NEWS

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
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HOLD FOR RELEASE UNTIL 1:30 P.M., EDT

THE FINANCIAL PRESS AND THE SEC

An Address By

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Securities and Exchange Commission

May 6, 1975

SOCIETY OF AMERICAN
BUSINESS WRITERS

Sheraton-Carlton Hotel
Washington, D. C.

If one takes a broad-scale, long-range view, it seems clear that the SEC and American business writers are essentially in the same business. We are both devoted to the process of keeping American citizens informed on what is going on in American business. We both like the truth and the whole truth -- the bad with the good -- and we both seek the widest possible dissemination of our product. We both strive for impartiality and objectivity.

This is not to say that we have always made common cause. Indeed, in many, largely local, skirmishes we must appear to you as the enemy. Our notions of propriety with respect to indirect selling efforts prior to a public offering -- so-called "gun-jumping" -- dry up sources of information for you. So do our ideas on insider trading and the selective dissemination of non-public, material information.

In this latter area, we are very conscious of the fact that we have made many persons confused and nervous. They are confused over what is material for this purpose, and what information is public and when, and they are nervous about the consequences of guessing wrong. Here we are still endeavoring to publish some guidelines, but it remains a subject of some contention and conflicting desires.

Despite our repeated exhortation for readability and the avoidance of boiler-plate and excessive technicality in disclosure documents filed with us, we continue to be viewed as the apostles of turgidity and the prime progenitor of the unreadable prospectus. In this regard, I must admit that we speak, to a degree, with a forked tongue. We urge draftsmen to write so that ordinary investors can understand, but we have no inclination to relax legal liability attendant upon erroneous or incomplete disclosures.

As a lawyer practicing in the field, I listened to the Commission when it exhorted, but I was even more keenly aware of the fact that the one person who could be guaranteed to read the prospectus, or whatever, with great care was the plaintiff's lawyer if things did not go well. So I wrote with him constantly in mind. A careful lawyer can hardly do otherwise. This does not excuse some of the unreadable stuff you encounter in what our disclosure processes produce, but it explains a lot of it. This really makes your efforts all the more valuable, since you are not subject to the same strictures.

One reason that we have so much in common is that the Commission and the acts that it administers are such a rich source of information.

The Congressional record surrounding the creation of the federal securities laws, especially the Securities Act of 1933, reflects Congress's understanding that, while the Commission would be the repository of the vast amount of information expected to be filed with it by registered companies, other institutions would carry a major share of the responsibility for analyzing and disseminating that information to the investing public -- not because of some general "public interest" attitude on the part of those institutions, but because it is in their interest to do so.

As you well know, there is a vast amount of information available for the asking in our Public Reference Section at 1100 "L" Street. For example, the Commission receives more than 200,000 formal filings and reports each year that are made public immediately. If you should wish to review reports of security transactions and holdings by officers, directors and ten-percent stockholders in securities of companies registered under Section 12 of the Securities Exchange Act, you would currently have to look at some 9,500 reports each month.

During our last fiscal year, we had approximately 19,000 visitors in our public reference room in Washington and more than 17,000 written requests for information not

involving the reproduction of documents. The Commission's staff conducted more than 52,000 searches of its records for information being sought by members of the public.

So we know that a great deal of this information is used. We know, also, that no other regulatory agency regularly makes available more information to a wider audience. For comparison purposes, during a recent year, the Federal Power Commission distributed approximately 500,000 copy pages of material filed with or available from it; in the same year, combining hard copy and micro-fiche, the SEC distributed more than 150 times as much, or over one hundred million pages.

We have become an even richer source by virtue of the recent amendments to the Freedom of Information Act, but here we also may encounter some disagreements.

The Act, as you know, requires the disclosure of all information contained in the files of an agency unless the information falls within one of nine exemptions, including investigatory records compiled for law enforcement purposes.

The Act now also imposes very stringent time requirements for the processing of requests. Initial decisions on requests must be made within ten working days of their receipt by the

agency; an appeal must be decided within 20 working days of receipt. The SEC publishes a release each time it decides an appeal; we are also going to make public each original request and our reply. The information, itself, must be made available within a reasonable time thereafter. If the appeal within the agency is denied, or if the agency, either in the initial stage or on appeal, fails to respond within the time limits provided, the requesting party may go directly into court to require the disclosure of documents. Where it appears appropriate, the court will make its own review of the records to determine whether their withholding is proper under the Act.

Freedom of Information Act matters receive expedited treatment on the court's calendar and the court may assess reasonable attorney's fees and other costs against the Government. Moreover, in order to get the bureaucracy's attention, so to speak, if the Court issues a written finding that the circumstances surrounding the agency withholding raise questions whether agency personnel acted arbitrarily or capriciously, the Civil Service Commission must promptly initiate a proceeding against the officer or employee who was primarily responsible for the withholding. The Civil Service Commission must submit its findings to the officer or employee and the agency must take the corrective action recommended by CSC.

As you might expect, the time period permitted by the Act for an initial decision is causing us, and I expect other agencies, a great many problems. In the abstract, ten working days may seem sufficient time to process a request and, if an agency has manpower to allocate for the task, it may be. But the fact of the matter is, at least at the SEC, that presently we don't have the manpower we need for this work or the money to obtain it. I don't think it is any secret that we underestimated both the amount of work required to process any one request and the number of requests we might receive. In any event, at least in the short-run, we are faced with the necessity of taking staff people off what we think is more substantive work, such as enforcement actions, in order to process FOIA requests.

In the first ten weeks of operation under the Act, as recently amended, we have received 134 requests, approximately ten percent of which emanate from the press. Approximately 75 percent of the requests we receive concern investigatory records. We have handled about 80 percent in the ten-day period, which does not bode well for Jim Rosenfeld, our Public Information Office Director and Freedom of Information Act person.

I don't know what your reaction to this is, but it bothers me -- both as a citizen and as the Chairman of the Commission. It bothers me as the Chairman, because I see staff people doing work that, in most cases, may not benefit the general public, as their "normal work" usually does and, because as an administrator, I know that it creates morale problems. As one young staff member recently put it: "I didn't go through law school and come to the Commission to search files." I have to agree.

A second general problem we have noticed is one raised by "harassing" requests. By this I mean members of the public who, in either one letter or multiple letters in one envelope, or multiple letters over a period of time, ask for voluminous amounts of information without any apparent motive other than ordinary curiosity. Even with the short experience that we have, it is becoming apparent that this may be a very serious problem. As now written, the FOIA does not require any showing by the requesting party as to why he needs or wants access to materials in our files.

As a general matter, this may be wise, but it seems to me that some type of limit ought to be considered, perhaps on the number of requests a person is permitted within some time period, in the absence of extenuating circumstances. Without such a limit, it would be possible for the public or any segment

thereof, including the press or the bar, for that matter, literally to bring the SEC or any other agency to a grinding halt.

A third problem is money. The FOIA permits an agency to charge fees for the provision of materials in fulfilling a request, but the fees are limited to "reasonable standard charges for document search and duplication" and may "provide for recovery of only the direct costs of" such search and duplication. Thus, we have not been charging for the time an attorney spends reviewing records to determine whether disclosure should be made. This is, as you may imagine, the most costly step in the process.

The most important substantive change effected in the recent amendments was to the exemption for investigatory materials -- the so-called (b)(7) exemption. This is the one substantive amendment which is having a major impact on Commission procedures.

As originally enacted, the Freedom of Information Act provided an exemption for "investigatory files compiled for law enforcement purposes except to the extent available by law to a party other than an agency." 5 U.S.C. 552(b)(7). Under this language the courts had held that once a district court has determined that records sought were property classified as an investigatory file, whether the matter to which they related

was open or closed, its inquiry would be at an end and it was required to sustain the availability of the exemption from disclosure. */

In order to protect innocent persons from undeserved embarrassment, and for other reasons, we conduct most of our investigations in private. Raw investigatory files frequently contain references to persons not involved in any illegal activity and in terms which, if publicly disseminated, could be quite harmful to them. All such references in the files could be removed, if at all, only through the most painstaking and time-consuming line-by-line analysis of the investigatory records. This is a process that is not merely clerical; it often involves matters of substantial judgment -- and the only people in a position to make that judgment may be the staff attorneys who should be conducting the investigation or enforcement action.

For these reasons and others, including the possibility that the target of the investigation may in fact prove to be innocent, the Commission has determined generally to attempt to protect the contents of files where there is an on-going investigation or there is a concrete prospect of further enforcement action. Our decision in this matter was contained in the first

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*/ Frankel v. Securities and Exchange Commission, 460 F. 2d 813 (C.A. 2, 1972); Weisberg v. United States Department of Justice, 489 F. 2d 1195 (C.A. D.C., 1973) (en banc), certiorari denied, 416 U.S. 993 (1974).

public release under the FOIA. */ There, the requesting party sought disclosure of all records relating to Equity Funding Corporation of America, particularly those contained in our investigatory files. Access had already been granted by the staff to records other than those of an investigatory nature. In support of its refusal to disclose investigatory records, the Commission noted the existence of both continuing investigations and judicial proceedings.

Where there is no continuing investigation and no concrete prospect of further enforcement proceedings, the contents of our investigatory files will generally be made available except for internal memoranda or materials that would disclose a confidential source or investigative techniques. This decision was made despite our deeply felt regret that, in some instances, disclosure of records would be made even though persons who cooperated in our investigations would have reasonable grounds to object for reasons of personal privacy or business secrecy.

We therefore invited any person who has previously given testimony or supplied documentary evidence in a Commission investigation, or who will do so in the future,

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*/ In the Matter of Request of I. Walton Bader, FOIA No. 1 (April 3, 1975).

to write to the Commission if he believes that particular portions of the testimony or specified documents would be exempt from disclosure, to specifically identify the testimony or documents and to demonstrate why disclosure would "constitute a clearly unwarranted invasion of personal privacy" or would publicly expose sensitive commercial or financial information that would not normally be disclosed.

Apart from specific problems under the FOIA, we have other areas of disaffection, based in part, perhaps, on lack of complete understanding, but also based on different motivations and standards.

We are not happy when we are criticized by business writers. Some criticism rolls off with little pain. One critic sent me a copy of a letter he had sent to a friend, which read:

> "Dear Jack:
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> > "What kind of an impression have people out your way of Ray Garrett? I get the impression, he's kind of a pawn, and not a very bright one at that.
> >
> > "Anyway, it's clear SEC is out to ruin the investment business. It ruined the mutual fund business and has no concern whatsoever about what it does to capital formation capabilities. More I have experience with them, more they seem to me mostly a bunch of jerks."

But, criticism from such informed persons as you, is another matter. When it is well taken, when we have simply not done the job we should, criticism is painful, even though, and especially because, it obviously is justified. Some criticism is of another nature.

I am referring particularly to the unfavorable comment that I have read rather often about our enforcement procedures. For some time, I have read that the lawsuits we bring against persons who have violated our laws, being frequently settled at the time they are filed, or shortly thereafter, result only in a slap on the wrist and an admonition to sin no more. This most recently has been raised with regard to our actions against certain large corporations for having substantial sums, in unaccounted-for funds, used, among other things, for illegal political contributions. Why do we let the management of such companies off with a promise not to do it again?

The first answer to the question is that we do not. In the cases that have generated this adverse comment, we, in fact, have obtained the creation of special committees of uninvolved persons to make a thorough investigation of all of the transactions involved -- a far more detailed investigation than we have been able to make with our own staff -- and sometimes the retention of special counsel to investigate and prosecute any claims that might justly be brought against management or others

on behalf of shareholders. We have, on occasion, however, successfully negotiated for the reimbursement to the company of substantial sums by officers responsible for misappropriations, and in every case we have insisted upon the establishment of procedures to reduce the likelihood of a recurrence.

The decision to employ some of these remedies is based upon the Commission's need to conserve its limited resources and to require that the persons responsible for the alleged misconduct bear the direct cost of completing this painstaking work. This is not to say that the Commission retains no further presence in the case. Indeed, the staff closely monitors the examination and, if it should believe that the examination has not been carried out according to the spirit of the court decree, the Commission is prepared to reassert itself in the litigation.

All this does not satisfy those who think someone also ought to go to jail. We, however, think these are substantial remedial measures that provide good assurance to investors against the continuation or repetition of the improper behavior. The criticism seems to be that they do not inflict sufficient pain. Perhaps they do not. I am not the best judge of that.

I do observe, however, that the pain may be greater than it appears as one reads of our complaint and the quick settlement. To a confirmed crook, it may be one thing. To one who has been operating among, and wishes to be regarded as, one of the leaders in American industry, it is quite another. While I am not an expert at measuring pain, I am quite certain that our actions -- the very fact of them -- against major corporations and their top management, inflict excruciating pain. We have, in fact, contributed to the destruction or impairment of more than one reputation and career, even though that has not been our desire.

It is also true that our enforcement actions customarily spawn one or more class actions on behalf of shareholders or others who seek big money damages, compensatory and punitive. We do not stimulate these, but they are the natural consequence of our making public our view that some illegal behavior has taken place. In many instances, these produce the penalty that hurts the most.

The important thing for our critics to understand in these matters is that our authority for going to court is to prevent illegal behavior or its recurrence, not to punish past behavior. We can go to court on the civil side, on the ground that the defendant is about to do something wrong and must be stopped -- a reasonably rare occurrence -- or that he has erred in the past and therefore might do it again -- our most common posture. On

the whole, the courts have been liberal in accepting our argument that a past trangression is enough to justify enjoining future transgressions, but occasionally we lose on the ground that there is no serious likelihood of recurrence.

Given the fact that our basis for being in court at all is to achieve protection against recurrence, it seems reasonable to accept settlements that offer everything, or almost everything, that we could obtain through extended and expensive litigation. All we can get from complete success in our court cases is an injunction against further violations and what lawyers call "ancillary relief" -- the appointment of special counsel, audit committees, a receiver, some disgorgement of ill-gotten profits and the like. If we can get the injunction and a reasonable deal on the ancillary matters, then it seems the wise thing to do. There is no assurance that we could do better at the end of a long trial, costing everybody, including the Government, a lot of money.

If one wants to inflict more pain, that must be done through criminal prosecutions, which are the province of the Department of Justice and the U.S. Attorneys. I do not want to disassociate ourselves from this process. When we think it appropriate, we are quick to refer a case to them with a recommendation for grand jury consideration, and, if a prosecution is undertaken, our attorneys often participate very actively in assisting the U.S. Attorney. The ultimate

decision as to whether a criminal action should be brought, however, is theirs and the grand jury's, not ours.

From time to time, it has been suggested either that the Commission be authorized to bring its own criminal cases or that it be authorized to sue for a civil fine -- that is, a money penalty -- instead of an injunction against future misconduct, and, possibly, some repayment of illegal expenditures. While I, personally, at least, am not convinced that it would be wise to free us from the discipline of referring criminal prosecutions to the Department of Justice, the idea of a civil fine has considerable merit. It would enable us to accommodate policy objectives to legal procedures somewhat more forthrightly than is now the case, although it could have some disadvantages if its existence also implied new procedural burdens in our proceedings. Whether it would satisfy those who want greater pain for corporate malefactors would depend upon what we were authorized to do and what we did with it.

As you can readily understand, the cases of illegal political contributions, bribes and slush funds, present us with quandries far more challenging than whether the penalties are tough enough. While I have no difficulty with the cases we have brought to date, they do raise the question of how far we wish to go.

These cases have all involved fairly substantial sums under the control of, and created with the connivance of, or at the direction of, the top management of the company. They raise questions, in varying degrees, of the quality of management, the quality of earnings, and the integrity of financial accounts and reporting. When these factors are present, we have decided they are material, even if the sums involved, had they been related to some other activity, would not otherwise have been considered material.

But, how far should we go? Is every illegal expenditure -- what the Mexicans call "la mordita," and what we Chicagoans call "a little grease" -- to be material for disclosure purposes simply because it is illegal? If this question is merely interesting domestically, it poses a significant dilemma internationally. And it arises in different forms. Here, I think, I have something of a difference of views with you or some of your brethren.

The press is often put in the same uncomfortable position we are -- when information about bribery or other management fraud comes to light, and its disclosure could prove harmful, particularly to the existing shareholders of the company. In some of our cases, particularly management fraud cases, the press has publicized all the important facts while we are still pondering the question. This, no doubt, makes it easier for us, and perhaps we should be grateful to the press for that. Once the facts are out -- and the companies involved usually produce a very frank press release promptly -- our philosophical concerns effectively are resolved.

But such episodes cause reflection on my part. Are we timid, or collusive, or corrupt in even considering that disclosures of dramatic stuff like this should be weighed carefully as to its effects on innocent persons, and as to timing? Are we flirting with heresy in even contemplating the effects of the timing of disclosure of difficult facts? Is this a deviation from our canon of full disclosure?

I am thoroughly familiar with Watergate and its dreary aftermath and administered news and bureaucratic cover-up. I have no desire to hide our mistakes or to avoid a proper, after-the-fact, review of our judgment and actions, but I wonder if the press should always feel obliged to disclose immediately information that we might consider should be disclosed only at a later time. These are issues that, under our system, can only be addressed by the press. But, should the press not consider, as we must, that the effect of disclosure is at least as important as the fact of disclosure? I know very well that this is slippery ground. Too tender a concern for the consequences of disclosure can lead to an erosion of sound principles both by you and by us. This burden of judgment is one we both share, and I suppose it is not surprising that we sometimes arrive at different conclusions.

Let me move away from this gloomy area, however. The Securities and Exchange Commission and the financial and

corporate community are increasingly well served by business writers.

The other day I received a copy of the report of Roper Associates on public reception of news media. It found that television was increasingly the major source of news and regarded as the most reliable. The report did not break out business news from news in general, so it does not signify much for our area of mutual concern. I only hope that investors do not rely on television for business news, because they will not get it. Considering the costliness of time on that particular medium, I suspect it will never rival the written word, but one would hope that some day it would show a bit more sophistication and attention to the serious problems of our economy than it has to date.

In closing, let me return to my original theme. Investors, and citizens in general, must know more about what our corporations are doing and why they are doing it. This is important both to improve the performance of our major companies in the public interest and to give people a better understanding of how business works, to provide jobs and, to this end, to attract capital investment. The level of understanding of these matters is dangerously low. It is not helped by abysmal ignorance of

our teachers at all levels. Too many of them do not know how the system works, and they are instinctively hostile toward it. In fact, it is high fashion in academic circles to be suspicious of, and to ridicule, all corporate behavior.

You know, and we know, that there is much to be improved in this regard. We do not intend to relax in our efforts to improve corporate behavior toward investors and the behavior of the various professionals who are so important to the process.

Some months ago our Denver Office was bombed. It was a very powerful bomb in the men's room used by our staff, and only by good luck did our people avoid serious casualties, although others were not so fortunate. The note planted in connection with the bomb said it was directed at the SEC as the tool of the capitalistic-imperialist pigs. We are not concerned with imperialism, but the capitalistic part is true. We are devoted to making the system of private ownership of capital work, by making it fair and efficient. This system has an enormous task to perform in the coming decade. To the extent that government can facilitate its accomplishment, we intend to be ready.