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(202) 755-1160

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CORPORATE RESPONSIBILITY SEEN FROM THE SEC

AN ADDRESS BY

WILLIAM J. CASEY, CHAIRMAN

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The American business corporation, spawned by the crown companies of 16th century Europe and the primary progenitor of the global multi-national corporation, has been hailed as one of the most successful insitutions conceived and developed by man. Whether this judgment is premature depends on how the American corporation responds to the new challenges which are being hurled at it today.

Having amply proven itself in the economic realm, the corporation finds itself challenged on all sides for having failed to achieve other national objectives. The demonstrated ability of business to meet the nation's economic needs has fostered the belief that business has both the capability and the responsibility of meeting urgent social and environmental needs as well. This has led to an insistent demand from many quarters that business redefine its goals in order to satisfy new priorities.

The stakes both for our economy and for our society are too large for these issues to be resolved on a piecemeal basis, through litigation or otherwise. We have come a long way on the basis of an economic system which emphasizes the virtues of competition responding to the needs of customers, expressed in a market economy and fueled by public savings mobilized in a national securities market populated by the most fully informed investors in the world. We have developed a framework of rights and duties, of responsibilities and liabilities, which has made that system hang together and operate.

But that may not be enough.

The American corporation today is faced with a revolution of rising expectations. Shareholders expect their corporation to grow and provide higher dividends. Employees expect higher salaries and wages and increased fringe benefits. Consumers want more and better goods at lower prices. The public expects the corporation to be a good citizen in safeguarding the environment, eliminating

racial discrimination, training the jobless and aiding the poor. In the growing clamor that corporations accept the burden of all these expectations, we hear less about taking them over in the name of the state and more about holding them to higher standards of social performance and responsibility.

Our corporations can hurt themselves both by failing to be sensitive to these demands or by being so acutely sensitive that they lose sight of their immediate mission to serve their customers and investors and provide challenges and opportunity to their employees. By failing to respond they can lose touch with the world around them; by overresponding they can incapacitate themselves. Clearly, there is a delicate line to be drawn.

I believe that the social responsibility movement is doing valuable work in making our corporations face up to hard questions they raise. I also believe that it is vital for our corporations to seize the opportunity to respond with hard facts about what they are doing and with realistic explanations of the limitations placed on what they can and should undertake. In doing this, we need some philosophic and some

practical conclusions about how our society functions--about how and where decisions are and should be made--about where freely contracted legal obligation prevails--about where legally imposed or contractually accepted fiduciary obligation prevails--about where obligation is imposed by the power of a majority acting at the polls, in a legislative hall or in a meeting. To answer those who would blame our corporations for all the ills of the world, this kind of a conceptual framework is necessary.

We at the SEC have to have this kind of a framework in order to intelligently make decisions about the kind and degree of disclosure required, about the matters to be raised by proxy statements, about the obligation of investment companies to concern themselves with the social policies of the corporations in which they invest, about the ownership and use of information relevant to investment in our corporations, about other obligations to investors. We at the SEC need this kind of framework to determine whether we should proceed on a given problem by requiring disclosure, by promulgating a rule, by recommending legislation or by calling a conference.

How does a corporation determine its responsibilities, how does it meet them, how can they be enforced? First, a corporation should be a good citizen and obey the laws which have been passed to safeguard the environment, promote equal employment and protect consumer interests. Then, to perform for its customers, employees and stockholders, a corporation has to look ahead and adapt its policies to the needs of the future.

A corporation also has an evolving set of obligations to its customers, neighbors, employees, shareholders and other investors. These multiple obligations and responsibilities may be enforced by government, by public opinion, by civil liabilities, by economic sanction in the marketplace.

How does the SEC fit into this spectrum of corporate responsibility? We have three prime statutory obligations in this area:

1. To oversee the proxy machinery through which stockholders elect corporate management and make other fundamental decisions;
2. To enforce the corporation's responsibility to inform the investing public; and

3. To specify the content and format of financial statements though a corporation's economic performance is reported to the public.

The demand for corporate responsibility has had its strongest impact on the machinery for corporate democracy as spelled out in the SEC's proxy rules. We have had to weigh demands for presenting more questions at greater length at more company meetings in the light of maintaining the cost and effectiveness of the procedures of corporate democracy and the need to keep operational authority and responsibility firmly on management, if we are to avoid impairing corporate performance and blurring corporate responsibility. We are trying very hard to maintain the opportunity for individual shareholders to put forward proposals and to press for appropriate corporate action without unduly burdening corporate management, which has a fiduciary responsibility to all shareholders, and diverting it from a fundamental responsibility for economic performance.

Let me tell you how we approach this problem. The average stockholder invests his savings in a company on the basis of the return which he expects to receive on his investment. He recognizes that he does not have any expert knowledge with respect to the conduct of the business and

places his confidence in the knowledge and wisdom of management. He doesn't want to tell management how to run the day-to-day operations of the business, nor does he want his fellow shareholders to control those decisions. I view the philosophy of corporate democracy embodied in Section 14 of the Securities Exchange Act in that light.

I am not suggesting that shareholders should not be able to recommend action in this area to management or that management should in the discharge of their functions fail to take these goals into account, particularly where the action recommended may prove to be beneficial to the corporation. But it seems to me that the ability of management to properly exercise its fiduciary responsibility to protect the investment of shareholders and conduct the ordinary business affairs of the company would be substantially diluted if judgments on these matters were taken out of management's hands. When social goals have overriding public value, legislative or budgetary action is called for.

The Commission has been studying possible revisions in its proxy rules relating to shareholder proposals. Let me say something first about the Commission's rules permitting exclusion of such proposals. These rules have their problems, but they will work if management makes a good faith effort to separate the wheat from the chaff. They are going to bog down, however, where management grasps for any straw to exclude a shareholders' proposal. As in other areas, corporate responsibility calls for listening to reasonable requests and excercising good judgment and common sense in drawing a fine line, guided this time by the relevancy of the proposition to the business and to stockholders' rights and legitimate interest in the purpose and progress of the business.

We are considering revisions which will facilitate and make more meaningful the presentation of shareholder proposals -- clarify the date by which such proposals have to be submitted to management, and expand the number of words that can be contained in the proponent's supporting statement. Also, to promote a better

understanding of our staff's interpretations on questions to be put up for vote, we are contemplating making public the papers submitted to the staff in connection with proxy proposals as well as the staff's response to these proposals.

On the other hand, we noted last year a new development whereby an individual purchased one share of stock in several companies, submitted multiple proposals to these companies, and then did not appear at the meeting to sponsor his proposals. This, in my opinion, is not in the best interest of, nor does it promote, corporate democracy. To deal with this kind of situation, we are considering a revision to our rules which would limit a proponent to three proposals and require a good faith statement that the proponent intends to follow through and actually present the proposals at the shareholders' meeting. Although we have been urged to go much further, we would like to see what effect such requirements would have before taking any further steps, such as proposing amendments which would impose a requirement that a person hold his stock for a year or more before qualifying to make a proposal, or a requirement that a shareholder have a certain minimum investment in the company as a condition precedent to submitting proposals.

In the past year or so we have been asked by public interest groups to use our statutory authority to regulate the content of registration statements, proxy statements and periodic reports filed with the Commission in order to compel corporations to be more responsive to new social priorities, particularly in the field of environmental pollution.

You may have read in the press that the SEC has been petitioned to require registered corporations whose products, services or operations cause either pollution or injury to natural resources to specifically describe in their registration statements and periodic reports the nature and extent of the pollution. We are also asked to require a corporation to describe the feasibility of curbing the pollution with existing technology, its plans for improving the technology, and its existing and projected expenditures for improving the technology. On top of that, we are asked to require corporations to make specific statements on their corporate environmental policies, including what they are doing or plan to do to aid the environment.

We have also been asked to use our power to conduct public investigative proceedings to focus attention on corporate activities resulting in environmental pollution. We currently have pending before us a petition filed by the Project on Corporate Responsibility which charges that a brochure distributed by Union Carbide to its stockholders summarizing its pollution control programs was false and misleading. The petition asks that, in addition to ordering a public investigation pursuant to

Section 21(a) of the Securities Exchange Act, the Commission direct that the company submit a proposed correcting statement for distribution to its stockholders describing in detail the impact of Carbide's operations on the environment, press and public criticisms of these operations, the efforts of government authorities to curb pollution from such operations, related private litigation, and steps planned by Carbide to curtail pollution and their costs.

I am concerned that in our efforts to implement the policies of the National Environmental Policy Act we do not lose sight of the need for procedural fairness. When we receive allegations of violations of the securities laws, inquiries are normally conducted privately by the Commission's staff in order to protect the rights of persons who may be innocent of the charges made against them. I don't think that the Commission should permit its investigatory procedures to become a pillory for companies which may be making good faith efforts to comply with these laws. Whenever a new legal requirement is imposed, there are always some who say that a company has gone too far and others who say that it has not gone far enough. I doubt that the SEC is equipped to deal with the adequacy of anti-pollution policies and practices by a particular company. While we are all interested in clearing up our air and water, our contribution has to focus on the impact of

environmental costs on the ability to run a profitable enterprise and to make goods that will be competitive. Our ability to perform our immediate statutory obligations would be impaired if the public hearing procedures under the securities laws became a means of conducting a public debate over the propriety of the practices of any particular company, short of some egregious violation of the securities laws where a public airing of direct fraud on investors serves a prophylactic purpose.

Now I want to emphasize that we at the SEC are committed to implementing the National Environmental Policy Act, which says that we are to interpret and administer our statutory authority to the fullest extent possible in accordance with the environmental policies set forth in the Act. I do not read that legislation, however, as requiring us to ignore our primary responsibilities which are to protect investors and to provide for the maintenance of fair and honest markets for transactions in securities. I do not find anything in this new legislation which is inconsistent with our other responsibilities, provided that we develop appropriate rules and regulations that will permit a proper coordination of our activities in order to promote shareholder as well as public interests in these areas. I can

say, however, that we are not going to adopt any rules which in our judgment will not serve the interests of the investing public or will tend to diminish the effectiveness of the coordinated scheme of disclosure which the Commission has built up over the last 35 years or so. I do not believe that we are required by the Environmental Policy Act to interpret our authority in such a way as to require the disclosure of a great mass of information in this one area with the result that environmental considerations take on a greater importance than they merit in relation to investment decisions. However, we do want disclosure of environmental matters which have investment impact. In July we issued a guideline (Securities Act Release No. 5170) calling to the attention of corporations registered with the Commission the requirements in its forms and rules under the Securities Act and the Securities Exchange Act for disclosure of material matters relating to the environment, as well as civil rights, which may affect the capital needs or earnings of a company. We now specifically require disclosure of any material litigation arising under the various air, water, and other anti-pollution laws and of any capital outlays arising from those laws which may have a material effect on the business which the issuer conducts or intends to conduct. In order to make sure that we have been obtaining

appropriate disclosure of those matters under our guidelines we placed the burden on the issuer to justify the failure to disclose if the information is omitted on the ground that it is not material.

Since the issuance of the guidelines we have been carefully monitoring the information which has been filed with us to see whether these guidelines have been adequate and whether rule changes in this area may be required. We are concerned that while some of the disclosures we have received have been quite detailed, in some cases at least we are getting a new kind of "boiler plate" which is hardly in accordance with the spirit of the guidelines. We will continue to study this matter in the weeks ahead to see what changes may be necessary or appropriate.

Much of the demand for corporate responsibility is really addressed to the purpose and objective of the corporation. I happen to believe that private enterprise can and should meet many of our education and training needs, much of our housing need, provide much of the environmental and safety protection we need and that this can and should be done at a profit.

I hope the present capital market will provide much of the money needed; that investors will know just how their money is to be used and what risks they are taking, and have a free choice to risk their money to meet these needs of the future; and that existing and new corporations will provide much of the technology and management skill.

I am announcing today that the Commission is launching an inquiry focused on developing new disclosure policies for new ventures which I hope will play a more meaningful and important role in influencing the social as well as the economic value to which investor's money is applied. There is a limited amount of venture money for new business. If the available venture money is applied to businesses realistically designed to meet genuine needs, to apply significant and well researched technologies and to employ people with good track records, I believe the prospects for both economic performance and the achievement of social values will be enhanced. This new inquiry, to be conducted by the Division of Corporate Finance, will look back at the splurge of fast food chains, bowling alleys, fried chicken and hamburger stands and the hot issue boom--the "sonics" and "tronics" of the 61-'62 and '67-'68 markets. Our purpose will be to define what an be done to promote more knowledgeable, more sophisticated and more seful investment in new ventures. We will study the prospectuses, eports and trading data on 60 of the hot issues and then give ore intensive analysis in public hearings to ten of them or so. believe that as a minimum we can require new companies seeking ublic money to spell out what they have discovered about the rket they seek to exploit and the competition and economic

experience in that market, what they have done by way of budgeting their funds and projecting their operations, what they have done to evaluate their technology and compare it with competing technologies, and what kind of qualifications and tract record their principal officers have. And if there has been no market research, no budgeting, no evaluation of technology, the investor is at least entitled to know that. I believe this inquiry and its conclusions can be important in focusing investment funds and corporate responsibility on worthwhile objectives.

The corporate responsibility to make more frequent, more equal and more sensitive and detailed disclosure about business development is being steadily expanded to the point where more and more of the information needed by investors first comes to light not in documents filed with the SEC but by informal announcements of negotiations and material changes in earnings prospects. I need only mention Texas Gulf, Glen Alden and Merrill Lynch.

The Courts are articulating a responsibility for more precise information and supplementary information to make financial statements not misleading. Note the 1969 decision in the Bowman case (296 F. Supp. 847 (D. Mass) aff'd 417 F2d 780) which imposed liability on the president of a company because he furnished total inventory figures to his accountants without giving details as to the derivation of the figures, particularly as to changes made in unit prices.

This trend and the increasing demand for the economic reality behind accounting figures should lead to the disclosure of material disparities between real values and book values of new developments in products and of changes in earning and dividend expectations which can materially affect the value of the stock or the desire of investors to buy, sell or hold the stock.

The responsibility to interpret information is as important as the responsibility to make it available. It has important consequences not only to investors but to the economy as a whole. It is less clear where that responsibility rests. To illustrate, there is little doubt in retrospect that some conglomerates got more capital during the sixties than they were entitled to. This resulted in large measure from the manner in which the impression of earnings growth per share could be exaggerated by skillful use of pooling of interest accounting, by using convertibles and warrants to acquire additional earnings not reflecting the potential dilution in reporting earnings per share and by other such shenanigans. The accountants were slow in tightening their rules, the SEC was slow in not requiring the disclosures to correct misleading impressions and the analysts were slow in not putting the information which was available in proper perspective. It seems to me that corporate officers have a primary obligation to rise above accounting conventions and lay economic reality on the line. Consistency in financial reporting cannot serve as an excuse for corporate officers to obscure economic reality which will affect market values in the long run if not in the short run.

Finally let me say a brief word about the liability that may flow from failure in corporate responsibility. Any responsibility, corporate or otherwise, in the final analysis depends on the quality of the human element which carries it. Potential liability is a very effective element in enforcing responsibility on those who assume it. But, it can be self-defeating if it is so capricious and so heavy as to induce good men to shun responsibility. Elements of knowledge, materiality, standing to sue, and measure of damages need careful review so that potential liabilities will, on balance, promote responsible performance rather than induce a flight from responsibility. This is an area where you of the bar can make a vital contribution to true corporate responsibility and one in which we at the Commission have a live current interest.