REMARKS OF RICHARD B. SMITH, COMMISSIONER
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"The Freedom of Information Act and the Agencies:
SEC No-Action Letters"

My agency's mission, as you know, is full disclosure of corporate affairs, so we should not, and for the most part do not, have any problems operating under the Freedom of Information Act, a statute that promotes full disclosure of government affairs. To me it is a salutary piece of legislation.

We do have a pending question involving an intra-agency memorandum. That is in litigation and so I shall not speak to it today. I should also point out, as is our custom, that the views I express are my own and not necessarily those of my colleagues at the Commission.

I would like to talk a bit (and the moderator suggested I do) about a kind of agency action at the SEC that we call "no-action." Now that may sound like too customary bureaucratic legerdemain, but in fact it is a process that the Administrative Conference of the United States only two months ago called "an outstanding example of administrative accessability and pragmatism." Let me describe it.

The Commission staff, in response to written requests from the public, issues two types of letters expressing views on the legal results under the securities laws of contemplated or proposed financial events. One type is called an interpretative letter. It is an informal opinion from the agency staff on the application of the law to a contemplated factual situation. The other is called a "no-action letter." In such a letter an authorized staff official may state--with respect to a specific proposed transaction--that the staff will not recommend to the Commission that it take enforcement action, if the transaction is consummated in the manner described in the incoming letter. Both types of staff letters are regarded by the Commission as subject to reconsideration and not as binding precedents on it.

A no-action letter is the outcome of an essentially informal process created early in the Commission's history. It is designed to assist and provide guidance to persons who appeared to wish to comply, in the highly varied contexts of the financial world, with the then new and rather broadly stated concepts in the securities legislation. The need for such a process, in my view, continues.

However, there have been two prime, inter-related defects in it, both of which I hope the Commission is now in the midst of curing. One of those defects arises in the substantive law and has led to some 80 or 90 percent of no-action requests. The other is a question of administrative practice that has a particular relevance to the Freedom of Information Act.

An adequate description of the substantive law point would require more time than I have here or would be warranted by the topic of this panel. Suffice it to say that the most visited area for no-action requests revolves around the question of when securities can be sold without registration under the Securities Act of 1933. There is a substantial public interest in preventing persons or firms who acquire unregistered securities from corporate issuers in private transactions from turning around and selling to the public what may be large amounts of such securities without the disclosure protections of the statute.

The language of the statute led the Commission over the years to require registration unless the hopeful seller, or re-seller, of such restricted stock could show that he did not acquire the securities in the first instance "with a view to" their distribution. To show that this subjective state of mind did not exist, the Commission required the hopeful re-seller to demonstrate a subsequent "change of circumstance" in his personal affairs that would reconcile his decision to sell with the existence of an original investment intent. The original investment intent came to be evidenced by a so-called investment letter given contemporaneously with the acquisition of the stock. The subsequent change of circumstance came to be a matter of the most vivid personal detail--divorce, loss of job, hospitalization of children, and so on.

Given the subjective test and the factual vagaries of change of circumstance, it was expectable that persons holding such restricted securities would want to assure themselves about staff reaction before re-selling and exposing themselves to rather severe statutory liabilities. Hence, the volume of no-action requests.

The Commission has rule proposals now outstanding that would turn to more objective standards for determining when registration is required for persons wishing to sell "investment letter" stock, rules that are also more addressed to the disclosure needs of the purchasers of such securities. After all, what the purchaser needs to know about the securities has little relevance to what the seller's state of mind was some time ago or what personal problems he may now be having.

Objective tests would not only improve the substantive law but would also cut back markedly on the volume of no-action requests that almost submerges the staff. Rules such as proposed would go far to eliminate the need--resulting from the type of standards imposed--for private citizens to communicate highly personal information (which the staff, in my view properly, has treated confidentially). We are currently considering adoption of those rules or variants of them.

What I have described so far is a point of substantive law that is deeply intertwined it seems to me with the administrative law or policy aspect of no-action letters. On this latter aspect there is also some movement at the Commission.

The principal administrative defect in the no-action process has been the private nature of the communication. Only the lawyer requesting no-action knows what the views of the staff are. Certainly it is important that new administrative constructions of the law, or change of existing constructions, or application of the law to situations of general significance, be made available to all members of the bar and not simply to the particular lawyer requesting the interpretation or no-action. While the Commission has from time to time published interpretations, there are often considerable time lags and gaps. Moreover, when the staff of a public agency indicates its views in this manner, regardless of whether technically it constitutes "agency action," it would seem preferable administrative practice to make the expression of views a matter of public record.

A concern expressed is that publication would build in a formality and slowness to the process that would neutralize its guidance value to the particular requesting person. Maybe. But I think we can guard against that, if we will to do so, in other ways and still achieve the value of public information.

In September 1968 the Commission published a release spelling out most of the pro and con considerations on whether staff interpretive and no-action letters should be made available to the public and invited comments. That release referred at several points to the helpful report of the Section's Committee on Public Information. In June 1970 the Administrative Conference of the United States made recommendations to the Commission aimed generally at greater public availability of intepretative and no-action positions taken.

Last month the Commission proposed a specific rule that would place letters requesting no-action or intepretation, and the staff reply, in the Commission's public information files within 10 days after the staff response. The 10 days could be extended to up to 60 days if there were sufficient grounds for confidential treatment. If confidentiality treatment were requested and denied, the person requesting staff views would have 30 days to withdraw his letter in which case no staff views would be given and the requesting letter would remain in the Commission's non-public files.

This proposed rule may well need some sharpening. But it, or some variant of it, and the substantive rule proposal on resale of restricted securities, or some variant of that, seem to me to go together. It is difficult to see how change in one aspect can be meaningful without change in the other. Were we to require that the very personal information called for under present subjective standards be made public or else the staff will not provide its views in this nebulous area, that is at the least an uncomfortable choice to give citizens who wish to comply with the laws we are administering. At the same time non-public expressions of administrative policy by the Commission staff are not desirable either. And so, I believe our two pending rule proposals, subject to some modifications, go far in accommodating the needs of the financial community, the bar, the Commission and the Freedom of Information Act.