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"THE PETROLEUM GEOLOGIST AND THE SEC"

ADDRESS

of

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Commissioner, Securities and Exchange Commission

before the

AMERICAN ASSOCIATION OF PETROLEUM GEOLOGISTS

Houston, Texas

Thursday, April 3, 1941
11:45 A. M., C.S.T.

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I am both a Commissioner of the Securities and Exchange Commission and an associate of the American Association of Petroleum Geologists. It seems to me only natural that I should want to speak to you about the relationship of these two organizations. In doing so, I welcome the opportunity to lay before you some specific proposals for your consideration.

The SEC is a federal agency established by Congress to help the nation's investors. Under the Securities Act the SEC doesn't prevent the sale of bad stocks or bonds. Nor does it advise the investor what to buy. Our job is merely to have the full truth about a security disclosed to the investor so that he can make up his mind intelligently about his investment. These requirements are not large. You and I expect that the truth be revealed to us about the geological equipment we buy and use. If the truth is kept from us and we buy damaged equipment, we feel gypped. The same is true about the investor who buys sour securities that were misrepresented to him as blue-chips.

Now I want to allay any possible fear that the SEC, being a federal government agency, is run by a lot of green-eyed monsters. The people who work at our shop are people like yourselves. Being public servants, their opportunity is to earn your friendliness by maintaining, as I believe that many of them are doing, an atmosphere of efficiency and cooperation. To do that it is necessary that they be modest as well as efficient; to be open-minded instead of bureaucratic; and more important than anything, to be human in their relations. They, as well as I, must think of the public whom we serve as human individuals, hoping that in return, you will recognize us not as distant and disagreeable policemen, not as symbols of irritation, but as a group of human beings possessing the usual quota of human shortcomings.

You may be wondering where the SEC fits in with petroleum geology. In one respect the oil and gas business isn't much different from other business

enterprises. It takes money to obtain seismograph records, to construct derricks, to drill wells, to refine crude petroleum and to market the finished products. In raising money the oil operator often sells stocks, fractional undivided interests in leases, royalty interests, notes or other securities to the public. At this point the oil operator finds that the Acts administered by the SEC require him to tell the complete truth about these securities.

It's customary for the petroleum geologist to make a report on the area which is about to be explored or exploited. And that's where you come in. If your report is going to be used to sell oil securities to the public a copy of it must be filed with us. Or if a geological expert helps prepare or certify a registration statement covering securities proposed to be sold, once again the geologist may come to know directly about the SEC.

These geological statements are matters of public, as well as private, concern. Geologists, therefore, must assume full responsibility for the preparation of sound reports. It is essential that petroleum geologists develop means of reporting, measuring and interpreting the geological aspects of the oil business to the prospective investor in accordance with principles and standards, which are definite, professional and widely accepted. Such principles and standards can and should be promptly developed.

To my way of thinking, there are minimum standards whereby geological reports should be judged. The geologist should be in good standing and entitled to practice his profession in the place of his residence or principal place of business. He should meet those requirements of training and experience which are prescribed by local law. If he passes these basic tests, the geologist would ordinarily be entitled to represent himself as one whose profession gives authority to a statement made by him. In addition, however, the report should be based upon procedures followed and recognized

by members of his profession as an adequate basis upon which to rest professional opinion. In this connection, I suggest that, except where otherwise noted, there should be no omission of any procedure which petroleum geologists would ordinarily employ for the purpose of making dependable statements. Finally the geologist should express his professional opinion as clearly and fairly as he can in language intelligible to the layman.

At the SEC, we have an Oil and Gas Unit, composed of experts who specialize in oil and gas problems. Our geologists and engineers go over the geological statements filed with us to find out whether the full truth is being told to the investor. Opinion plays so large a part in making geological estimates that absolute mathematical accuracy is impossible. Still, within limits, considerable accuracy can be attained. There are areas, as I have already indicated, wherein the reports of geologists should be subjected to scrutiny from the point of view of the interest of the public investor. That is the job of the SEC. Of course the great majority of the statements filed with us are the products of respectable, honest, capable geological experts. Many of these experts are members of the American Association of Petroleum Geologists.

The virtue of simple honesty would seem easy to maintain. Unfortunately, not all of these geological statements tell the full truth. Some are plain frauds. Others are unintentional but careless misrepresentations. Above all, there are instances of inadequate disclosure. There are few geologists whose reports fall into these categories. Yet there are enough of them to create a problem. Some of them are members of this Association.

The SEC therefore has a keen interest in the professional standards of geologists. There always have been and always will be subtle influences at work to corrupt the high functions which professional geologists perform. When I speak of corruption I don't necessarily mean larceny. I include the

application of pressure from employers so that these high functions be exercised solely for the employers' profits. A personal financial interest may influence the geologist to prepare statements which do not fully disclose material facts. I refer to geologizing solely by cash-register standards. I also include the corroding influence of unscrupulous promoters. You and I have known geologists who were but "yes-men" to overreaching promoters. In short, I mean that the idea of geological service has sometimes been forsaken for geological salesmanship. For these reasons one of the chief problems of geologists is an ethical one. In these regards, petroleum geologists are no different from other professional groups. The lawyers have their shysters, the doctors their quacks, and the geologists their "geo-quacks".

The American Association of Petroleum Geologists is vitally concerned about these "geo-quacks". The Association's Code of Ethics, quoting Article II of the Constitution, provides that, -- "The object of this Association is to maintain a high standard of professional conduct on the part of its members and to protect the public from the work of inadequately trained and unscrupulous persons posing as petroleum geologists."

There is good reason for this Association to be concerned about the professional standards of its members. We all know that a few rotten apples can spoil a whole barrel. The "geo-quacks" create ill-will for the geologists' profession.

Article II of the Association's Code of Ethics deals with the relation of the geologist to the public and his profession. I don't want to sound as if I were delivering a sermon but I do want to emphasize a few of the principles set forth in the Code. A geologist, the Code says:

1. "should avoid unwarranted statements that might induce participation in unsound enterprises."

2. "should not knowingly permit the publication of his report for the purpose of raising funds without legitimate and sound development in view."
3. "may accept for his services an interest in the property reported on, but it is desirable that the report state the fact of the existence of the interest."
4. "should not give an opinion or make a report without being as fully informed as might reasonably be expected, considering the purpose for which the information is desired. The opinion or report should make clear the conditions under which it is made."

Such principles are, after all, the living difference between professional conduct and non-professional conduct. They introduce the element of public service which distinguishes the profession. True, it is most difficult for the professional to think in terms of the cumulative effect of his daily activities in terms of the ultimate public welfare. While this is not peculiar to the geologist, it is an acute problem in his case because in the final analysis his is a profession affected with a public interest.

Unfortunately codes of ethics too often remain just codes of ethics. Enforcement of the code by this Association depends largely upon one member reporting violation of the Code principles by another member to the Executive Committee of the Association. Being human, you and I don't like the brand of "tattle-tale" so we pass the buck and fail to report our unethical fellow members. Other professional groups have the same problem.

I want to suggest one way in which the SEC and the Association can work together to put into effective practice the geologists' code of ethics. Part of our job at the SEC, as I have previously said, is to protect the public investor from the "geo-quacks." The Association has the same objective from the point of view of the good of the geologists' profession. We at the SEC have a few ways of dealing with untruthful geological statements. We can refuse to permit the registration statement to become effective, thereby preventing the securities from being sold lawfully. We may induce the oil

company to withdraw the untruthful geological material or substitute accurate statements. On the other hand, the SEC may recommend to the Department of Justice that it institute criminal proceedings against the deceitful geologist. The SEC's Rules of Practice also provide that any person who has engaged in unethical or improper professional conduct may be disqualified from preparing any statement filed with the SEC. These methods may be either too mild or too drastic in many cases. The middle ground would seem to lie in disciplinary action by the Association itself. Judgment by one's fellow members who are expert and aware of changing and current conditions should prove very effective in deterring unwarranted geological statements.

Our mutual aims can be accomplished through some working arrangements between us whereby we cooperate to stamp out "geo-quackery" and foster high standards of professional conduct. Therefore, I respectfully suggest that the Association set up a committee to maintain liaison with the SEC. If the SEC uncovers unethical or improper professional conduct by some Association member, it will relay the information to the Association for appropriate action by the Association. The Association can discipline its own members if it deems it appropriate and thereby maintain its high professional standards. The SEC, in performing its duty of protecting investors, may thus provide its administrative machinery to inform the Association of possible infractions of its Code of Ethics. Not only can we work together in this regard, but there are surely other common problems in connection with petroleum geology which can be talked over to our mutual benefit. If there is real cooperation, the Association's liaison committee can function as an advisory body with which the SEC can consult on mutual problems. Out of this working arrangement can come understanding and cooperation which will be beneficial to both the Association and the SEC.

A similar cooperative arrangement has proved successful in the accounting field. For several years, the SEC has had a working arrangement with the American Institute of Accountants, the Controllers' Institute of America, and the American Accounting Association. The disciplinary committee of the American Institute of Accountants keeps in close touch with the SEC. The American Institute of Accountants has also designated a "Special Committee on Cooperation with the Securities and Exchange Commission" to work with us. The accountants' Special Committee on Cooperation with the SEC had the following to say in its report in 1940:

"The S.E.C. and the accountancy profession have common objectives. Differences of opinion are bound to arise as to ways and means for accomplishing the objectives, but our experience has shown that representatives of the S.E.C. and committees of the American Institute of Accountants can discuss opposing views frankly to their mutual advantage."

I believe that it can be made to work successfully in the petroleum geology field too. The SEC can help you. And you can help the SEC. I sincerely hope that the Association will give serious consideration to this proposal.