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THE subject under discussion, "Federal Control of Corporations," is as broad as the multifarious activities of the people of this widely diversified country of ours. I propose to limit myself to the subject of the regulation of corporations by policing the sales of their securities.

On general principles, I am opposed to the wholesale surrender by the citizens of the several states of their control over their business, and I am opposed to the alarming tendency fast becoming prevalent of assigning their minute and intimate affairs to the Federal Government at Washington for regulation.

Our dual form of government was established on the wise theory that the citizens of the several states retained the full and complete government over their own affairs. In forming a Federal Government they delegated to it only certain limited powers relating chiefly to transactions with foreign nationals, transactions in commerce between the states, the postal service and other interstate matters, all of which is defined in the Constitution of the United States.

It was the spirit of our government then, and the spirit of our government now, an inheritance from our Anglo-Saxon origin, that the individual citizen shall regulate his own affairs with the least government possible; and that such governmental control as is found necessary shall be primarily local and extend from the locality to the state only where the common interest requires the application of broader rules.

The problem that confronts us here is not so much the expediency of Federal regulation of your or my business, but it is essentially the power and the ability of your state to properly regulate that business. The question is, has the authority of the several states collapsed over the corporate Frankensteins that they have created? This question I propose to answer in my remarks that follow.

A corporation is merely a form under which natural or individual persons transact their affairs. Like "Christmas spirit," it has no physical existence. It is what the philosophers call an idea. To us lawyers it is a contract between the state and a group of individuals with certain reservations, whereby these individuals and their successors may transact their joint affairs with certain privileges and liabilities that as individuals they do not have. Beyond a charter filed in a public office, nothing material is created, but the group thereupon take on certain relations among themselves and toward the public. This conception of a relationship is a corporation.

Creatures of the several states, these privileges and relations may be modified or regulated by their creators. Thus the right to succession, or the right to transfer the shares of corporations, may be regulated or even forbidden by the states.

The members of these groups are "stockholders." While in most instances these groups are composed of citizens of different states, yet their corporate privileges are valid only by

virtue of the laws of the state of their incorporation.

Originally corporations were composed for the most part of small groups of business friends, associated in a common enterprise, each with a substantial interest. There are now, of course, many such. But in modern times stockholders constitute relatively enormous groups of the citizens of this country. The stockholders of some of our large corporations number many thousands, most of them owning but few shares. The United States Steel Corporation is a group of over 160,000 stockholders; the Pennsylvania Railroad, of over 140,000; the American Telephone and Telegraph Company, of over 366,000. Their personnel is constantly shifting, as these stockholders buy and sell out of the corporation. Hundreds of thousands of shares of United States Steel are bought and sold daily on the New York Stock Exchange. The transactions in shares of other corporations are almost equally as large. Hundreds of thousands of shares are bought on margin and the owner's name seldom appears on the books of the corporation. A large portion of these stockholders are women and people of small means with no business experience. More and more of the employes of corporations are becoming shareholders of their employers on partial payment plans, and some of these plans require the return of the stock when the employment ceases. The purpose of the scheme is to tie the employe to the business.

SEEKING A CURE

It is probably agreed on all sides that they need protection and need it badly, not only from the schemes and manipulations of wicked promoters, but also from their own cupidity. But where we doctors disagree is about the method of protection and the degree.

To approach the problem on the mob rule theory that this uninformed and undiscriminating mass of speculators can be equipped by publicity to regulate for themselves the intricate details of corporate business will certainly get us nowhere.

Recently a distinguished economist in the September issue of the *Atlantic Monthly* has most persuasively voiced a call for publicity of corporate transactions. He criticizes the meagerness of the usual annual report and then suggests as a remedy that the Federal Trade Commission be goaded into a general excursion into the books of all the corporations of this United States and divulge the results to the public.

This cry for publicity was made in the interest of present and of prospective stockholders. Now, let us inquire how such proposed publicity may benefit the stockholders, either actual or prospective. Does it secure a more economical management of the affairs of the corporation, or does it primarily enable investors to select, buy and sell shares in corporations to their advantage?

It is estimated that about 20,000,000 investors live in the United States. The vast proportion of this 20,000,000 are minority stockholders scattered from Maine to California. The individual voice of the greater portion of them appears so feeble and their inability to grasp the intricate and technical details of their business is so manifest that they wisely prefer to leave the helm in the hands of others, contenting themselves with the quotations of their stock on the public markets. Few of them attend corporate meetings. Hence, the actual management of their corporations is actually in the hands of one or two individuals who can and do perpetuate their own control, their own employes and their own policies by assembling proxies of

fifty-one per cent of the stock in advance of meetings. So we find, particularly in our large corporations, that the responsible heads are placed there and are dominated by a few owners of the larger blocks of the stock, but nevertheless minority blocks. Although theoretically the vote of this enormous mass of stockholders may control bad management, practically a disgruntled minority stockholder's sole remedy against bad management is to sell his stock, take his loss, and reinvest the proceeds in other stock which he believes may be more fortunate.

It seems fairly obvious that the outcry for publicity has no direct relation to any cure for mismanagement of corporate affairs.

On the other hand, the public ventilation and exposure of the affairs of corporations tends to restrict fraudulent, unjust and unfair practices in the issue and marketing of their securities and enables investors to select, buy and sell with full knowledge of the facts.

In the last analysis, fraud is effected either by positive mis-statements or by concealments of facts. In the issue and sales of securities most frauds are accomplished by cunning innuendo and by concealments of fact. Investors buy and sell securities on cleverly circulated rumors, tips and hunches, and usually in complete ignorance of what they are buying and selling. Thus, the whole subject of disclosures by corporations of their affairs is closely related to the prevention of frauds upon stockholders, and inasmuch as the interest of the average stockholder is identified with the market for his stock, it follows that the state, by policing sales of stocks and by the enactment of laws for that purpose, may provide a full measure of protection to stockholders where it is vital. And this I hold is a proper function of government.

Again, I believe, and I assert it without fear of contradiction here, that government interference with the management of private business is not a cure. I am aware of the fact that the socialist thinks otherwise. My own experience in government operation has been disastrous. Frequent complaints are made to us against corporations whose business is conducted unwisely, where no dividends are being earned and particularly where the market price of the stock has collapsed. In one corporation we found that the moving spirit was a visionary inventor who was conducting the corporate affairs more to the end of developing a toy than to the production of dividends. In that case we interfered and compelled the inventor, a man with an international reputation, to eliminate himself from the management and install a voting trust controlled by the minority stock of the corporation. The stockholders responded by saddling the entire business on our office.

PASSAGE OF BLUE SKY LAWS

Forty-five states of the Union have passed blue sky laws regulating the sales of shares of corporations to the public. The dominant feature of all these laws is the grant of full powers to the several Security Commissioners to discover the condition of corporations selling stock or whose stock has been sold in these states.

With the exception of Delaware and Nevada every state in the Union has thus installed machinery to expose fraudulent, inequitable, unjust and unfair practices, not only in the sales of corporate shares in such states, but also from them.

Now, let us see whether these statutes are designed to protect stockholders and if they are administered with that effect.

The state blue sky laws do not

primarily regulate the management of corporate business, but they are designed to prevent the sale of corporate securities whenever fraudulent, unfair and unjust practices are discovered. They are all substantially uniform in that they all require corporations and individuals to give full information of their affairs to the state for that purpose.

Forty-three of these states prohibit any sales of securities in their states, and thereby exclude their citizens from owning shares in corporations unless these corporations are previously licensed. The burden is placed on the corporations to show a clean bill of health. New York, Maryland and New Jersey, on the other hand, differ from the other forty-three states in that respect. New York, Maryland and New Jersey freely permit unrestricted sales of shares of corporations until fraud or unfair and unjust practices are discovered, in which event the investment may be prohibited. The burden of proof is here placed on the state of discovering unhealthy conditions. Forty-three states have licensing laws. Those of New York, New Jersey and Maryland are known as investigation and injunction laws.

The effectiveness of blue sky laws depends absolutely on the vigilance, energy and intelligence of their administrators. A weak law, wisely and energetically administered, is far more effective than a strong law that is feebly enforced or not enforced at all.

In all state blue sky laws the teeth lie in the provisions for a discovery of facts, a compulsory and supervised discovery. Subpœna powers are granted the Security Commissioners with heavy penalties for perjury and disobedience, and where the provisions are enforced and are publicly known to be enforced, only corporations which can present a good balance sheet and only promoters whose records are presentable seek capital within these states. Let me demonstrate how in New York the provisions for discovery of themselves have served to protect stock-holders.

THE MARTIN ACT OF NEW YORK

The City of New York is perhaps the financial capital of the world. Over 5000 corporations a month are organized in the State of New York. On some days over three million shares of stocks are traded in on the New York Stock Exchange. There are approximately five thousand dealers in securities registered in my state. Almost every large corporation in the country has its main office there. Thousands of corporations locate their transfer offices there. Billions of dollars are loaned by the banks of New York on collateral consisting of corporate shares. The business of this entire nation is inextricably interwoven with the purchasing and selling and transfer of corporate securities in the City of New York.

A license law restricting these transfers of securities in New York State preliminary to a thorough investigation would choke business, not only in the state, but in the entire United States.

The Martin Act permits the free sale of any stocks or securities in the State of New York provided they are sold without any misrepresentation or concealment of their real nature. On the other hand, no security can be safely sold under the provisions of this act if its character is in any way misrepresented.

It has been estimated that over $1,700,000,000 is taken from the public annually by stock swindles. If this estimate includes fraudulent promotions, watered stock, wash sales on rigged stock markets, fraudulent re-

organizations, bonds secured by mortgages on over-appraised real estate, bucket shop operations and other forms of frenzied finance, then I say the estimate is over-modest.

Over three-fourths of this loot, I venture to say, has been taken by transactions conducted in whole or part from the State of New York. The result of this is that to the average rural American "Wall Street" is synonymous with fraud and unjust and inequitable practices. Yet the proportion of unfair practices to the enormous volume of honest transactions is small.

Nevertheless, the fact remains that frauds and unfair and inequitable practices in the sales of stock in the State of New York were a public scandal and have earned the deep and abiding resentment of the public. Brokers and banking houses of at least respectable appearance have unloaded stock on the public at fancy prices based on inflated inventories, retaining enormous promotion profits secreted in items of good-will, patents and inventories. Manipulations of these stocks on the stock exchanges by means of pools, washing the sales back and forth at rising prices, have lured the public into purchases in the belief that large profits would follow. Bucket shops equipped with stock tickers, boards and mahogany furniture nested among the respectable addresses in every office building and reaped their harvest among the small wage-earners, encouraging gambling and speculation. Fallow mines and visionary oil wells bought for a song were capitalized at millions and sold by ex-convicts through apparently unbiased "tipster" papers which were in reality owned by the promoter. The entire mechanics of frenzied finance was in full operation.

The Martin Act is New York State's substitute for a blue sky law. As I said before, it is not a license law. It gives the Attorney-General of the state power to issue subpœnas and examine under oath any corporation or individual and command the production of any book or paper. The scope of this examination is limited to practices in the sales of securities. Obviously, any matter, however, that relates to the business of the corporation, its management, its property, is material in uncovering innuendo, concealment and fraud. Such practices as are found to be fraudulent, unjust and inequitable may be enjoined by our Supreme Court in a suit by the Attorney-General.

These injunctions do not absolutely prohibit sales of the offending stock. But as a condition of continuing they require corporations and promoters to make full disclosure of all facts and discontinue mis-statements and misrepresentations of facts. They require brokers to reveal their interest in these transactions and disclose secret profits and to actually buy and keep on hand their customers' stocks. In other words, these injunctions in the main force publicity of facts and true conditions on the theory that the investor or speculator is the person most competent to buy without the advice of the state. Also the injunctions move against the individual actors, bringing home to them as individuals the moral and legal responsibility for the corporate delinquency.

The teeth of this statute is the power in the Attorney-General to compel full and prompt disclosure of corporations' affairs.

The Martin Act was originally enacted in 1921 following the public outcry against the bucket-shop scandals of Wall Street. The criminal laws as a remedy had completely collapsed, due to the difficulty of obtaining evidence, and the necessity of proving the offense within its strict statutory definition.

Define fraud and you advise the swindler how to circumvent.

RESULTS OF ENFORCEMENT

However, until 1923 there was no appropriation for the enforcement of the Martin Act. And from that date until January 1, 1925, it was but feebly administered.

Commencing with January, 1925, however, the present Attorney-General of the State of New York, Albert Ottinger, obtained an appropriation from the Legislature of $100,000 and commenced a vigorous enforcement of this law. Questionnaires demanding complete information were broadcasted, not only to corporations organized in this state, but to corporations with offices out of the state. In two years over ten thousand witnesses were examined about the most confidential and diverse affairs of numerous corporations, banks, investment trusts, stock exchanges and brokerage houses. Attorney-General Ottinger has not hesitated to place under his subpœna the employes and officers of the large public utility corporations, the city departments, the New York stock exchanges, the Federal Reserve Bank, the large real estate bond and mortgage companies, and many of the large stock exchange houses in the city. Proceeding on the theory that corporations are but cloaks under which individuals act, we have invariably ignored the corporation and probed the actors.

The result of this general inquisition has been apparent. A general housecleaning has ensued in the State of New York and an exodus of undesirables to Florida, Boston, Canada and New Jersey.

Our bucket shops which have heretofore flourished like the bay tree have been almost completely eliminated. One large stock exchange and three or four small ones, and several commodity exchanges have been either closed or effectively regulated. Herds of confidence men, working through the rural districts, have been run out of the state. The "Roaring Forties" (our Great White Way) are no longer distinguished by crowds of high pressure stock salesmen. Unfair and unhealthy conditions in the real estate bond and mortgage houses are in process of voluntary correction. Several large reorganizations have been supervised. The district attorneys and the police are constantly referring complaints to us. Yet, with all our examinations, the number of injunctions we have obtained have been relatively small, not over two hundred and fifty.

From my observation this change of condition was brought about by our power to examine and discover. The ever-present threat of thorough ventilation, coupled with the announced determination of Attorney-General Ottinger to enforce the statute, has been a preventive just as effective as any actual injunctions to cease and desist.

It is my observation that the average person is a law-abiding citizen. Any law that appeals to his conscience and has the backing of public opinion will be obeyed generally without any particular threat of punishment. But a law that has no appeal to the conscience of the average man and is not backed by public opinion will meet public resistance no matter how severe the penalties.

A law merely designed to investigate corporations and publish information to satisfy public curiosity, even if constitutional, is odious. But any law that has for its object the prevention of frauds upon the public will obtain, and has always obtained, the full measure of public support, and it is that support that enables government to enforce the law. The Martin Fraud Act is such a law. It has the full public support and it is accomplishing its purpose.

NATIONAL ASSOCIATION OF SECURITY COMMISSIONERS

Frauds and unjust and inequitable practices in the sale of securities are not only intrastate, but they are often interstate. Thus, at the present time we have found a promoter or stock manipulator of a particularly evil reputation publishing and circulating a paper from the City of New York, a so-called tipster paper, in which the subscribers are brazenly advised to buy the stock of a copper mine in Idaho. Over 600,000 of these papers are mailed from New York City to subscribers all over the United States. The mine in Idaho is fallow and cost the promoter less than $10,000. Its stock is listed on the Boston curb market, where the prices have been washed from 50 cents to $5.00, giving the mine a capitalization of over $15,000,000. To expose this fraud investigations are required in three states, New York, Idaho and Massachusetts.

To meet situations like this the Security Commissioners of the several states have voluntarily organized a National Association of Security Commissioners, supported by appropriations from each of the member states. This association holds an annual convention and there formulates a policy of uniform principles and procedure, suggests legislation and considers mutual problems. A president and secretary are elected. During the year monthly bulletins are distributed of the proceedings pending before each Commissioner. The fullest co-operation is secured among the members and each is thereby provided with the machinery of the entire group of forty-five sovereign states, and of forty-five experienced and capable executives.

In actual practice the utmost harmony and co-operation is afforded by this association. Each learns by the experience of the other. Local problems are treated locally, while national and interstate problems are treated broadly. In the example I have just given, the State of Idaho is presenting me with full information and evidence of the Idaho mine, and the State of Massachusetts of the manipulations on the Boston Curb Market. New York is maintaining proceedings against the promoter to stop the fraud.

Thus it seems to me that the control of corporations which are, after all, merely groups of the citizens of the several states endowed with certain privileges, may be safely left to the states that created these privileges, and that this control is more properly exercised by policing sales of securities than by state or stockholders' interference with management. Perhaps in some instances the frauds are not exposed and corrected with the vigor expected by the public, but that, it seems to me, is the fault of administration rather than with the laws.

And as New York State is the source of a greater part of the public resentment, the responsibility is put up to the Attorney-General of that great state. As his deputy, charged by Mr. Ottinger with the responsibility of enforcing that law, I therefore say, he assumes that great responsibility, we have no alibis to offer, the law is entirely adequate with slight amendments, and we propose to enforce it to the limit, to the end that fraudulent and unjust and unfair practices in stocks shall discontinue. This includes the operations of any individuals whether done singly or with others, and whether done under the cloak of a corporation, partnership, stock exchange, investment trust, bank or any form of human organization. And in expressing myself thus, I do so with the conviction that we have the organized backing and co-operation of forty-five states of this nation.