



**SECURITIES AND  
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**SEC DISCLOSURE POLICY  
REGARDING MANAGEMENT INTEGRITY**

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Commissioner

SEC Disclosure Policy  
Regarding Management Integrity

Why talk about the SEC approach to management integrity?

Since 1973, much printer's ink has been spilled concerning the SEC's disclosure policy regarding management integrity. It was in that year, you will recall, that the Office of the Special Prosecutor charged several corporations and executive officers with using corporate funds for illegal domestic political contributions. Investigations by the Commission revealed that widespread violations of the federal securities laws had occurred through questionable or illegal payments and practices -- both domestic and foreign.

There ensued in the '70's much ferment:

- The Commission's voluntary disclosure program, in which more than 450 corporations made public disclosure of questionable or illegal practices.
- The Commission's submission to the Congress, in 1976, of its Report on Questionable and Illegal Corporate Payments and Practices, in which the Commission stated that its purpose had been "to restore the integrity of the disclosure system and to make corporate officials more fully accountable to their boards of directors and shareholders," and that its approach was "to insure that investors and shareholders receive material facts necessary to make informed investment decisions and to assess the quality of management."
- The Congress' enactment, in 1977, of the Foreign Corrupt Practices Act, making illegal much of the corporate conduct that had been addressed by the Commission through disclosure.

Today the issues are far from resolved. Recent SEC decisions -- Mobil and Citicorp -- have attracted widespread interest -- both in the press and on Capitol Hill. The tenor of many comments suggests a wide divergence of view concerning what role the Commission ought to have in regard to disclosure of facts relating to management integrity.

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The views expressed in this speech are my own and do not necessarily represent those of the Commission, my fellow Commissioners or the staff.

Therefore, a need exists for SEC Commissioners to shape and refine their views, and to make them known. More of a dialogue is needed, but thus far only Congressmen and the press have done the talking.

What follows is, by no means, an attempt to achieve a total synthesis of this difficult area. It is simply an effort to sort out the issues, identifying those that can be easily resolved and those that cannot. And with respect to the more difficult ones, to see what, if anything, useful can be said about them.

What kinds of disclosure are we talking about?

The securities acts require disclosure of facts material to investors -- that is, as defined by the Commission and, more importantly, by the federal courts including the Supreme Court -- facts of which a reasonable, prudent investor should be informed in connection with an investment decision to buy, to sell, to hold or to vote.

Economic materiality lies at the heart of the Commission's disclosure scheme. I do not intend to address that subject today. The question I am going to try to answer is whether, and under what circumstances, the Commission can, as a matter of authority, and should as a matter of intelligence and discretion, compel disclosure of information not rooted in economic materiality, but bearing on the integrity of management. It is sometimes referred to as qualitatively material, in an effort to distinguish it from the sort of information that must be quantitatively material to warrant mandatory disclosure.

Some examples will illustrate the kind of information I have in mind.

1. Should corporate documents disclose that a senior officer and director of a cable TV company has been convicted of bribery and perjury in connection with obtaining cable television franchises, permits and privileges, all for the benefit of the company?

Note here that there was no self-dealing, but the information sought to be disclosed was already public and related to the core of the company's business.

2. Should proxy materials disclose a secret bribe and kick-back scheme involving senior officers and directors when the amounts involved were not financially material to the company's earnings?

Here we have self-dealing -- the kickbacks -- and first time disclosure of the wrongful activity, which was not at the time publicly known or the subject of any criminal or civil charge or complaint.

3. How about proxy disclosure that bribes had been paid to secure a non-material amount of business and had been concealed, with the full knowledge of directors?

No self-dealing here, and the information sought to be disclosed was not publicly known or the subject of any charge or complaint.

4. Or, consider disclosure of a management decision to ignore a pollution statute and regulations clearly applicable to the company and to accept the possible consequences, if and when the company's continued practice of dumping pollutants into the river is discovered. The decision was made on the basis of a careful cost-benefit analysis correctly showing that immediate compliance would probably be many times more expensive than the delayed cost resulting from discovery and sanctions.

Here, of course, disclosure, if compelled, would skew the cost-benefit analysis, making immediate compliance the only option.

5. Should an investment company's proxy statement soliciting approval of an investment advisory contract disclose the existence of some 22 major lawsuits against the investment adviser's parent, alleging breaches of fiduciary duty and violations of federal and state securities laws and seeking damages totalling some 25% of the parent's consolidated assets? Would it make a difference if the proxy statements contained representations that the adviser's parent was "responsibly managed" or that its "financial strength and the quality of its investment skills" were important factors warranting approval of the contract?

6. Should a registration statement asserting that the registrant maintained "satisfactory labor relations" at its sole plant have also disclosed that those relations were based upon bribes made to several members and officials of the applicable union?

Most of these examples sketch out the facts of decided cases. They all relate to disclosure of illegal or unethical behavior, which is what management integrity is all about. They illustrate the difficult questions that can, and do, arise.

What does the case law teach us?

Source of Obligation. The source of the obligation to disclose information bearing on management integrity is no different from that for any other kind of information.

1. The general antifraud provisions of the Securities Exchange Act and related rules; and

2. The affirmative disclosure requirements of the Commission's rules that specify what must be contained in proxy materials, registration statements, periodic reports and the like.

To date, no court has squarely held that there is an affirmative obligation to disclose, independent of these two sources.

Rule-based disclosure. Courts have consistently held disclosure documents to be defective if the issuer failed to include information bearing on management's integrity that was required by the Commission's rules. Those rules require specific line item disclosure. But the Commission cannot anticipate and describe in its rules all the information that should be disclosed to investors under all circumstances. Thus, the Commission's rules also require disclosure of such additional information, not specifically required by a line item, that is material and necessary to give the investor a complete picture of those matters being described in response to specific line items. And courts have held documents defective where there has been an omission of information not specifically required by line item, but which renders other statements made in response to the item materially misleading.

Self-dealing. Courts consider self-dealing by directors and officers to be particularly significant, and they frequently require disclosure, especially in proxy solicitations for the election of directors. Courts have generally found either that the self-dealing must be disclosed under a specific line item, such as the item relating to management remuneration and affiliated transactions, or that a failure to describe the self-dealing renders misleading other statements made in response to specific line items. On occasion, a court will require disclosure based solely on the qualitative materiality of the self-dealing activity. For example, in a recent case, General Steel Industries v. Walco National Corp., the district court held that the tender offeror's Schedule 14D-1 was false and misleading, without reference to any line item or specific statement in the filing, because it failed to disclose that a director, with the cooperation

of management, had used his controlling position in the company "improperly and unethically to appropriate Walco resources for his own personal financial and political benefit."

Illegal or unethical behavior, absent self-dealing. In the absence of self-dealing, courts have been far more reluctant to compel disclosure of matters relating to management integrity. Of course, where the behavior in question has an impact on the company that is economically material, courts have typically required disclosure. Thus, disclosure of the authorization by management of questionable or illegal corporate payments has been required if the payments are quantitatively material, relate to a quantitatively material amount of business or subject the company to other quantitatively material risks. Beyond these areas, it remains uncertain to what extent any court will require disclosure of information bearing on management's integrity, in the absence of specific disclosure rules promulgated by the Commission.

It may be helpful at this point to mention two recent, and important, Circuit Court decisions. Gaines v. Haughton, decided in 1981 by the Ninth Circuit, involved a class action against Lockheed Aircraft Corporation and certain of its officers and directors, alleging violations of the proxy rules arising out of Lockheed's payment and concealment of millions of dollars in bribes and other questionable payments from 1961 to 1974.

In confirming the district court's dismissal for failure to state a claim, the Ninth Circuit held that the alleged payments and their concealment constituted "simple mismanagement" that, as a matter of law, could never be material in the proxy context. In so doing, the Court said:

"We draw a sharp distinction . . . between allegations of director misconduct involving breach of trust or self-dealing -- the non-disclosure of which is presumptively material -- and allegations of simple breach of fiduciary duty/waste of corporate assets -- the nondisclosure of which is never material for § 14(a) purposes." [Emphasis supplied.]

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"Absent credible allegations of self-dealing by the directors or dishonesty or deceit which inures to the direct, personal benefit of the directors . . . we hold that director miscon-

duct of the type traditionally regulated by state corporate law need not be disclosed in proxy solicitations for director elections. This type of mismanagement, unadorned by self-dealing, is simply not material or otherwise within the ambit of the federal securities laws."

The Gaines case purports to establish a per se rule of immateriality for director misconduct without the element of self-dealing -- at least for proxy statements. The opinion seems to rest on the rather cynical assumption that shareholders, in exercising their rights of corporate suffrage, care plenty about a management that is stealing from the company, but are concerned not a whit about a management that is stealing for the company.

In a similar case, Decker v. Massey-Ferguson, Ltd., the Second Circuit declined to follow the absolutist approach of the Ninth Circuit. The plaintiff in Decker alleged that the company's annual report to shareholders contained misleading statements about its management and its financial condition, in that it failed to disclose that the growth of sales resulted from illegal payments to persons in positions to influence those sales. Rejecting the company's claims that the payments and the affected sales were immaterial as a matter of law, the Second Circuit suggested that those payments would be material if they were significant in amount or related to a significant amount of business. In remanding the case to the district court, the Second Circuit ordered discovery to determine whether the improper payments, which totalled \$30 million over a five year period and affected between 3.3% and 4.4% of the company's annual sales, were material. Quoting from the Commission's 1976 Report on Questionable and Illegal Corporate Payments and Practices, the court went on to suggest that even smaller payments might require disclosure.

"[T]he fact that corporate officials have been willing to make repeated illegal payments without board knowledge and without proper accounting raises questions regarding improper exercise of corporate authority and may also be a circumstance relevant to the 'quality of management' that should be disclosed to the shareholders. Moreover, . . . a questionable or illegal payment could cause repercussions of an unknown nature . . . ."

In trying to reconcile these cases, it may have been significant that the claim in Gaines was based on anti-fraud violations of the proxy rules, while Decker involved anti-fraud violations in connection with open market purchases of stock. In any event, these two cases illustrate the uncertainty that remains with us today in the area of disclosure bearing on management integrity.

For the Commission's enforcement effort, these uncertainties have posed a dilemma in deciding whether to commence an action in the management integrity area, absent economic materiality or self-dealing. With four new Commissioners appointed since 1980, the Commission has understandably been cautious, seeking, with staff help, to review this important and sensitive area of disclosure policy and law. In June, 1981, the Commission filed an amicus curiae brief in support of rehearing in Gaines v. Haughton, and lost. Then, in February, 1982, in light of its pending review, it declined to file a brief in Decker v. Massey-Ferguson, Ltd., despite Judge Ellsworth Van Graafeiland's written invitation to do so. As things turned out, the Second Circuit's decision in that case parallels rather neatly the arguments advanced by the Commission in its brief filed with the Ninth Circuit in Gaines v. Haughton.

What can the Commission do by way of rule-making?

This brief analysis of the case law suggests that a failure to disclose or a misleading disclosure, in response to a specific rule promulgated by the Commission, will invariably render the company liable. If this is so (I hear you ask), what has the Commission done by way of writing rules to elicit information about management integrity? As investors subscribing to the services of the Investor Responsibility Research Center, some of you even may be asking why the Commission hasn't done more along these lines.

What we have done to date. The Commission is given broad authority to promulgate rules "for the protection of investors" and "in the public interest." Indeed, a Commission rule could be rejected under the Administrative Procedure Act only if a court found it to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."

Acting pursuant to this authority, the Commission has adopted many rules to elicit disclosure bearing on management integrity. These rules relate to the filing of registration statements and periodic reports, and the solicitation of proxies. Without getting too technical, let me briefly describe the reach of these rules.



Self-dealing is the most developed area for disclosure bearing on management integrity. Disclosure is required concerning transactions between management and the registrant, and concerning relationships between the registrant and its significant customers, suppliers, and creditors with which a director or nominee has a relationship. Here it should be noted that directors who are associated with law firms or investment banking firms that supply services to the registrant must disclose those associations, regardless of the dollar amounts involved in those services. In this regard, these particular relationships stand apart from all others, where a quantitative standard of materiality is employed.

Indebtedness of management to the registrant is required to be disclosed. So too is remuneration paid to each of the registrant's five most highly compensated officers or directors and to all of registrant's officers and directors as a group. This item has been construed to require disclosure of kickbacks and other secret forms of compensation. In the proxy rules, disclosure is also required of any substantial interest of a director, officer or director-nominee, or an associate of any of them, in any matter to be voted on.

Disclosure is required, to the extent material to an evaluation of the integrity of an officer, director or nominee, of whether he has been named in a pending criminal proceeding or, within the past five years, has been the subject of a bankruptcy or similar proceeding, convicted of a crime, or enjoined from violating federal or state securities laws, working in the securities industry, or engaging in any business practice.

Disclosure is required concerning the existence and operations of any nominating, auditing or compensation committee of the registrant, and of those directors who, in the last fiscal year, attended fewer than 75% of the board and applicable committee meetings.

Disclosure is also required when a director resigns because of a disagreement over the registrant's operations and writes a letter describing the disagreement and requesting that the matter be disclosed. Similarly, disclosure is required when the registrant's independent accountant resigns or is dismissed.

Beyond these specific line items, disclosure of illegal or unethical behavior may be required in order to avoid material misstatements of fact made in response to line items not directly aimed at management integrity. For example, there are several rules designed to elicit a description of the

registrant's business, how it has developed, whether it is based upon dealings out of the ordinary course of accepted business practice and what risks affect its continuance and growth. These rules have been interpreted to require disclosure of illegal or questionable business practices where those practices need to be described in order to make the description of the business not materially misleading.

In the area of self-dealing, even in the absence of a specific line item, the Commission is particularly vigilant in seeking disclosure, especially in connection with voting decisions.

What more could be done by way of rule-making? Now, certainly the Commission could issue more rules bearing on management integrity. There have been repeated efforts to push the Commission in this direction by advocates of greater corporate disclosure -- particularly disclosure relating to the impact of business activities on the environment and in our communities. "Ethical investors" -- as they are sometimes called -- have asserted an interest in questions of corporate social responsibility, corporate governance and the accountability of management to all those affected by the corporation's activities.

In these areas, which are outside the central core of our disclosure scheme, based as it is on economic materiality, questions of the legitimacy of our effort to compel disclosure, as well as its feasibility, necessarily arise. In 1973, this question of legitimacy was addressed by Philip A. Loomis, Jr., who just this summer concluded a distinguished 28 year career with the SEC. Speaking with A. A. Sommer, Jr., then a Cleveland lawyer and later to become an SEC Commissioner, and myself, on an American Bar Association panel considering corporate social responsibility issues, Commissioner Loomis said:

"It is one thing for a person to believe and to act upon his convictions that something is right and just and should be done. It is quite another thing . . . to exercise a delegated power of government. We compel people, when we act, to do what they do not want to do or to refrain from doing what they want to do. And the question arises, for what reasons can we exercise that power? And the answer is, the reasons for which the power was given to us."

Our powers were given to us to compel disclosure of information material to informed investment and corporate suffrage decision-making. Economically significant information is central to our mission. Other information, how-

ever, such as facts bearing on management integrity, may be material to investors, particularly in the context of proxy solicitations for the election of directors. Where we believe information to be material to investors, we compel disclosure.

I believe the Commission should try to provide investors -- and here I include, especially, the professional analysts and other financial intermediaries who advise investors or as fiduciaries act on their behalf -- with the disclosure they want. But the trick, for us, is to decide what they want, beyond the core area of financially material information. There is much discretion here. But I submit that, in considering a new disclosure rule, we ought to be satisfied in our own minds -- and in a position to satisfy a court, if need be -- that the disclosure would be material to the reasonable investor in making an investment decision or in exercising his voting rights.

At this point I should like to point out that we seldom receive comments from investors on rules we propose for their protection. This is unfortunate, given our mandate and the need to infuse our judgment of what investors consider important with the real-world judgments of those we are trying to help. We need input from investors such as those represented in this audience. I beseech you to help us more in the future. Taking it another step, I suggest to you that an important opportunity exists under our statutory scheme for investors -- individually or in groups -- significantly to affect the Commission's judgment as to that which is material, and therefore necessary to disclose, concerning the business of issuers, the manner in which that business is conducted and by whom, and the impact of that business on others.

For one given to speculate about the future, it is interesting to ponder where investor notions of materiality may lead us in the years ahead. Over the past two decades, non-insured pension funds, both private and public, have been distinctly the fastest growing group of equity owners in the United States, increasing their share of the aggregate market value for all stocks listed on the New York Stock Exchange from under 5% in 1960 to 17.7% in 1980. While Peter Drucker appears to have grossly exaggerated the numbers, he is no doubt correct in predicting an acceleration of this trend toward employee ownership of, as he put it, "the means of production." Will this new group of investors insist on disclosure different from what we now offer? Might they not instruct their trustees to insist on satisfactory disclosure as to labor practices, retirement plans, corporate governance,

political activities, plant closing and relocation policies or other aspects of the business not considered, today, as sufficiently material to investors to warrant compulsory disclosure?

Is materiality the same for investment and voting decisions? The question is often asked whether facts deemed material to a decision to buy, sell or hold are co-extensive with facts deemed material to a decision to vote. In our effort to integrate the Securities Act of 1933 with the Securities Exchange Act of 1934 -- to equate a purchase from the issuer with a purchase on the open market, for purposes of disclosure -- we have tended to unify the disclosure rules for proxy statements with those applicable to registration statements and annual reports. While desirable as a matter of simplification, I want to stress that the range of information that could be material to a decision to vote for or against a slate of directors is significantly broader than that applicable to investment decisions. Notwithstanding the virtues of simplification, where an adequate showing of investor interest has been made, I do not think we should shy away from requiring different, and broader, disclosure concerning management, for purposes of voting one's shares.

How about disclosure to serve the public interest? It has been argued that the "public interest" standard in our statutes permits the Commission to compel disclosure in service to that goal, apart from the needs of investors. I do not accept this view, nor has the Commission itself when, on past occasions, it addressed the issue. Thus, in 1975 the Commission maintained that "it is generally not authorized to consider the promotion of social goals unrelated to the objectives of the federal securities laws . . . ." This position is well supported by judicial interpretations of other statutes containing similar authority for an agency to require disclosure "in the public interest." These cases have typically restricted the agency's power to act only in that area of the public interest implicated by the agency's particular mission.

Of course, disclosure can serve many goals. The Congress has written vast numbers of laws, compelling disclosure for one purpose or another. Thus, for example, to assure the proper workings of government, we have the Freedom of Information Act and the Government in the Sunshine Act; to protect borrowers, the Truth in Lending Act; to protect buyers of land, the Interstate Land Sales Full Disclosure Act. The list is nearly endless. Typically, these laws do not affect the Commission's disclosure responsibilities. However, in

in the case of one statute, the National Environmental Policy Act, Congress incorporated the policies of that Act into all other laws and regulations of the United States "to the fullest extent possible." In recognition of this directive, the Commission has adopted disclosure rules regarding a registrant's environmental proceedings, compliance expenditures and policies, some of which apply without regard to economic materiality.

The era of illegal and questionable payments.

In the mid-seventies, when the Commission was called upon to grapple with the problems of illegal and questionable payments by corporations, both domestically and abroad, it may have reached the outer limits of its authority in accommodating disclosure of these practices with what is material to investors.

As I mentioned at the start of this talk, the Commission's Report on the subject said that it had required disclosure not only "to insure that investors and shareholders receive material facts necessary to make informed investment decisions," but also to enable them "to assess the quality of management." In this effort the Commission found itself asking directors and officers to disclose illegal and unethical behavior and even intentions.

There is no problem with compelling disclosure of such matters where they have economically material consequences. The difficulty comes when the only purpose of disclosure is to enable investors to assess the integrity of management. To ask management to recount all illegal actions taken over the past year or illegal intentions for the next will obviously not promote disclosure. As District Judge Pierre Leval said in Amalgamated Clothing and Textile Workers Union v. J. P. Stevens & Co., Inc., "it is simply contrary to human nature" to expect management to make such disclosures.

What, then, is the purpose of such a disclosure rule? It may be to add a securities law violation to the substantive violation about which disclosure is sought. Or it may be to discourage management from engaging in illegal activities. Some would applaud these purposes, and did so during the seventies. As the Commission became increasingly seen as the champion of management rectitude, higher and higher public expectations developed of what it could do, and what it ought to do, in order to assure ethically sound standards of corporate behavior.

At least some of the recent cases would suggest that, in responding to these heavy pressures, the Commission reached the outer limits of its authority, and perhaps even exceeded those limits at times, during this turbulent period. I do not mean to suggest that the Commission ought not to have acted to meet the challenge that these widespread practices posed. While winning few friends in the corporate community, and shocking the sense of fairness of many, the Commission's enforcement efforts and voluntary disclosure program proved effective, and its 1976 Report to Congress on questionable and illegal payments and practices formed the basis for substantive legislation -- the Foreign Corrupt Practices Act -- requiring the maintenance of accurate books and records and an appropriate set of internal accounting controls and making foreign bribery a crime.

By enacting the FCPA, Congress shouldered a responsibility that the Commission had been carrying nobly and to good effect, but on a statutory structure strained almost to the point of breakage as a result. Congress dealt directly, through substantive rules, with what the Commission was trying to do indirectly, through disclosure. If public policy demands that accurate books and records be maintained, it is far more effective to prescribe that result by law than to try to achieve it by compelling disclosure of whether, and in what respects, the books and records are inaccurate. Similarly, if corporate bribery abroad is to be stopped, better to make it a crime than to compel disclosure of each occurrence.

Looking to the future, I do not believe the Commission should require line item disclosure of something that common sense tells us will seldom, if ever, be disclosed. For example, it would be ineffective to require disclosure of all illegal acts committed by management over the past year. Investors would not be informed.

Nor do I believe we should require line item disclosure of the ethical behavior of management. I have tried to write such a rule to elicit management's approach to compliance with laws -- a matter on which important differences no doubt exist among companies. How close to the wind do you sail? What role does counsel play in determining whether a particular corporate initiative is legal? These questions and others might be useful to investors. However, what one quickly realizes is that a boilerplate response would immediately result from such a demand, conveying little or nothing of importance to investors.

On the other hand, disclosure of illegal acts may be required in order to answer correctly line items eliciting other corporate information. Returning to the examples mentioned at the outset, a company which describes its labor relations as satisfactory but fails to disclose that the peace it enjoys is built upon bribes paid to labor union officials, has omitted a material fact necessary to make the statements made not misleading.

As to ethics, it doesn't seem useful to demand of a director standing for election that he describe how honest he has been or what code of ethics he will bring to his job. No meaningful disclosure is likely to result. However, if, as in one of the examples, an investment company touts the responsible management and financial strength of its investment adviser in proxy materials soliciting shareholder approval of the advisory contract, it becomes necessary, to avoid misleading statements, to disclose that the adviser's parent has some 22 major lawsuits against it, alleging breaches of fiduciary duty and seeking damages equal to 25% of its consolidated assets.

Similarly, in the example of a management decision to ignore a pollution statute on the basis of a cost-benefit analysis, disclosure of the likelihood and magnitude of the fines, penalties and other effects of this policy may be necessary, although not economically material in and of themselves, to prevent other required disclosures covering the corporation's business, financial statements, capital expenditures for environmental compliance or legal proceedings from being misleading. This was our position in the 1979 administrative proceeding against United States Steel Corporation.

How about disclosure to affect substantive behavior?

These observations lead me more generally to the question of whether the Commission may properly use disclosure to establish norms of corporate behavior considered by it to be desirable. It has long been recognized that compulsory disclosure tends to deter questionable practices and to elevate standards of business conduct. The Congress was aware of this phenomenon when it enacted the securities laws, and made it an important premise of those laws. And the Commission has recognized it down through the years.

The special treatment accorded law firms and investment banking firms with members on the boards of directors of corporations they serve is an example of disclosure not only

to inform investors, but also to promote business practices widely viewed as desirable. The Commission releases proposing and adopting this disclosure item make this dual purpose abundantly clear, although the adopting release was considerably tempered as a result of comments criticizing the Commission for having as its principal purpose the shaping of corporate behavior. Whether influencing the conduct of management was the primary purpose or an incidental by-product of informing investors, it succeeded brilliantly. As reported in the Commission's proxy statement disclosure monitoring report for 1981, between 1979 and 1981 there occurred a 25% decrease in the number of corporations with a lawyer from a retained firm on the board, and a 51% decrease in the number of corporations with an investment banker from a retained firm on the board.

Now, I don't object to this example, because there is an important disclosure purpose being served, in the minds of many within the investment community. But there are limits. My own belief is that, absent specific Congressional direction, the Commission ought not to adopt disclosure rules whose primary purpose is to achieve particular corporate behavior. Let me illustrate the kind of rule I have in mind. In 1980, the Institute for Public Representation at the Georgetown Law Center petitioned the Commission to adopt rules of disclosure concerning relationships between registrants and their attorneys. In brief, the rules would have required registrants to include in their annual reports a certificate stating that the board of directors had received and taken appropriate action on reports from all employed or retained attorneys of violations or probable violations of law. They also would have required registrants to file copies with the Commission of written agreements delineating the relationships between the registrant and all attorneys which it retained. Now, obviously, these rules were not simply rules of disclosure. In effect, they would have regulated the ways in which a corporation deals with its attorneys. They were substantive commands, parading as rules of disclosure. For, to comply with the mandated disclosure, one would have to establish the prescribed relationships with attorneys.

It is this type of rule, no matter how splendid its goal, that I think the Commission ought not to adopt, even if it had the authority to do so -- which authority I too would question.



What else can the Commission do?

The Commission, and its Commissioners, individually, have a long history of speaking out on subjects of concern to corporate America and its financial institutions, even where those subjects may not fit comfortably within the Commission's charter to address under its delegated authority. Former Chairman Harold Williams' persistent interest in corporate governance and accountability is one example. And Chairman John Shad's leadership in organizing the recently concluded conference on major issues confronting the nation's financial institutions and markets is another. The major issues conference addressed questions far beyond the reach of the Commission's own power to answer -- yet questions whose resolution would have profound effects on the financial markets we are now charged with regulating. This tendency to reach out, I submit, has been a salutary one over the years.

It is out of this tradition that I now turn, most briefly, to the recent takeover maneuvers of Bendix, Martin Marietta, United Technologies and Allied Corp.

This episode is not a proud one for corporate America. Various aspects of the battle leave one uneasy. The sheer volume of articles and comments by corporate leaders, academics, Congressmen, takeover specialists and press attests to this fact. I'm particularly uneasy as an SEC Commissioner, because to a considerable extent the game was played according to Commission rules. We are, to a degree, implicated in the process, if not associated with the results.

What, then, are the sources of this unease?

First, there is something strange about the apparent freedom of management to vastly alter, and frequently weaken, the capital structure of its own corporation, in pursuit of a takeover, allegedly in the best interests of its shareholders, but without any reference to their views. This is strange, and unsettling, because corporate law has traditionally accorded shareholders a significant voice in mergers and other major corporate events. The so-called PAC-MAN defense raises similar issues.

Second, it is equally disquieting to observe the apparent freedom of management, when faced with a takeover threat, to award themselves a "golden parachute" in the event their defense proves ineffective. Have our corporate laws been outflanked by the new acquisition techniques? Are traditional notions of abuse of trust, corporate waste, and breach of fiduciary duty insufficiently flexible to reach

behavior widely viewed as undesirable? If so, those laws should be reviewed, and perhaps overhauled. I would prefer to see that done, than to try federally imposed restrictions on acquisitions.

Third, there is the growing use of two-tier offers. Are they unduly harsh on the public shareholders?

I would hope that such organizations as the Business Roundtable, the National Association of Manufacturers, the Conference Board, the American Bar Association, the American Law Institute and our host today, the Investor Responsibility Research Center, will be addressing these questions in the coming months.

For our part, I believe the Commission should study these matters too. We are, in fact, committed to a study of the tender offer rules. These questions should be added to our list. We should consider, for example, whether, through disclosure, investors could gain material information concerning management policies and attitudes toward takeover attempts, whether by or of their corporations. One suspects that meaningless boilerplate would result from such a requirement, but I mention it as illustrative of the kinds of questions I hope the Commission and its staff will be considering as part of its review of the Williams Act.

I do not mean to suggest that the Commission's charter is broad enough to resolve all these questions. It isn't. But we ought to be involved in the process, and I hope that process gets underway soon.