

REMARKS OF  
JAMES J. NEEDHAM, COMMISSIONER  
SECURITIES AND EXCHANGE COMMISSION

Before the  
Securities Law Committee  
of The Federal Bar Association

The National Lawyers Club  
Washington, D. C.

December 2, 1969

Before I address my subject I would like to say a few words about something which has impressed me since the first day I came into public service. I have always had a high regard for the staff of the Securities and Exchange Commission -- a feeling I share with thousands of professional people with whom the Commission deals. During these past few months I have come to regard the staff even more highly. They are devoted, competent and loyal professionals. The devotion of the non-professional staff is such that it borders on professionalism. I think the American taxpayer in the private sector should be proud that people of such high caliber devote themselves to the operation of the government and in many cases at a considerable financial sacrifice. Were it not for these devoted public servants, the work of the Commission could not continue. A Commissioner like myself, in terms of the history of our agency, is present only for a moment. It is on the shoulders of the loyal public servant that the responsibility for administering the laws of the Commission rests. I am proud to be associated with these people and I trust that my performance and theirs will be benchmarks for those who come after us.

I would also like to congratulate the Federal Bar Association on the very fine program of the Council of Younger Lawyers, the Bill of Rights Program for the D.C. High Schools. By working with the young people of this community and apprising them of their rights and obligations as citizens, I am sure that in the long run the activities of this committee will have a beneficial effect not only on the individuals involved but on society as well. I encourage you to continue with this endeavor. The program appears so worthwhile I wonder if you have considered promoting it throughout the country so that all of our youth can have this type of exposure. I wonder, too, if as lawyers you have ever given any consideration to the fact that many people never meet a lawyer except when they buy a house, draw up a will or are in some type of difficulty. Because I feel that the public should have a more frequent exposure to professionals of all types, I urge you to expand this program.

At the outset I must state that the Securities and Exchange Commission, as a matter of policy, disclaims responsibility for any personal statements by any of its Commissioners. In other words, the views I express are my own and do not necessarily reflect the views of the Commission.

It is indeed a challenging time to be a Member of the Commission and a time when the professional competence of the securities bar is most urgently needed. I understand that many of you are in private practice but that all of you at one time have been lawyers in the federal service. I am sure that you therefore appreciate the need for open and candid discussion between the members of the practicing bar and the Commission. It is this free flow of ideas that has helped the Commission to provide the quality of protection to consumers it has over the past 35 years.

Today, more people than ever before are investing in securities. The New York Stock Exchange estimates that at the beginning of 1969 26.4 million persons owned shares in publicly held corporations. Obviously, the number holding all types of securities is far larger. The amount of information available to investors about the issuers of these securities has never been greater, but at the same time never has it been more urgent to insure that investors have access to such information.

But the responsibilities of the industry and the Commission extend beyond the obtaining and disseminating of information -- for example, the mechanics of buying and selling securities. While the industry weathered a crisis in the back-office area last year, the problem is not solved, and still additional problems have been brought on by the tight money situation. In the last few months the press reported two large brokerage houses had experienced financial difficulties. Some firms have sought to merge to alleviate their capital crises, and others have closed many of their branch offices.

While we may expect the tight money situation to correct itself, the operational problem is something else. I have read the North American Rockwell report on its study of the securities industry and find many interesting and worthwhile recommendations. Some day, as it points out, we may have a certificateless society -- the question of when is another matter and may never come to pass if the leaders of that industry do not join their forces. Of course, we at the Commission have a vital interest in the structure of the industry and the manner in which its business is conducted. Though we prefer to await action by the industry, in all honesty, I must point out our patience is not infinite.

The experience gained in your public career has given you some insight into solving the problems you encounter daily in the securities field. I am sure you considered your public service valuable, and this is why you have retained your association with this organization. I am also sure you appreciate the need for a continuing close relationship with the government. Those of us currently in government believe that your expertise in the securities field imposes upon you, in turn, certain responsibilities.

Along these lines, I recently read a proposed description of the financial condition of a company and frankly was amazed at its complexity. In fact, I believe it was misleading. When I asked our staff which accounting firm had been consulted when the description was being prepared, I was told that it had been prepared by the company's attorneys, without consulting the accountants. Now I am not here to drum up business for the accounting profession, but I would like to point out that it may be helpful for an attorney when preparing the financial description of a company to obtain suggestions from the accountants. Too often the lawyer is over-zealous in trying to protect his client at the cost of a meaningful presentation. His basic objective is fine when done in moderation, but when carried too far may in fact be harmful, as in this case, to the average investor.

All professions associated with the securities industry have a positive duty to insure objective compliance with the provisions of the securities laws.

The previous Chairman of the Commission stated that

The privilege of appearing and practicing before the Commission imposes on you a corresponding obligation to assist in achieving the protection of investors and the public interest that the securities laws are designed to bring about.

I strongly support that proposition. It means that the lawyer must be more than an advocate for the position espoused by his client. To do so requires some independence of counsel. And this is why it concerns me when a corporation which is engaged in a public offering has as counsel a lawyer who holds an equity interest in the registrant, or who receives shares of stock as compensation for his services in connection with such offering.

I understand that many law firms forbid their members from receiving such shares. However, from the registration statements I have seen since I have been with the Commission, many do not have such a policy. The other day I saw a registration statement which showed that the attorney who passed on the legality of the shares being offered was also the Chairman of the Board, had received 16,000 shares of stock for services rendered to the corporation, and held options to purchase another 2400 shares at \$.50 per share when the public offering price was \$5.00 per share. I cannot help but wonder how objective this counsel's advice was to the corporation and how much he considered the interest of the public.

I grant it is nothing new for lawyers to receive an equity interest in a corporation in return for providing legal services. But I suggest that when the corporation is making a public offering a lawyer consider carefully the problems which may confront him because he holds a proprietary interest or receives shares of stock for compensation for services performed.

On this general subject, it is appropriate to recall the Code of Professional Responsibility, the final draft of which the American Bar Association Special Committee on Evaluation of Ethical Standards published on July 1, 1969. Canon 5 entitled "A Lawyer Should Exercise Independent Professional Judgment on Behalf of His Client" states, in part, that a lawyer should refrain from accepting property rights which tend to make his judgment less protective of the interest of his client. The text portion of the canon goes on to state that a lawyer should not seek to persuade his client to permit him to invest in an undertaking of the client. I am inclined to ask if the canon gives rise to a possible conflict when a lawyer receives shares of stock as compensation or owns shares in a corporation which is his client. In those circumstances, is he an advisor or an investor?

By way of illustration of my dilemma in this matter, this is an appropriate time to mention that when I began practicing accounting I had, as a partner, a man who was both an accountant and a lawyer. My partner was also in a partnership with a lawyer. His common expression when I questioned a statement of his was that the reason I did not understand was because I was not a lawyer. He in turn would make the statement to his other partner that the reason he did not understand was because he was not an accountant. Maybe the reason I cannot understand how a person who has an equity interest in a corporation can still be objective is that I am not a trained advocate.

I have no doubt, however, about the fact that responsibility for assuring compliance with securities laws is a two-way street. If you are to direct your clients correctly, guidelines must be provided. While in all professions, especially those segments of a profession in a specialized field, there develops certain folkways to practice, these do not always give the practitioner comfort when he has to write an opinion. However, many times the lawyer is in a position to give an opinion or advice but hesitates to do so without asking the staff of the Commission. If this group continues to grow, the number of requests for letters expressing the position of the Commission or the staff will be considerably increased. The Commission has always been available to assist all professionals in solving their clients' problems. We feel such service is part of our job description and are delighted to be of help. However, I am informed many of the issues presented to us are not complex and should be answerable by a competent professional.

It is interesting that the Bar Chris case caused some legal writers to believe one of its primary effects would be to make accountants and lawyers not thoroughly familiar with the issuance of securities hesitate before agreeing to undertake such work. I have been told this has not been borne out by a review of the number of first filings the Commission received during the past year (about 50% of all filings) many of which were prepared by professionals trying their hand for the first time at preparing a registration statement. It is my opinion that a competent professional who prepares adequately should be able to serve his client in matters involving the Commission; however, as was indicated in Bar-Chris, the professional has special responsibilities when dealing with the Commission's disclosure statutes; therefore, he, the professional, should proceed prudently.

As you know, the Commission operates on a very small budget. As a result we must always search for maximum utilization of our authorized personnel and resources. One of the ways to accomplish this is to make available on a current basis to all professionals, information about current matters with which the Commission has dealt. Another way is to simplify and codify our rules and practices.

It was with this in mind that in September 1968 the Commission requested comments on whether the staff's interpretive and no-action letters should be available to the public. The staff is presently reviewing the matter and studying ways by which such letters can be made available to the public.

The Commission has also taken steps to clarify some of its practices, which were reviewed at great length in the Wheat Report. As you know, in October the Commission published for comment a number of proposals to adopt new, and amend existing, forms and to adopt new rules. The comment period of these proposals terminated November 28. It will take the staff some time to assemble the comments received. I hope we can take action on these proposals early next year.

The number of comments which the Commission receives is indicative of the caliber and interest of the securities bar. Many of them, I am sure, are prepared without remuneration to the lawyer. But the securities industry is becoming more complex and the number of investors is growing. Accordingly, the need for competent lawyers with imagination and ingenuity to develop solutions to the problems and with the tenacity to see these solutions implemented becomes imminently clear. Likewise, never has there been a greater need for forthrightness on the part of the Commission. Too much is at stake for both of us to waste valuable time because of a failure to communicate properly.

The structure and composition of the securities market are among the matters presently being examined by the Commission. Involved are the rates charged to investors for purchases and sales of securities, the impact of institutions on the market place, the desirability of public ownership of stock exchange member firms, and the matter of access to the market place by non-member firms.

Because these issues are interrelated, I doubt they can be resolved on an individual basis or quickly. We must be certain we have the total problem in view as we reach for solutions. Precipitous action could be at the least unfair and at the worst, devastating.

I cannot talk about the current concerns of the Commission without recognizing the problems you face daily. You are, in fact, the front-line troops in many instances. You know the magnitude of the problems. The decisions the Commission makes in the next few months will not be panaceas. Hopefully they will be reflections of the needs of the industry in light of present and future economic and business conditions. The implementation of these decisions will depend to a great extent on the cooperation of many groups, including the securities bar. Together we have the capability to cope with the problems which exist. Together we must take the initiative to develop solutions to these problems and then have the courage to implement the solutions. In this way we can best fulfill our responsibilities to the American investor and the Government.