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OVERREGULATION AND DEREGULATION -- THE ROLE OF LAWYERS AND THE PRIVATE BAR

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It is a great privilege to be with you at this first annual institute in memory of Ray Garrett, a distinguished member of your bar and of my commission. Precisely because Ray Garrett was such a good lawyer as well as a good regulator, I thought it would be appropriate to discuss with you the role of lawyers and the bar in the issues of overregulation and deregulation. I hope you will accept my comments as they are given -- from one lawyer to others in the spirit of what John Gardner has called loving criticism.

Overregulation

Let me begin with overregulation, for the bar has been the designer of both the greatest achievements and the greatest excesses in both the architecture and the detail of government institutions. Its role as a major participant in the design of government began before the American Revolution and the Constitutional Convention. It has continued as changes in our system of government have been tested in the crucible of Supreme Court litigation and social change. But surely the flowering of the bar's role has occurred in this century, reaching its most luxuriant growth in the New Deal.

The governmental institutions that were created represent an attempt to preserve the advantages of the free market system while using laws and regulations to ameliorate some of its harsher elements -- the antitrust laws to fix the economic ground rules for competition, the securities laws to increase the fairness, efficiency and stability of the public markets, and so forth. That effort was, and continues to be, a daring experiment in a world in which state-owned enterprise has played an increasing role. In a seminal book called "The Structure of Scientific Revolutions," Thomas Kuhn describes the process by which new ways of perceiving reality are first put forth in broad strokes by men of true genius -- Copernicus, Freud, Einstein -- and then the contours and limitations of those broad strokes are fleshed out by years of testing in countless individual experiments in the academic community and elsewhere.

In a sense, we have seen the same kind of experiments going forward in the area of regulation. The fundamental notion of delegating essentially legislative authority to independent and highly expert commissions -- or even to not-so-independent administrators -- is an idea of extraordinary power. Now, nearing the end of the life cycle of large parts of that great experiment in government-building, we have sketched some of the contours and limitations of that idea.

The 1970's and 1980's have seen a dismantling of much of the economic regulation that was put in place in this century

-- in airlines, communications and banking, and, to a lesser extent, in transportation. These changes have occurred in part because shifts in the structure of the regulated markets have ended much of the monopoly power which the original regulators feared. Thus, microwave transmission, satellite technology and cable television are revolutionizing communications. The growth of unregulated financial intermediaries has undermined the closed-system assumption on which certain aspects of bank regulation rests. In those cases, overregulation was just the growing obsolescence of the old system in new circumstances.

At the same time as the markets were changing, the administrative system was becoming less flexible and more legalistic. The attempt to exempt administrative agencies from some of the rigidities of the judicial system -- which was an important part of the basic idea -- became frustrated. The development of ex parte rules for informal proceedings, exhaustive pre-trial discovery and other procedural rigidities, all in the interests of justice, have hardened the arteries of the system and made it a less appropriate instrument for the implementation of public policy. There are no better examples of the direction in which the system is evolving than the IBM and ATT antitrust suits. The endless proceedings and litigation that result have come to be viewed -- properly, I think -- as excessively burdensome.

There is another strain of the disease of overregulation, and that is in the area of so-called social regulation -- civil rights, equal employment opportunity, occupational safety, the environment, truth-in-advertising, and so forth. Here the legal method and the lawyer's instincts have not proved as readily transferable to the public sector as one would have liked.

Someone lost to history once described a corporate trust indenture as representing the accumulated fears, anxieties and mistakes of 100 years of American lawyers. Indeed, in many respects we value most highly the corporate lawyer who foresees the largest number of alternative scenarios and devises a little regulatory system -- whether an indenture or a joint venture agreement -- to provide for them. You will quickly see the parallels between the building of the myriad provisions of an indenture and of a system of regulation.

We can watch such a system a-building in the tender offer area today -- right before our eyes -- with great speed. It is a lawyer's first instinct to close loopholes and right wrongs in any conceptual systems he builds -- adding a new covenant in one case a new regulation in the other.

Unlike private lawyers, government lawyers are engaged in a constant battle with thousands of market participants and their advisers, and neither time nor numbers is on the side of

the regulators. Their response is a natural one -- a rigid rule that may not take adequate account of the variety of human endeavor. When your client is a bank, its response to the claim that a loan agreement is too rigid is to say "I will be happy to consent to any reasonable exception." The regulator deals with too many people to use consents effectively. He can only say "the public interest requires this rule." The consequences of this approach are far different in a private transaction, involving only a few parties, than in a regulatory system affecting a whole sector of the economy. For a regulatory system, the inevitable result is for government to be drawn deeper and deeper into the details of everyday life. And the result is contempt for the law and for lawyers.

To be sure, it is the habit of the private bar to condemn, or even to disdain, the examples of overregulation which government agencies serve up from time to time. But in thinking about how to deal with this problem, it is worth remembering that the techniques are much the same on both sides of the line that separates the public and private sectors. A Swiss banker once remarked to me that government would be much better if there were more bankers in government. Then he paused and said "It's very strange, though; whenever bankers join the government, they all end up talking like government officials instead of bankers." The same is true of lawyers.

There is a second respect in which the bar is deeply involved in the problem of overregulation. The problem is seen in the voluminous detail of disclosure documents and in the elaborate questionnaires and other paper records that are used to establish claims for exemptions from registration under Rule 146 and otherwise. This is really the converse of the problem of overly prescriptive rules promulgated by government. From our perspective, the evil of overregulation is the reliance on overly detailed and rigid rules. But a decision not to adopt such rules does not always mean that the conduct should be permitted to continue. Often the alternative is reliance on general rules, such as Rule 10b-5. Yet sometimes when the government relies upon broader principles, such as the antifraud rules, then the bar steps into the breach and furnishes the detailed regulation. It is the Catch-22 of deregulation.

Why does that happen? Part of the responsibility clearly lies with the Commission. We promulgate rules like 146 which seek to draw common sense lines -- like the requirement that an offeror have reason to believe that the people it approaches fall into an appropriate category of financial means or sophistication. That requirement is a perfectly sensible way of preventing a "public offering" as a prelude to a "private sale." But we may then proceed to interpret the rule in a hypertechnical manner or fail to issue disclaimers when the bar does so.

Another cause goes to the heart of the relationship beween a corporate lawyer and his client. We all live in a

highly uncertain world. And while the securities laws comprise only a thin slice of that world, there is a high degree of uncertainty there as well, especially for lawyers dealing with slippery concepts like "materiality" and "scienter." Nevertheless, lawyers have held themselves out as offering, and clients have come to demand, a high degree of certainty. That is the lesson of the unqualified, conclusory opinions delivered in so many corporate transactions.

But that degree of certainty does not exist outside of the middle of the road. And so the demand for certainty becomes a strong force for conservatism in the practice of law, for the construction of endless paper records and for the high legal fees that result.

Deregulation

I would like to turn for a few minutes to deregulation. The first question is the proper role of the bar in that process. In Washington, the deregulation debate has been cast in part as a battle between economists and businessmen (read deregulators) on the one hand, and lawyers (read regulators) on the other. It is clearly the case that economists like Fred Kahn and Murray Weidenbaum have been in the forefront of understanding and publicizing the basic ideas underlying deregulation:

-- that we live in a world of constant change, and a regulatory system designed for one reality does not work in another.

-- that rules which appear to work effectively in concontrolling the people to whom they apply may fail to have the desired overall effect because of events outside the system. Thus the attempt to control the interest rates paid to small depositors failed in part because of the growth of money market funds.

-- that the government's ability to control economic behavior is limited to the edges of human activity, while the mainstream of conduct responds to deep running economic forces.

-- that sometimes the attempt to reach concededly improper behavior results in so rigid a rule that the result is not worth the candle -- that a fair balance of government and liberty requires the toleration of some abuses, or at least requires leaving their remedy to the civil and criminal enforcement process.

-- and finally, that carrots are sometimes as effective as sticks, and that the basic task is one of affecting human behavior not legislating morality. That difference puts in a new light such issues as tax-based income policies and tax schemes that result in companies internalizing the costs of polluting the environment.

Does that mean that lawyers should surrender the regulatory field? I think not, for the very term "deregulation" misconceives the basic objective of this exercise. The fact that we recognize that we have chosen inappropriate means to deal with problems does not make the problems go away. The excesses of some affirmative action programs do not detract from the importance of equal employment opportunity. The silliness of rules specifying the precise place on the wall for the location of fire extinguishers does not diminish the importance of safety in the workplace.

Most sensible observers agree that what is ordinarily required is not deregulation, but an adjustment that makes the regulatory effort more functional and less burdensome. The principal burden of that task will, I submit, continue to fall upon the legal profession. That responsibility is not an easy one to discharge. First, some of the lessons of the past decade are, as I have suggested, at odds with what I believe are a lawyer's first instincts. Second, all of us spend much of our time working within the regulatory system. That is true of us at the Commission, who have the statutory responsibility for administering the securities laws, and for the bar, which has the de facto responsibility for administering the securities laws. Yet the task before us requires precisely the ability to step outside the system and assess its performance. Even more difficult, we have to assess whether, even in those areas where the system is working well, that is a result of our regulatory efforts or in spite of them.

The initiative for this fresh perspective must come from outside the Commission. The SEC has taken important steps in the direction of deregulation:

-- integrating '33 Act and '34 Act reporting.

-- lightening the disclosure burden for small issuers.

-- bringing much more certainty to the exemptions from registration.

-- moving first by rule and then by statute to mitigate some of the horrors of Section 17(d) of the Investment Company Act and other barriers to public investments in venture capital pools.

Yet all of those efforts may fairly be called tinkering with the system. Inevitably, most people at the Commission see their basic task as perfecting the regulatory system that exists today, rather than testing its continuing relevance. More radical suggestions have come from the private bar:

-- a proposal to eliminate the whole superstructure built around independent directors of investment companies and to deal with the problem of conflicts of interest in an entirely different way.

-- a proposal, embodied in the proposed options on Ginnie Mae securities and suggested for the proposed options on Treasury securities, for a truly radical change in the way in which margin is fixed for derivative securities. Like "earnest money" for futures contracts, the margin would be set at a level adequate to protect the broker-dealer (and his customer) from the anticipated short-term fluctuations in market value -- a matter far closer to the Commission's net capital rule than the Federal Reserve's concern with monetary policy.

While these suggestions emanated from outside the Commission, they are being studied carefully and with minds on the Commission staff that are not only open, but eager for better ways of dealing with old problems.

Both suggestions have a common characteristic. Private parties have taken the initiative to develop a proposal fully. That is not easy to do. It is time-consuming and expensive. And the more detailed a proposal, the more it runs afoul of the interests of individual companies. In the typical case, comments made in response to Commission proposals are either so broad as to be of limited help, or so detailed that, even if helpful, they fall into the "tinkering" category. Nevertheless, no one knows the impact of the securities laws on the capital-raising process better than securities lawyers and the securities industry. You are in the best position to suggest the location of that delicate balance which permits the government to deal with the problems for which it has responsibility in the least intrusive and rigid manner.

I can think of no better example of that kind of effort than the suggestions of the Securities Industry Association for changes in the net capital rule in ways that will preserve customer protection while liberating additional capital for productive purposes. Whatever one thinks of the specific proposal -- and it is currently under consideration at the Commission -- the effort commands emulation.

Finally, I think we have to devote increasing attention to our role as lawyers in responding to uncertainty by imposing

excessively detailed regulatory rules -- that are self-created -- upon our clients. The bar's response to this problem has been to suggest the creation of more "safe harbors" -- in effect, to deal with the problem of uncertainty by asking the Commission to make it go away. That is an avenue of very limited potential. Nor, I think, can the blame be fully laid at the feet of clients' search for certainty. While they ask for certainty, they also complain about high legal fees and nit-picking.

This is no small matter. The legal profession and, in deed, the legal system, is not held today in the high regard that has been traditional in America. Nor is the corporate and securities bar exempt from this questioning. When we hear widespread complaints in the American business community about the regulatory system and the way it is administered, or the failure of the litigation system to resolve disputes in a satisfactory way, we are also hearing complaints about the end product of the legal profession's efforts. And so our future as lawyers, and the regard in which the bar is held, are intimately intertwined with our ability to restore the effective functioning of the legal system.