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Required Periodic Disclosure Under the Securities Acts and the Proposed Federal Securities Code

GEORGE J. BENSTON*

The author offers a critique of the disclosure aspects of the current securities acts and the proposed Federal Securities Code from an economic perspective. He concludes that the costs of disclosure may outweigh the benefits, and that decisionmakers must make a fundamental reevaluation of the rationale upon which disclosure requirements are based before such a policy is continued.

A rewriting of the federal securities acts and their attendant rules is surely a considerable, almost awesome undertaking. Since I am not a lawyer, I can only begin to appreciate the difficulty that this effort must have entailed. It seems clear, though, that Professor Loss and his colleagues deserve the praise they have received.

In the comments that follow, the fact that I am not a lawyer will be quite evident, for I am concerned with the basic economic goals of the securities acts. I recognize that the drafting of a code which will be acceptable to various interest groups, and ultimately to the Congress, requires compromise. But if the essential goals of the legislation and its prospects for implementation are not clearly delineated and understood, the new law may do more harm than good.

One ought to reexamine the securities laws periodically, perhaps not every ten years, or even every thirty, but it would be nice for it to be done every forty-five years. The drafting of the proposed Code presented such an opportunity. I can understand, somewhat, the politics of a comprehensive review. It is difficult enough to get any type of a statute through the securities bar, the Securities and Exchange Commission, the Congress and whomever else, without the additional complication of trying to reexamine just exactly why the statutes should exist in the first place. I also recognize that many may believe me naive to ask that we probe into why we have the securities laws at all and also to inquire into whether this particular redrafting of them will meet the basic reasons for which the

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statutes were drafted in the first place. Nevertheless, if we accept the premise that the rationale for securities regulation is to effect certain economic relationships among people in a beneficial manner rather than to provide gainful or at least profitable employment for attorneys and accountants, we ought to examine some of the basic underlying concepts to see whether regulation improves these relationships or not.

The proposed Code contains a variety of interesting modifications of the present securities laws. I would like to discuss many of them. Given the time restraints, however, I am going to restrict my comments to questions on which I have done some empirical work, namely, the disclosure aspects.¹ Professor Loss has recognized in his introduction to the proposed Code that, within the traditional philosophy of securities regulation, the disclosure changes are perhaps the most dramatic.² I cannot speak directly in terms of whether the modifications are the most dramatic in the sense of the economic ramifications they will have. In fact, as far as I can foresee, the major result will be etching into stone the aspect of continuous disclosure. Companies will register only once and will disclose continuously to the market.³

The question, then, that I will address is: "To what extent is such disclosure a good thing?" In particular, will continuous disclosure meet the objectives for which the federal securities laws were originally drafted, and are there any viable alternatives to this type of mandatory disclosure? For while it may be rather easy to question things, it is much more difficult if someone asks: "Well, what would you do if anyone ever asked you?"⁴

Disclosure of corporate financial accounting data is a central aspect of the present acts and the proposed Code. The expectation, therefore, that the mandated publication of accounting data will be beneficial to society should be carefully examined. If it appears that there are benefits, the first step is to estimate whether the costs of the requirements exceed these benefits, and then to determine who

1. See, e.g., Securities Act of 1933, §§ 5-7, 10, 15 U.S.C. §§ 77e-77g, 77j (1976); Securities Exchange Act of 1934, §§ 12-13, 15 U.S.C. §§ 78l-78m (1976). See generally G. BENSTON, CORPORATE FINANCIAL DISCLOSURE IN THE UK AND THE USA (1976); Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132 (1973).

2. ALI FEDERAL SECURITIES CODE xxv (Mar. 1978 Proposed Official Draft). See also *id.* §§ 401-406, 501-515, 601-607.

3. *Id.* §§ 402-403, 602.

4. I do not expect to be asked, however, as I believe The American Law Institute did not inquire into the opinions of economists in the drafting of the proposed Code.

bears the costs and who receives the benefits. Only then can informed judgments be made as to whether the proposed Code represents an improvement over the present statutes, or whether the statutes should be changed in some other ways.

To begin, let us consider the reasons that corporations might and might not voluntarily disclose financial information. For this inquiry, two extreme assumptions are made. First, corporate controlling shareholders and managers make decisions about disclosure that they believe are in the best interests of the shareholders as a group. Second, the controlling shareholders and managers act to benefit themselves only. These individuals would, without compunction, defraud and mislead other shareholders or anyone else for that matter.

Controlling shareholders and managers who act in the best interests of the shareholders will want to disclose accounting-based and other information up to the point where the marginal benefits to the shareholders exceed or equal the marginal cost of producing and disseminating the information.⁵ The benefits are considerable, with three being of prime importance: (1) the cost of producing the information is less to the corporation than to potential and present investors; (2) disclosure, audited by independent public accountants, avoids the cost of the investor's beliefs that corporate resources will be misused; and (3) nonpublication of information is taken as a signal that the corporation has something to hide.

First, prospective shareholders and creditors, whose funds the corporation and present shareholders want to attract, demand information on which to base their investment decisions. The value to them of investments in the corporation is the present value of the cash inflows net of outflows that they expect to obtain.⁶ One of these outflows is expenditures on gathering information designed to determine the amount of other cash flows. The greater the cost to potential investors of obtaining information about the corporation, the less they are willing to offer for a share in the corporation or the

5. "Marginal" in this sense means the incremental cost or benefit of providing one additional unit of information to the shareholder or potential shareholder. The cost of producing such information is usually borne initially by the corporation. The information is produced until the point where the incremental cost exceeds the incremental benefit to shareholders and potential shareholders. In the absence of market failures, the amount of information provided in a competitive market will be at the point where marginal cost and benefit are equal, a presumably efficient amount. See *Bates v. Arizona*, 433 U.S. 350, 377 & nn.34-35 (1977); Stigler, *The Economics of Information*, 69 J. POLITICAL ECON. 213, (1961).

6. The arithmetic of present value discounts future returns by an appropriate interest rate during the period between initial investment and the time when returns are realized. See J. HIRSHLEIFER, *INVESTMENT, INTEREST, AND CAPITAL* (1970).

higher the interest rate necessary to satisfy them.⁷ Thus, if the cost to the corporation, that is, to the present shareholders, of providing information is less than the cost to potential investors of obtaining this information, the corporation benefits by providing it. The present investors also benefit if the cost of having information produced by the corporation is less than they would be willing to incur individually, in aggregate. It is likely that the cost to the corporation of producing such information is less than the aggregate cost to potential and present investors since their efforts are likely to be duplicative. Therefore, it benefits the corporation to produce and disseminate this information to these investors.

Any information that is specific to their firm will be beneficial to the shareholders of that firm because prospective buyers of the firm's securities, lenders, or others who are investors in one sense or another (including employees who are investing their time and their careers in the firm) will discount the cost to them of gathering information about the firm that they think is useful. In other words, if I have a product about which I give information that prospective buyers want, then that product is more valuable to them. They are willing to pay me more for it because they do not have to engage in the expense of learning as much about it. Thus, so long as it is more efficient for the supplier of the product to disclose and communicate information about the product than it is for the consumer to obtain it himself, it is beneficial for the purveyor of the product to disclose, and for the consumers who will not have to spend their own resources for this purpose.⁸

In addition, it is likely to be much less costly to communicate to people in general, by way of financial statements and publicity releases and so forth, than to answer questions one by one as individuals ask them. The empirical work on why people have disclosed long before they were required to, is very consistent with that hypothesis. Indeed, the fact that companies produced financial statements long before they were required to, and that the extent of such disclosure increased as the degree of public ownership of shares

7. All predictive statements made herein should be taken to include the caveat, *ceteris paribus*, or all other things unchanged.

8. A good example illustrating the above discussion can be found in the case of brand name versus generic products. Consumers are often willing to pay more for the name brand due to assurances of quality that the name conveys. Compare *FTC v. Borden Co.*, 383 U.S. 637, 645 & n.6 (1966) with *id* at 649-51 & nn.3-8 (Stewart, J., dissenting). See also F. Milne & R. Watts, *Corporate Information: A Public or a Private Good* (Aug. 1977) (unpublished manuscript, University of Rochester).

increased, is consistent with that hypothesis.⁹

Second, the owners and managers of corporations can expect potential investors to be suspicious of the possibility that those in control will divert the resources of the corporation to themselves.¹⁰ Once owners or managers have less than a one hundred percent interest in corporate resources and profits, they have incentives to waste, misuse or divert resources when the benefits to them exceed their share of the reduced profits. Since potential investors have reason to expect this behavior, they reduce the predicted returns from their investments to take account of the resources that the majority shareholders and managers might divert. When those in control do not intend to divert corporate resources, they must find some means of convincing potential investors of this fact; otherwise, they will bear the full cost of the expected diversion.

One way that owners and managers can do this is by installing a monitoring system of accounting controls that inhibits, if not prevents, both those in control and other employees from misusing corporate resources. Additionally, the majority shareholders and managers must convince potential investors that the system is working and that it will be maintained after the outsiders have committed their funds to the corporation. Independent certified public accountants provide this service. Certified public accountants (C.P.A.s) assure investors that the managers' reports to the shareholders on the financial condition of the enterprise are presented in accordance with generally recognized professional accounting standards. The accountants certify that these records have been audited and that the numbers reported were not manipulated to cover up serious problems or to mislead investors. As is generally the case with the production of any good or service, the marginal cost of the C.P.A.'s work should not exceed the marginal benefits therefrom.¹¹ Investors, therefore, would not want C.P.A.s to warrant that *all* uncontracted for managerial activities are accounted for.

Certified public accountants can be trusted to perform this service, not because they are morally superior to others, but because their "stock-in-trade" is professional integrity and expertise. In general, they stand to lose more than it is worth by accepting a bribe

9. See Benston, *Accounting Standards in the United States and the United Kingdom: Their Nature, Causes, and Consequences*, 28 VAND. L. REV. 235 (1975).

10. See generally Jensen & Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FINANCIAL ECON. 305 (1976); G. Benston, "The Market for Public Accounting Services: Demand, Supply and Regulation" (Mar. 1979) (presented to the Liberty Fund Seminar, Law and Economics Center, University of Miami).

11. See note 5 *supra*.

from a client (directly or indirectly in the form of a higher fee for an engagement), for if accountants should lose their reputations for integrity, the expected cost is likely to exceed the bribe. It benefits corporations, therefore, to publish financial statements that are audited by C.P.A.s.¹²

Third, any information a corporation discloses or refuses to disclose is likely to be taken by investors as a signal.¹³ Once one corporation discloses its sales, for example, the failure of other comparable corporations to publish sales figures may be viewed by investors with suspicion. Investors will ask: "What is the corporation hiding?" To distinguish itself from corporations that have something to hide, and thus to avoid the discount that investors are likely to apply to investments in the corporation, a corporation that has nothing to hide benefits from publishing information. Those corporations that do not follow suit must suffer the cost of suspicion generated by nondisclosure or must convince investors that the numbers either would not be meaningful or that they would be too expensive to produce. Therefore, a corporation that would prefer not to disclose some unfavorable or embarrassing information will do so nevertheless, in order to avoid the belief by investors that the condition of the corporation is even worse.

Once a corporation begins to disclose and then quits, a signal is also given. The firm is in effect saying: "Now we are not going to tell you." That is very suspicious to people reading financial statements. Consequently, once one starts to disclose voluntarily, it is very hard to give it up, unless the firm has some overwhelming reason and can communicate it to investors.

Thus, there are very good reasons to expect that promoters, owners or managers of diffusely owned corporations who are operating in the interests of the shareholders would disclose everything that one would want them to, with some exceptions. One problem that could cause an exception to this general rule is what economists call an externality.¹⁴ That is to say, there is an advantage from disclosure that cannot be fully captured by the company making that disclosure. If Ford Motors tells investors something about itself, and the investors are thinking about buying General Motors

12. See Benston, *Accountants' Integrity and Financial Reporting*, 43 *FINANCIAL EXECUTIVE* 10 (1975).

13. See S. Ross, *Disclosure Regulation in Financial Markets: Implications of Modern Finance Theory and Signalling Theory*, in *ISSUES IN FINANCIAL REGULATION* 172 (1979).

14. Externalities are benefits or costs which are not fully captured or imposed on the producer or consumer of privately owned goods. See A. ALCHIAN & W. ALLEN, *EXCHANGE AND PRODUCTION: THEORY IN USE* 248-51 (1969).

stock, they might like to know how General Motors fits into the whole milieu of the alternate investments they may want to make. It would be very difficult to obtain this information if General Motors does not disclose. The first corporation may not receive the full benefit of this disclosure unless some other corporation also discloses, if this information is, in fact, useful for making investment decisions. If it were useful for making investment decisions, then there is a benefit to all potential investors and corporations if everyone discloses, which benefit cannot be fully captured by any individual firm. This is a limitation of voluntary disclosure, to the extent that it exists empirically.

Another limitation, possibly, is that the management of the firm in fact does not know what is good for its own shareholders. If so, one must ask who knows better. It is possible that the people who work for the SEC, or who teach accounting in the various universities, or who write articles, know much more than the corporate management about how to run corporations and communicate with shareholders. Almost anything is possible.

Consider, now, a world where controlling shareholders and managers are dishonest. They would prefer or are willing to misuse their fiduciary positions and present false and deliberately misleading financial reports to the public. The relevant questions, I suggest, are whether disclosure, as mandated by the securities laws, can prevent them from acting in this manner, and, in any event, whether such stockholders and managers are likely to be able to deceive investors. Three issues are considered: (1) the relevance of accounting data for investment decisions; (2) the usefulness of financial statements as a vehicle for defrauding investors; and (3) the necessity of suborning or not using C.P.A.s to certify the financial statements.

First, it is important to recognize that no accounting system, mandatory or voluntary, can provide investors with the economic information required for their decisions. It is inherently impossible for accountants to measure economic values objectively where arm's-length market transactions are absent. This situation affects most of the items recorded in the records of a corporation since relatively few operations are completed on a cash transaction basis within the reporting period of a quarter or a year. The best that the accounting reports can provide is a subset of the data that investors might find useful. Even then, the data will be subject to alternative measurements that, *ex post*, may appear to have been chosen to mislead unwary readers. For example, consider a situation where the sales manager of a corporation believes that a very large order

for products that have already been produced will be placed a few days after the end of the business year. If the accountant does not record revenue or sales until the contract is signed, and the contract is signed in the next year, the corporation's assets, equity and net income for the previous year-end and year will have been understated. But if the contract is not signed, the financial statements will not be incorrect, unless the sales effort of the past year results in a greater probability that the goods will be sold. In this event the statements will be incorrect since an asset, "investments in sales efforts," will not be recorded, and an expense, "sales expenses," of the previous year will be overstated.

Second, financial statements provide a very inefficient vehicle for dishonest corporate owners and managers to cheat investors. Investors, in deciding whether or not to purchase shares or debt in a corporation, estimate future cash flows.¹⁵ Accounting data necessarily present a history of past activities. It would appear, therefore, preferable to mislead them by floating rumors, tips, and other ostensible "inside" information indicating that the future will not be like the past. For example, rumors concerning a new process or product having been developed or oil having been discovered is likely to be more effective in defrauding investors than the manipulation of accounting data.

Third, those who would use financial statements to defraud or mislead investors either must suborn the independent public accountants who certify the statements or do without their services. As discussed above,¹⁶ it is contrary to the self-interests of C.P.A.s to allow themselves to be bribed, and firing or not using C.P.A.s represents a signal to investors that the statements may be false or misleading. Hence, investors would be likely to assume the worst, which means that they could not be readily defrauded. If investors are defrauded, it should be recalled that laws other than the securities acts make this an illegal act, subject to civil and criminal penalties.¹⁷

To summarize, there are several factors that motivate controlling shareholders and managers of corporations to disclose financial information that is unbiased and not fraudulent. The corporations benefit because suspicious investors are likely to pay more for a share in the corporation than investors who have to find the infor-

15. See E. FAMA & M. MILLER, *THE THEORY OF FINANCE* 87-89 (1972).

16. See p. 1475 *supra*; note 12 *supra*.

17. The common law of fraud and deceit in tort are available. See W. PROSSER, *HANDBOOK OF THE LAW OF TORTS*, 683-736 (4th ed. 1971).

mation for themselves, and because prospective investors are likely to assume the worst if there is no disclosure. Independent public accountants are employed by corporations to certify the published financial statements to obviate the fears of investors that the disclosed numbers will be untrustworthy. In any event, if corporate insiders want to defraud outsiders, financial statements are not a preferable vehicle. At best, they are histories of the economic status and progress of a corporation and, therefore, are not well suited for making unfounded claims. In addition, the existence of laws that make fraud illegal works against the use of financial statements for this purpose since the statements could be used as documentary evidence of the fraud.

Against these benefits, the corporation must consider the costs of disclosure.¹⁸ The direct costs include the production and dissemination of the numbers. The indirect costs include the time and resources required to answer inquiries about the numbers and also the contingent cost of legal actions should people claim that the numbers are incorrect and caused them damage. Another type of indirect costs is action by competitors and others who can use the information to the detriment of the corporation. It is likely, therefore, that as the number of present and potential investors increases, the corporation will find it cost effective to publish audited financial statements that present general accounting data on standard forms to a large number of users. The extent to which information is disclosed will be based upon a consideration of the benefits and costs, as outlined above.

It is important to note that this analysis has focused upon only private benefits and costs. Should there be any externalities,¹⁹ the resulting quantity and quality of disclosure need not be optimal. One such externality is the use by investors, government and others of information for purposes other than investing in the disclosing corporation. As discussed above,²⁰ knowledge of the sales and net profits of General Motors might be useful to investors who are considering buying or selling shares in Ford. Before deciding that this "public good"²¹ aspect of information is sufficient to require disclosure by corporations, one should first ask whether private services,

18. See Benston, *An Appraisal of the Costs and Benefits of Government-Required Disclosure: SEC and FTC Requirements*, 41 *LAW & CONTEMP. PROB.* 30, 33-35, 39-41 (1977).

19. See note 14 *supra*.

20. See pp. 1476-77 *supra*.

21. Public goods are a class of goods wherein the use of the good or service by one person does not reduce the amount available to others if the good has been produced. See A. ALCHIAN & W. ALLEN, *supra* note 14, at 164-65, 251-53.

such as Standard and Poor's, Moody's and other securities analysts, would not provide the relevant data. It is also vital to know whether the costs of government regulation would exceed the benefits to the public.

In my opinion, the available empirical evidence supports the analysis presented above. Before enactment of the periodic disclosure requirements of the Securities Exchange Act of 1934,²² the companies whose shares were listed on the New York Stock Exchange²³ published the following financial data in 1926 and 1934 respectively (expressed as percentages of the total number of companies): balance sheet, 100% and 100%; current assets and liabilities, 100% and 100%; sales, 54% and 62%; cost of goods sold, 45% and 54%; depreciation, 71% and 93%; net income, 100% and 99.6%. In addition, the percentage of companies whose statements were audited by C.P.A.s was 82% in 1926 and 94% in 1934.²⁴ Furthermore, a comparison between the extent of voluntary disclosure in the United States and the United Kingdom reveals that, as the number of shareholders increased, the amount of disclosure, and the formality of the standards under which it was produced, increased.²⁵ Similar studies of prospectus disclosure, as now required by the Securities Act of 1933,²⁶ are not available. There is, however, reason to question whether the disclosure now required provides data that are useful to investors. As Professor Kripke has observed:

I have reluctantly come to the conclusion that the Securities Act of 1933 is not operating as it should and that the prospectus has become a routine, meaningless document which does not serve its purpose. Trying to keep from going entirely academic on the ivory shelf by maintaining my contacts with the practicing bar, I have reached the conclusion that most lawyers agree with me, and think of the registration process as simply a useless, but lucrative bit of paperwork.²⁷

There is very little evidence that financial statements were prepared fraudulently before enactment of the securities acts.²⁸ The

22. See Securities Exchange Act of 1934, §§ 12-13, 15 U.S.C. §§ 78l-78m (1976).

23. New York Stock Exchange companies accounted for 70% of the security transactions of all registered exchanges. See Benston, *The Value of the SEC's Accounting Disclosure Requirements*, 44 ACCOUNTING REV. 516, 519 (1969).

24. *Id.*

25. See Benston, *supra* note 9.

26. See Securities Act of 1933, §§ 5-7, 10, 15 U.S.C. §§ 77e-77g, 77j (1976).

27. Kripke, *The Myth of the Informed Layman*, 28 BUS. LAW. 631, 631 (1973).

28. See G. BENSTON, *The Effectiveness and Effects of the SEC's Accounting Disclosure Requirements*, in ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES 23, 51-53

paucity of cases, though, may be due to the rule of privity which made it very difficult to maintain suits against public accountants.²⁹ Almost no instances of such fraud or even misrepresentation or negligence are mentioned in the hearings that preceded passage of the securities acts, however.³⁰ Furthermore, though the Acts removed the rule of privity and the requirement that a plaintiff must have relied upon or even have seen the statements,³¹ almost no actions were found (or even brought) against public accountants until the 1960's. If there were a serious problem with fraudulent or misleading statements, one would have expected that the new laws would have released a flood of actions. In any event, from such cases in recent years as *Equity Funding*,³² *Home-Stake Production*³³ and *National Student Marketing*,³⁴ it seems clear that fraudulent or misleading financial statements have not been banished from the land.

Nor have the acts eliminated or even reduced losses for investors. It may be that the securities acts were enacted because investors had suffered tremendous losses in the crash of 1929 and in the years of the Great Depression. It seems clear, however, that financial disclosure had little, if anything, to do with these losses. One measure of this relationship is the delisting during the depression of companies whose shares were traded on the New York Stock Exchange, either because the share prices declined below the minimum amounts or because they were merged into other companies. In fact, a comparison of corporations that disclosed sales prior to 1934 with corporations that did not disclose sales before 1934 showed that a higher percentage of the disclosing corporations merged over the periods 1929-34, 1934-37 and 1938-40. Moreover, a higher percentage of corporations that disclosed sales prior to 1934 had stock traded off the exchange.³⁵

(H. Manne ed. 1969), for a review of the existing evidence.

29. See *Peek v. Gurney*, L.R. 6 E. & I. App. 377 (1873); W. PROSSER, *supra* note 17, at 702-04.

30. See SENATE COMM. ON BANKING AND CURRENCY, STOCK EXCHANGE PRACTICES, S. REP. No. 1455, 73d Cong., 2d Sess. (1934).

31. See, e.g., *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964); Securities Act of 1933, §§ 11-12, 17, 15 U.S.C. §§ 77k-77l, 77q (1976); Securities Exchange Act of 1934, §§ 12, 14, 15 U.S.C. §§ 78j, 78n (1976). *But see* *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (reliance required for § 10(b) civil damages); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (purchase or sale required to maintain private cause of action for money damages under rule 10b-5).

32. *In re Equity Funding Corp. of Am. Sec. Litigation*, 416 F. Supp. 161 (C.D. Cal. 1976).

33. *Geo. H. McFadden & Bros. v. Home-Stake Prod. Co.*, 295 F. Supp. 587 (N.D. Okla. 1968).

34. *SEC v. National Student Marketing Corp.*, 402 F. Supp. 641 (D.D.C. 1975).

35. See *Benston*, *supra* note 1, at 136.

Nor has the disclosure mandated under the Securities Exchange Act of 1934 prevented investors from suffering the losses experienced during the past several years. The major reason is that the securities acts have virtually nothing to do with such losses. These losses are basically a function of underlying economic events which affect equities of corporations and, therefore, necessarily affect people's investments in these equities. Similarly, when one looks at the financial statements of *Equity Funding*, which was a fraudulent scheme, or at the financial statements of *National Student Marketing*, it is hard to understand why, if disclosure was so important, people simply did not look at those financial statements and say: "How could anyone be growing at this rate? How are they doing it? What is going on here?" One can only surmise that investors were not looking at the financial statements because they were aware that the financial statements could not tell them what was going to happen—which was what they were buying the stock for. The financial statements are simply not designed for that purpose and can never be conceptually designed for that purpose. Therefore, we see enormous reductions in the market prices of blue chip stocks like Xerox, Kodak and Chrysler without someone claiming that there is something wrong with their financial statements. The problem arises from their economic condition. Consequently, one cannot reasonably expect that financial statements or any other type of disclosure have very much to do with all of this.

If required disclosure has not been necessary or very useful to investors, it seems clear that the continuous disclosure proposed by the Code is not likely to be desirable. The proposed Code, however, would go even further than this. It would give the SEC even more rulemaking power.³⁶ As a consequence, even greater costs will be imposed upon the economy. As is generally the case for active administrative agencies, the SEC is likely to use its authority to impose additional disclosure requirements upon corporations, whether or not the cost of the disclosure exceeds the expected benefits. The SEC must act in this way because it bears the costs of criticism when it does not require disclosure of a particular item that, in retrospect, appears desirable. The details of compensating balance arrangements for the Penn-Central loans present a case in point. Since the agency rarely receives praise for relieving corporations of reporting burdens,³⁷ its natural tendency is to add new reporting

36. *E.g.*, ALI FEDERAL SECURITIES CODE §§ 404, 502(c)(1), 505, 512(b)(3), 602(a)-602(b), 603(d), 604.

37. See Benston, *Public (U.S.) Compared to Private (U.K.) Regulation of Corporate*

requirements, while not removing even clearly obsolete and ineffective requirements.

Because I prefer not to end this comment on a negative note, I make the following suggestions. The Code might copy the Companies Acts of the United Kingdom³⁸ and require disclosure only of specified items, such as current assets, sales, cost of goods sold, net profit, contracts with top officers and directors and salaries and emoluments paid to them. The rulemaking power of the SEC should be attenuated, if not entirely eliminated, while the basic disclosure concept of the acts should be reasserted in the following way. Companies should be allowed to register under a special section that permits them to file whatever financial statements they wish, including no statements at all. All these corporations need do is require each of their investors to sign a declaration of informed consent to the effect that the investors realize that the statements filed have not been approved or even looked at by the SEC and that the investors will not sell their shares or bonds to anyone who does not sign a similar declaration. Corporations and their accountants would still be subject to suits alleging fraud. The financial statements filed could provide evidence of fraud if it were perpetrated, although the extent of disclosure would be voluntary. It would be interesting to observe what and how much would be disclosed and the effect on investors and on their investments, under a system of voluntary disclosure.

In conclusion, I would like to see some of the above suggestions tried. While I have my own presuppositions, I would like to find out what would happen. I would have also liked to have seen at least some experimentation in the proposed Code. Now, to say that there is a section in the Code that states that the Commission can do this, is not to really expect that they will do this. As Professor Loss stated,³⁹ it is unreasonable to expect the staff of the SEC to have the necessary objectivity to reform the law. I also would suggest to you, with great humility, of course, that the legal profession which deals with the law may not have that objectivity. It is possible that economists do not have it either. Still, I believe it would be useful to go back and look at the underlying rationale of the statutes, even though to do so may not be politically feasible or desirable. At least it might be intellectually interesting to question whether this rewrit-

Financial Disclosure, 51 ACCOUNTING REV. 483 (1976).

38. Companies Act 1948, 11 & 12 Geo. 6, c. 38; Companies Act 1967, ch. 81 (London: Her Majesty's Stationery Officer 1972 reprint).

39. See *Panel Discussion, Fourth Annual Baron de Hirsch Meyer Lecture Series*, 33 U. MIAMI L. REV. 1519, 1535-36 (1979).

ing of the original statutes will accomplish some expressed and clearly specified goal. We should be clear as to what the probable effect of the Code is likely to be.

Let me end by restating the well deserved praise that Professor Loss should get from me, and all of the rest of us. He is clearly a Caesar in this endeavor, and I wish I had the eloquence, perhaps even more than that of Mark Antony, for while I have not entirely praised Caesar, neither would I want it thought that I wished to bury him.