not, apparently, been eradicated by the Securities and Exchange Commission which has strict rules against sales prior to formal registration."

A particularly amusing instance which has come to the attention of the Commission of this unwillingness to abide the statutory period was disclosed by a communication which was received from a large insurance company. The official wrote in praise of the prospectuses which have been prepared as a result of the Securities Act. He expressed his gratification because intelligent investment could be done more easily. He then said that doubtless we were familiar with the rapidity of sales of recent bond issues, and I quote him: "It has been rather a question of allotment by dealers than purchases by investors. On the day public offering is made one who wishes to buy must accept immediately. No time at all is allowed for perusing the facts as set forth in the prospectus. In many cases several days elapse between the purchase of bonds and receipt of the prospectus. The greatly diminished value of the prospectus is apparent." We have requested specific information on this point and have pointed out to him that the failure to deliver a prospectus was a violation of Section 5 of the Act, as was any attempt to sell prior to the effective date of registration.

The Commission has received a number of complaints against the growing practice of "blind buying". As the Federal Trade Commission pointed out in its Release of November, 1933, the theory of the waiting period of twenty days contemplated a change from the method of distribution in vogue prior to the Act which attempted complete sale of an issue within a very few days, thereby compelling minor distributors, dealers and salesmen, as the price of participation in future issues of the underwriting house involved, to make commitments blindly. The House Report of Mr. Rayburn makes interesting reading. Speaking of the compulsion to blind buying the Report states: "This has resulted in the demoralization of ethical standards as between these ultimate sales outlets and the securities-buying public to whom they had to look to take such commitments off their hands. This high-pressure technique has assumed an undue importance in the eyes of the present generation of securities distributors, with its reliance upon delicate calculations of day-to-day fluctuations in market opportunities and its implicit temptations to market manipulation, and must be discarded because the resulting injury to an underinformed public demonstrably hurts the Nation. It is furthermore the considered judgment of this committee that any issue which cannot stand the test of a waiting inspection over a month's average of economic conditions, but must be floated within a few days upon the crest of a possibly manipulated market fluctuation, is not a security which deserves protection at the cost of the public as compared with other issues which can meet this test."

Perhaps in this connection I should make two observations regarding the conditions recently, and probably presently, obtaining which to some extent must affect one's judgment on this problem. In the first place, the present demand is for sellers not for purchasers. No high-pressure technique is required at least in the current bond issues; rather is the problem one of securing a sizable allotment. In the second place, distributors, and particularly salesmen, are very human. There has been a long period of starvation and it is understandable that with business in sight the twenty day period should receive scant attention from the impatient salesmen. While these factors may explain, they fall far short of justifying a practice which, in the last analysis, undermines a safeguard inserted for the protection of the dealer himself, as well as for the protection of the investor. It is unfortunate that the business itself has failed to develop the social outlawing for violations of this kind, however technical they may be regarded. If this practice of playing fast and loose is to continue to a time when market conditions have changed and selling magic is more necessary, we are likely to find ourselves faced with all the evils that made the disclosures of the nineteen twenties so sickening. May I address to you a solemn warning that the Commission is aware of this growing evil and is prepared to take all possible measures to prevent its continuance.

One of the practices which has been called to our attention, without giving us chapter and verse, in connection with recent distributions which discloses elements of pure viciousness is as follows: A member of an underwriting group who has a distribution department is charged by a small dealer with having given him but an insignificant fraction of the participation his standing in the community and his customers' needs demanded. Thereafter, prior to the twenty day period, an agent of this underwriter solicited a customer of this dealer. The customer came to the dealer and stated that he had been solicited but would rather do business with the dealer who regretfully informed him that he could not take any order, and that it was unlikely he would have sufficient bonds to assure him of delivery. This conduct cannot be too severely condemned. Apart from the evils of 'jumping the gun' and violating the statute there is disclosed a manifestation of selfishness which tends to indicate that the lessons of experience have not been learned. It has been intimated that dealers are not likely to disclose to the Commission the existence of such practices because they thereby run the risk of losing a position of preference on the underwriter's list. I believe such an attitude is ill-advised. The Commission is very anxious to find out the extent to which the letter and spirit of the law is being observed. Any underwriter, having distribution facilities, who condones such a practice is in reality exhibiting great stupidity. As it is now, with the scarcity of issues, the underwriter-distributor occupies a contradictory position. No objective standard is applied as to what proportion of his commitment shall be given to dealers and what proportion shall be reserved for his own organization. When to this evil there is added the crime of "beating the gun" and the dastardly practice of competing with one's own dealers who have been denied sizable participation you have as unfair a situation as can be conceived. Abuses of this kind would make it very easy to convince Congress that there should be a sharp differentiation between the underwriting and the distribution function. The moral is obvious. It is one that cannot be repeated too often despite the risk of boredom. What the securities business needs is long range selfishness - the kind of vision which will disregard apparently advantageous considerations of immediate concern and which will prefer a realistic approach to the future of the business, realizing that the customer's good-will is the best guarantee that business will be conducted profitably. The future of a business of this nature rests almost entirely on good-will, and that in turn is largely controlled by whether your customers have been given a run for their money. The underwriter who permits himself to lose sight of this great truth is deserving of severe censure.

Another development of the recent financing might be of interest to you. Many communications have been received by the Commission from banks and small investors generally expressing resentment over their inability to obtain proportionate participation in refunding operations.

Their plight is a serious one - a 5% bond is called and the bondholder finds himself unable to secure the refunding security even with its lower coupon. There are practical, as well as theoretical difficulties in these circumstances. As a practical matter, the underwriter is not concerned with the individual securityholder. He wants to know definitely the amount of his underwriting risk. He wants to be in a position to move with speed because of the market's sensitiveness to various factors. Theoretically there are difficulties. Inquiries to find if present securityholders wish to make an exchange are likely to be regarded as solicitations and, therefore, illegal in advance of registration. The Commission is making a study of this problem and hopes to be able to work out a solution within the framework of the Act, so that priority may be given to the present securityholders whenever refunding operations are undertaken, assuming, of course, that the issuer so desires. It perhaps should be observed at this point that the sympathy of the Commission for the bondholder whose security has been refunded from under him is rendered less acute by the realization that if money rates should change radically, these new prime securities will be likely to be selling at a considerable discount.

We are also anxious to extend, so far as we can, to the public the information regarding a proposed new offering prior to the effective date of the registration statement. Here, again, the risk that communications oral or written by dealers to prospective customers might be found to be solicitations is a real one. It is important that no sanction, directly or indirectly, be given to the practice of soliciting prior to the effective date of the registration statement. However, insofar as informative literature is concerned, it is regarded by the Commission as entirely proper that all available information be at the disposal of the investing public. For that reason, the Federal Trade Commission issued Release No. 70 which though applicable only to underwriters is in its spirit and in its principle applicable to dealers. Our Commission adopts the principle of Release No. 70, and particularly the excerpt from the House Report which states:

> "The bill, apart from section 16 (b), is not concerned with communications which merely describe a security. It is, therefore, possible for underwriters who wish to inform a selling group or dealers generally of the nature of a security that will be offered for sale after the effective date of the registration statement, to circulate among them full information respecting such a security. This could easily and effectively be done by circulating the offering circular itself, if clearly marked in such a manner as to indicate that no offers to buy should be sent or would be accepted until the effective date of the registration statement."

It is not an easy matter to decide in a particular case whether a course of conduct amounts to a solicitation, but generally speaking it is true that where information of a proposed offering is circulated by underwriters or dealers, and where there is not sought from the recipient any

expression of his desires regarding the purchase of the security, then there is not likely to be a violation of Section 5.

A survey of the Securities Act, as a whole, clearly indicates that the proposed beneficiaries of the legislation were the dealers as much as the investing public. This is true, directly as well as indirectly, by reason of the protection afforded purchasers. The dealer's true status in the distribution system is recognized. It will be most unfortunate if despite the safeguards provided in the statute, the dealers through short-sightedness permit themselves to be caught in the same old web so characteristic of the late twenties. I think it is safe to assume that the law will be a permanent regulatory measure, and it is idle to dream wistfully of the good old days of cut-throat competition. About the adequacy of the present Act, or of its administration, critics may differ. About the permanency if federal control I think most sensible people recognize its inevitability.

In our legal conception, doctrine and juristic technique America is regarded as somewhat of a "copy-cat" and on the whole rather inept. Few, if any, features of our legal system have attracted the admiration of foreign observers. For this there are countless explanations - the most impressive of which is the number of governmental units which may affect men's lives in this country. In the field of security regulation, however, we may point with justifiable pride to the fact that our approach to the problem is being copied by at least one other country. A recent report by the Royal Commission on Price Spreads for the Dominion Government, the name of whose chairman is incidentally Kennedy, makes most interesting reading. It is a temperate well-documented intelligent appraisal of the problems of concentration of wealth and the corporate system of doing business, with particular reference to the field of securities. It is realistic in its recognition that the helpleseness of the average investor cannot be lost sight of by a politically organized society. It recognizes the problems of management in a company publicly owned. It recognizes the sanitative value of adequate publicity. It recognizes the growing practice of multiple interlocking directorship, and it recommends legislation to insure that directors shall occupy a trustee capacity with regard to all securityholders.

To me perhaps one of the most interesting recommendations is the creation of a Securities Board with functions largely similar to the Securities and Exchange Commission. In one respect the recommendation is broader in that altho not given the power to approve of security issues, this board is to be given the power to disapprove of them, not because of a failure to disclose adequate information or a misrepresentation in the statement, (which is the provision of our law) but because of the improper investment features of the proposed security in the judgment of the Securities Board. The Royal Commission states:

"The functions of such a board should be to review the proposed capital structure of all companies incorporated under the Dominion Act and desiring to issue bonds or stock to the public. In other words, the Board would pass on all issues of bonds or stock after thorough investigation. In performing this duty, the Board would necessarily give careful consideration to the proper relation that bonds or stock to be issued, bear to the company's assets. In the case of an industrial company, for instance, the Board would have to decide up to what percentage of the fixed assets a bond mortgage should be issued and, in the case of shares, what return could reasonably be expected. It might insist that a bond issue should not exceed the percentage of fixed assets which is normally considered sound practice for the mortgaging of real estate. This would eliminate the issuing of bonds by holding companies secured by assets consisting largely or wholly of shares in another company; thereby placing the bondholder in a junior instead of a senior position so far as the fixed assets of the other company is concerned. It should insist also that, before the proposal for an issue is submitted to it, the sanction of the shareholders in special meeting be obtained and that the approval of bonds should be given only for the amount actually required at the time of issue."

To indicate how closely this Commission, whose report has been received with great acclaim in Canada, has followed the solution of our corporate evils as found in our legislation of 1933 and 1934, let me give you a summary of their recommendations:

"1. Abolition of shares of no-par value

or

A requirement that the full consideration received for no-par shares be credited to the capital account.

2. All premiums from the sale of par stock should be placed in the capital or non-distributable account.

3. All increases in surplus or reserves which result from an increase in asset values (as a consequence of write-ups, appraisals, etc.) should be regarded as capital surplus, i.e., incapable of having dividends charged against them.

4. Companies should be incorporated only for activities which they intend seriously to pursue at the time of incorporation. They should be prevented from engaging in activities not directly related to those for which they were incorporated, unless they have previously secured,
   a. approval of the shareholder, and
   b. supplementary letters patent.

5. A company's annual statement, together with the auditor's report should be required to be published in the daily press and in The Canada Gazette, in such a way as to ensure the widest publicity.

6. The company should be also required to file such statements with a public authority more specifically with the Securities Board recommended below.

7. The responsibility for this publicity should be placed on the Board of Directors of the Company, who should file with the Securities Board, satisfactory proof that this obligation had been carried out. Suitable penalties should be provided for non-compliance with these provisions.

8. Annual statements should be given in more detail than at present and should include information under the following headings:-
   a. Fixed and intangible assets to be given in more detail than present:
   b. Investments and securities - nature, and market value;
   c. Inventories - so as to show raw materials in process of manufacture.
   d. Accounts and Notes Receivable - in such a form as to make a distinction between current and overdue and doubtful accounts.
   e. Executive salaries and bonuses - so as to show the number of executives and the total amount paid.
   f. The amount, if any, by which fixed assets (including goodwill and other intangibles), have been written up.

9. The prospectus provisions of the present Act should be altered to place upon a company and its directors the responsibility for representations made on any offering for general public subscription, whether made on behalf of the company or not. If this change cannot be made through the Companies Act, it should be made a criminal offense to offer for public subscription, securities of a company with federal incorporation, if those securities have not been subjected to the prospectus obligations of the Dominion Companies Act.

10. Every prospectus should be required to state in clear detail all commissions, fees, and other remuneration received by promoters, underwriters or middlemen.

11. Whenever shares are allocated otherwise than through an offer to the public, a statement in lieu of prospectus should, as formerly, be filed. It should also be published in the press and in the Canada Gazette in such a way as to ensure the widest publicity.

12. The classes of shares that may henceforth be offered to the public should be limited to common and preferred without any subdivisions.

13. All shares offered, both common and preferred, should bear equal voting rights.

14. Management shares should be prohibited.

15. When the management of a company have become aware of the serious impairment of the capital of that company, they should be required forthwith to inform the directors of that fact, who shall be under obligation immediately to call a meeting of shareholders and put the above situation before them.

16. The first permanent directors of a company should be held responsible for all business transacted by the provisional directors.

17. Directors should be prohibited from speculating in the shares of their companies. They should be required to disclose annually to their shareholders the extent to which they have directly or indirectly purchased or sold their company's shares during the year.

2. Provisions to Prevent "Stock-Watering":-

1. It should be made illegal for directors, promoters, etc. to issue fully paid-up shares unless the company receives for these shares, adequate consideration in cash, property, or services. The Courts should investigate the adequacy of such consideration, when such adequacy is involved in any litigation. If the Courts decide that inadequate consideration was given, then liability for the balance of the consideration unpaid should attach to the directors concerned, if it is shown that,
   a. such directors had knowledge of the inadequacy of the consideration, or
   b. failed to take reasonable steps to ascertain the adequacy of the consideration.

2. A Securities Board should be set up, functioning as a section of the proposed Federal Trade and Industry Commission. Its functions would be:-
   a. To review and investigate the proposed capital structure of all companies incorporated under the Dominion Act and desiring to issue stock to the public.
   b. To pass on all such issues of bonds or stock after careful investigation.
   c. To scrutinize the advertising and publicity material accompanying such issues.
   d. The Board should have no power formally to approve; merely to reject.
   e. No company or investment house whose proposed issue of shares has been under review, and not rejected, should be permitted to make any reference to that fact in its advertising literature.

3. Appraisal companies should be made liable in damages to anyone suffering loss through the purchase of stock, to which purchase any such appraisal has contributed, if it can be shown that such appraisal was untrue in any material part, and that it was issued or published by the Appraisal Company,
   a. without honest belief in its accuracy, or
   b. without such company first having taken all reasonable means to verify the accuracy of the facts or opinions contained in the appraisal.

4. Mining companies might be exempted from those specific recommendations concerning inadequacy of consideration, with the directors being liable for any inadequacy found, since such companies are by nature highly speculative.

5. The whole trend of law should be towards putting the managers and directors in a trustee capacity, with respect to all security holders.

This is the clearest indication that an analogous corporate situation in Canada has resulted in modes of treatment strikingly similar to our own legislation.

Law, which is the collective expression of the wit and wisdom of a particular period, is an expanding dynamic phenomenon, and in dealing with the problems of the modern corporation society first of all had to realize the threat implicit in large enterprises and to appreciate the great extent of public participation, thereafter some form of legislative and administrative protection was inevitable. Congress has committed to the care of the Securities and Exchange Commission the administration of

these statutes designed to rehabilitate the securities distribution and trading businesses. The Commission in its task has given many evidences of its desire to be temperate, realistic and yet uncompromisingly forthright in carrying out the commands of the statute. It is, and expects to be, an ally to the reputable dealer. It expects in return a large measure of cooperation.

Let us not forget the oft repeated lesson of history, that restrictive punitive legislation is always consequent upon a failure of compliance with regulations about the importance of which society feels deeply. To you, as a group, there should be present a strong sense of obligation to insure that the statutes be observed in letter and in spirit; that where friction is disclosed or an imperfection is revealed such matters be called to the attention of the Commission. All constructive criticism will be received, I am sure, in a spirit of tolerance and fairness. In this way, and in this way only, can there be guaranteed to you the orderly control of your enterprise, so that aggressiveness and honesty should be rewarded, and that the lack of those qualities should be visited with the outlawry of the trade, with loss of prestige and with material failure. There is under the present statute and its administration, so far as I know, no serious obstacle to successful security distribution. Strict observance of the statute and the regulations thereunder, in spirit as well as in letter, should be the objective of groups like this. The urge to compliance cannot be furnished by the law. It should spring from your instinct for decency, from your farsightedness, and last but not least from your common sense.