MEMORIES OF BILL CARY

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More than thirty years have passed since I completed the interviews for the first edition of *The Transformation of Wall Street.* My interview with Bill Cary on October 28th and 29th, 1980 was particularly memorable. I met with Bill in Columbia Presbyterian Hospital, where he was being treated. Bill had already written a memoir of his years as chair of the Securities and Exchange Commission, *Politics and the Regulatory Agencies.* Bill met with me to be helpful to my effort to draft a comprehensive history of the SEC.

Only at the end of the interview did I appreciate another aspect of our interview. When we were done talking about the Commission, Bill asked me what I planned to do in life. I had recently begun an academic career. I expressed uncertainty about my long-term plans. Bill spoke about his love of academia, remarking that it "is one place you have full control of what you say and write. There is no other career so intellectually rewarding." He encouraged me to spend time with Harvey Goldschmid, a young colleague of Bill's at Columbia Law School. Of all the words of encouragement to continue an academic career, none meant as much to me as Bill's.

The background to Bill's period at the SEC was of great consequence to Bill. The Commission had had perhaps the most remarkable initial years of any independent regulatory agency, beginning in 1934 until World War II subordinated virtually all domestic programs.

Bill was deeply influenced by this formative period. He served at the Commission between 1938 and 1940, initially

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under Chairman William Douglas. It is noteworthy that Douglas swore in Bill as SEC chair.

The Commission that Bill Cary led was strikingly different than the New Deal's SEC. The Commission was no longer "the sacred cow," that Judge Learned Hand had mocked in welcoming SEC attorneys during the 1950s. The agency that had grown to 1,723 employees by 1941 had been reduced to 666 employees by 1955.[1] The same Commission that under Douglas had forced a reorganization of the governance of the New York Stock Exchange ("NYSE"), implemented what then was the largest industrial reorganization program in the nation's history through the Public Utilities Holding Company Act, created our modern systems of corporate disclosure and fraud enforcement, and registered broker-dealers, investment advisers, securities exchanges, and securities associations, by the late 1950s seemed a spent force, a toothless watchdog. There was a vast increase in boiler rooms[2] and fly-by-night promotions.[3] By the time that Cary was sworn in as SEC chair in 1961, there had been a near-complete collapse of self-regulation on the American Stock Exchange, which was widely and accurately characterized as the most serious stock market scandal since Richard Whitney's 1938 misappropriations at the NYSE.[4]

The close bonds that President Roosevelt had with successive SEC chairs, especially Joseph Kennedy and Bill Douglas, were distant memories. Bill told me that he did not once see President Kennedy on official business and found that Ralph Duggan, the White House aide who oversaw the Commission "literally had no free time to talk with us."[5] Gone too were the days when the Commission could rely on decisive support from congressional leaders such as Sam

1 JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 267–68 (3d ed. 2003).

2 *Id.* at 273.

3 *Id.* at 277–79.

4 *Id.* at 281–89.

5 *Id.* at 292.

Rayburn, who was instrumental in the enactment of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Public Utilities Holding Company Act of 1935.[6] The major challenge Cary faced with respect to the Securities Act Amendments of 1964 was persuading House Committee on Interstate and Foreign Commerce Chairman Oren Harris to schedule hearings, which Cary ultimately did by convincing Harris that he was not "an ogre or an excessive bureaucrat."

The Commission that Bill Cary led was as Bill wrote in a memorable passage in *Politics and the Regulatory Agencies*,

> [A stepchild] whose custody is contested by both Congress and the Executive, but without much affection from either one. . . . Without the cooperation of both Congress and the Executive, little constructive can be achieved. To reemphasize the point, an agency is literally helpless if either branch is uninterested or unwilling to lend support.[7]

The absence of White House support for new SEC legislation, coupled with the conservative leadership of the House of Representatives, fundamentally affected the SEC during the chairmanship of Bill Cary. In retrospect he described himself as

> [C]onvinced that no major step forward can be achieved by an old-line regulatory agency in the absence of support from some of the leaders in the industry it regulates. . . . Even as to rule-making, if none of the industry's spokesmen feel there is a need and complaints mount, congressmen are likely to intervene and commence inquiry, and a committee may either stall the proposal or kill it.[8]

During Cary's chairmanship, only one legislative initiative was advanced, the "noncontroversial" 1964 Securities Acts Amendments bill. More far-reaching legislation, such as a bill to reform the mutual fund industry, was deferred.

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6 *See* SELIGMAN, *supra* note 1, chs. 2–5.

7 WILLIAM L. CARY, POLITICS AND THE REGULATORY AGENCIES 4 (1967).

8 *Id.* at 69.

Against this backdrop, what Cary did accomplish was remarkable. Working closely with James Landis, who briefly served in the White House to implement his December 1960 Report on Regulation Agencies to the President-Elect, the Cary Commission was able to add 250 employees to the SEC in his first fiscal year.[9]

During his chairmanship, Cary revived efforts to complete several unfinished projects first attempted during the New Deal, including the enactment of a statute extending the Securities Exchange Act's requirements to all unlisted firms above a minimum size, and a highly publicized attempt to abolish floor trading. This sense of revival of the New Deal's SEC was cultivated by Cary. Troubled by the intransigence of the NYSE, Cary renewed Douglas's accusation that "the Exchange, though a public institution, still seems to have certain characteristics of a private club."[10] Like the Douglas SEC, Cary's Commission kept as a mission the reduction of opportunities for Exchange floor members or corporate insiders to take advantage of their positions, as well as a general commitment to raising fiduciary standards.

Cary skillfully recognized that some of the great strengths of the New Deal's SEC could be revived. The work of the New Deal's SEC had been preceded by a generation of study of the securities markets and corporations law. The Pecora hearings, the Federal Trade Commission's study of public utilities, and the SEC's own reports on stock exchange governance, segregation of brokers and dealers, protective committees, and investment companies had provided an informed basis for major SEC policy initiatives. Each of these studies also had afforded the SEC the opportunity to employ commissioners or staff members with broad expertise in an industry or industries subject to the SEC's jurisdiction. No comparable studies had been made of the securities markets for over twenty years when Cary arrived. As the

9 SELIGMAN, *supra* note 1, at 291.

10 William L. Cary, *Self-Regulation in the Securities Industry*, 49 A.B.A. J. 244, 246 (1963).

securities industry expanded and qualitatively changed, the pathbreaking studies of the New Deal period had grown increasingly dated.

Cary began at the SEC with a determination to restore the Commission's policymaking capability and to increase its attraction to highly competent staff members. The principal vehicle for achieving both aims was the 1961–1963 *Special Study of the Securities Markets*. Early in his chairmanship, Cary began the practice of hiring consultants to make "critical studies . . . of the Commission in the light of present-day problems." Among others, Cary hired Joseph Weiner, one-time director of the Public Utilities Division, to review the Commission's performance under its principal enabling statutes; Yale Law Professor Frank Coker to evaluate the earlier-commissioned Wharton School Investment Company Size Study; Yale economist Raymond Goldsmith to analyze the SEC's research and statistical activities; and, later, securities attorney Carl Schneider to study the extent to which the requirements of the 1933 and the 1934 Securities Acts could be integrated by SEC rules.

Most significantly, the Commission hired Milton Cohen, also a former director of the Public Utilities Division, and a professional staff of forty attorneys, economists, statisticians, financial analysts, and investigators to work full time for close to two years on the *Special Study of Securities Markets*. It was a stellar staff, several of whose members, including Eugene Rotberg, Stanley Sporkin, and Sheldon Rappaport, were to continue to make contributions to the Commission long after the study was completed.

In some sections of the *Study*'s report, such as those covering fixed commission rates and NYSE specialists, the *Special Study* reached conclusions that stopped short of the implications of its findings in a manner that later House and Senate reports on the securities industry often did not. The *Study's* failure to analyze Rule 394 of the NYSE, which hindered securities dealer competition by generally prohibiting exchange members from transacting business with nonmembers, also was a striking anomaly, reflecting the belief of many SEC senior members that it was wiser to

centralize securities trading on a single exchange than increase the difficulties of market regulation by encouraging competitive market-makers.

Given even these substantial questions about the *Special Study*, its report undoubtedly was the single most influential document published in the history of the SEC: it provided a foundation for most of the reforms that occurred in the securities industry during the ensuing fifteen years. In large measure, the *Special Study* was a factual documentation of the limits of self-regulation in the securities industry. Although Cary's transmittal letter and the report itself repeatedly stated a "continuing belief in self-regulation as an ingredient in the protection of the investor,"[11] the report's findings illustrated that without the "pointed stimuli" of the SEC,[12] securities industry self-regulation consistently had been self-interested and self-protective, often failing to produce standards of conduct superior to those that existed before the enactment of the securities laws. Significantly, in most of the principal areas covered by the report—for example, entry requirements, selling practices, back-office problems, exchange floor members, fixed commission rates, mutual fund selling practices, and exchange disciplinary procedures—similar disadvantages of securities industry self-regulation were found. In several instances, like floor trading regulation, the SEC's postwar passivity had, in fact, permitted a deterioration of standards.

Lacking both a congressional sponsor to introduce new securities legislation or an understanding that President Kennedy would endorse a securities bill, Cary's SEC determined early that its initial 1963 legislative proposals would be far narrower than the full list recommended by the *Special Study*. The most controversial of the *Special Study*'s

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11 SEC, REPORT OF SPECIAL STUDY OF SECURITIES MARKETS, H.R. DOC. NO. 88-95, pt. 1, at v (1963), *available at* http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1960/1963_SSMkt_Chapter_01_1.pdf (Letter of Transmittal from William L. Cary, Chairman, SEC).

12 *Id.* pt. 4, at 695, *available at* http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/papers/1960/1963_SS_Sec_Markets/Chapter_12_5.pdf.

legislative recommendations, the regulation of mutual fund contractual plans and segregation of customers' securities held by broker-dealers, were never seriously considered for the initial securities bill.[13]

The 1964 Amendments ultimately did extend the registration, reporting, proxy, and insider trading provisions of the Securities Exchange Act to over-the-counter companies with more than $1 million of gross assets (soon raised to $10 million by exemptive rule) and a class of equity securities held by at least 500 persons.

For Cary, the political limits of addressing key issues at the NYSE was his greatest frustration. During his tenure, the SEC did not initiate a course of action concerning the Exchange Commission rate structure[14] and was unable to secure abolition of floor trading, which Cary and the *Special Study* both regarded "as morally and . . . legally wrong."[15] As Cary later wrote about the Commission's 1964 floor trading rule, "We waffled and wound up with a series of rules that did not achieve much."[16] With respect to the far more consequential specialists "who ran the Exchange at that time," the *Special Study* had concluded that "the Exchange's regulatory and surveillance programs had been inadequate."[17] Nonetheless, the SEC pursued modest reforms, including reiteration that dealing should be limited to the 1934 statues' "reasonably necessary" standard, a new affirmative obligation requiring specialists to deal when dealing was necessary to maintain a fair and orderly market and a higher minimum capital requirement.[18]

Only with respect to securities litigation did Cary's Commission consider itself unrestricted by the political limitations that bound its legislative and rulemaking program. In broadening the bases for private litigants to bring damages actions against corporate officers and

13 SELIGMAN, *supra* note 1, at 310.

14 *See id.* at 314–15.

15 *Id.* at 326–27.

16 *Id.* at 335.

17 *Id.* at 340.

18 *Id.* at 341.

directors who exploited inside information or distributed false and misleading proxy statements, Cary's SEC fundamentally altered securities law enforcement.

Cary had arrived at the SEC in March 1961 with "no agenda." But there was one priority he did have from the start of his chairmanship: to use Section 10(b) of the federal 1934 Securities Exchange Act to reverse, in effect, state corporations law decisions concerning insider trading, such as the Massachusetts Supreme Judicial Court's 1933 opinion *Goodwin v. Agassiz.*[19] The question in *Goodwin* has been a classic one in securities law: Could a corporate director with nonpublic (or "inside") knowledge of facts that would increase the share price of a security purchase stock from an uninformed shareholder without informing him or her of these facts? Some state courts had held that this was impermissible if done under the "special circumstances" of a face-to-face transaction.[20] *Goodwin* had held that the purchase of stock by a director with inside knowledge would be permissible if done "impersonally" through a stock market.[21] The Massachusetts Supreme Judicial Court reasoned:

> An honest director would be in a difficult situation if he could neither buy nor sell on the stock exchange shares of stock in his corporation without first seeking out the other actual ultimate party to the transaction and disclosing to him everything which a court or jury might later find that he then knew affecting the real or speculative value of such shares.[22]

The court also had stated: "Business of that nature is a matter to be governed by practical rules. Fiduciary obligations of directors ought not to be made so onerous that men of experience and ability will be deterred from accepting

19 Goodwin v. Agassiz, 283 Mass. 358 (1933).

20 *See id.* at 362.

21 *Id.*

22 *Id.*

such office. Law in its sanctions is not coextensive with morality."[23]

Cary also did not believe the law could be "coextensive with morality," but he insisted that it was shocking for either courts or business executives to believe that it was permissible conduct for executives to use inside information for their personal benefit.[24] Few actions were more likely to reduce confidence (and, ultimately, aggregate investment) in the securities markets than the failure to enforce rules guaranteeing, as far as the law could, that all investors trading on stock exchanges have relatively equal access to material information.

Within months of assuming the chairmanship, Cary wrote an SEC administrative opinion, *In the Matter of Cady, Roberts & Co.*,[25] that not only contravened *Goodwin v. Agassiz*, but also broadly expanded Rule 10b-5 as a basis for private causes of action. Rule 10b-5 was soon to be of such significance in securities law that Harvard Law School's Louis Loss would remark in 1969, "[T]he great Rule 10b-5 . . . seems to be taking over the universe gradually."[26]

Section 10(b) of the 1934 Securities Exchange Act had been intended to be a residual antifraud provision meant to outlaw types of manipulation not specifically proscribed by the Act's more precise denunciation, in Section 9, of touting, wash sales, and other forms of stock market manipulation identified by the Pecora hearings. Since nearly identical language in Section 17(a) of the 1933 Securities Act prohibited fraud in the offer or sale of securities, Section

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23 *Agassiz*, 283 Mass. at 362–63.

24 William L. Cary, *Corporate Standards and Legal Rules*, 50 CAL. L. REV. 408, 416–17 (1962), *available at* http://scholarship.law.berkeley.edu/californialawreview/vol50/iss3/2.

25 Cady, Roberts & Co., Exchange Act Release No. 6668, 40 S.E.C. 907 (Nov. 8, 1961). *Cf.* Donald C. Langevoort, *Rereading* Cady, Roberts: *The Ideology and Practice of Insider Trading Regulation*, 99 COLUM. L. REV. 1319 (1999).

26 Louis Loss, *The American Law Institute's Federal Securities Code Project*, 25 BUS. LAW. 27, 34 (1969).

10(b) was not employed by the SEC until March 21, 1942, when the Commission adopted Rule 10b-5.

In 1943, the SEC issued a report concerning the Ward La France Trucking Corporation's purchases of its own stock.[27] In the report, it "call[ed] attention" to the existence of Rule 10b-5.[28] The Rule, however, was little used during the next eighteen years because of uncertainty as to whether it applied to purchases or sales effected through securities exchanges.[29] This was the key issue in *Goodwin v. Agassiz* and the issue that *Cady, Roberts* resolved with its holding that a person possessing inside information must either disclose it to others from whom he seeks to purchase or sell stock or abstain from trading until the inside information becomes publicly know, regardless of whether the person engages in securities transactions face-to-face or over a securities exchange.

Because the person possessing inside information in *Cady, Roberts* happened to be a securities broker, the decision was of concern to the NYSE. Cary recalled that shortly after his opinion was published, NYSE President Keith Funston telephoned and read a strongly critical letter that he was about to send to the SEC characterizing the *Cady, Roberts* decision "as an unwarranted step toward raising standards to an unrealistic level."[30] Cary defended the decision and did not hesitate to inform Funston that the letter would not influence the Commission. It was, in fact, never sent.

Cary's SEC also supported private enforcement of the securities laws through the SEC's successful appearance as amicus curiae in the Supreme Court's 1964 case *J.I. Case v.*

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27 La France Trucking Corp., Exchange Act Release No. 3445, 13 S.E.C. 373 (May 20, 1943).

28 *Id.* at *1.

29 Exchange Act Release No. 3230, 1942 WL 34443 (May 21, 1942); *Ward La France Trucking Corp.*, 13 S.E.C. 373, at *1. Milton v. Freeman, *Administrative Procedures* 22 BUS. LAW. 891, 921–23 (1967).

30 CARY, *supra* note 7, at 84; Interview with William Cary, in New York, N.Y. (Oct. 28–29, 1980).

Borak.[31] In *Borak*, the Court held that stockholders had an implied statutory right to bring damages actions when they were defrauded by corporate proxy solicitations, agreeing with the SEC's argument that "[p]rivate enforcement of the proxy rules provides a necessary supplement to Commission action. As in anti-trust treble damage litigation, the possibility of civil damages or injunctive relief serves as a most effective weapon in the enforcement of the proxy requirements."[32]

The cumulative effect of the SEC's actions in *Cady, Roberts* and *Borak* was rapidly apparent. The Administrative Office of the United States Courts' 1961 annual report noted that a total of 171 private civil cases filed in the United States district courts were based on the federal securities, commodities, and exchanges statutes in 1961, the year *Cady, Roberts* was decided.[33] By 1963, the number of private cases had more than doubled, to 388;[34] by 1970, it had reached 1091.[35] Although it is generally treacherous to cite such aggregate data for such a factual demonstration, there is little doubt that private litigation based on Rule 10b-5 was a primary cause of this rapid increase in private litigation. In Professor Loss's 1961 *Securities Regulation* treatise, he enumerated the number of private Rule 10b-5 actions as "somewhat larger [in] number" than fifteen.[36] By 1967, Professor Alan Bromberg would require an entire treatise to analyze private and SEC cases brought under the 1934 Act's Rule 10b-5.[37]

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31 J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

32 *Id.* at 432.

33 WARREN OLNEY III, DIR., ADMIN. OFFICE OF THE U.S. COURTS, REPORT OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 239 (1961).

34 WARREN OLNEY III, DIR., ADMIN. OFFICE OF THE U.S. COURTS, REPORT OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 199 (1963).

35 ROLAND F. KIRKS, DIR., ADMIN. OFFICE OF THE U.S. COURTS, REPORT OF THE PROCEEDINGS OF THE JUDICIAL CONFERENCE OF THE UNITED STATES 223–33 (1970).

36 3 LOUIS LOSS, SECURITIES REGULATION 1449 (2d ed. 1961).

37 *See* ALAN BROMBERG, SECURITIES LAW: FRAUD, SEC RULE 10B-5 (1967).

Five decades after the publication of *Cady, Roberts*, the decision endures as among the most fundamental in securities fraud enforcement. Only the implication of a private cause of action under Section 10(b) looms larger in establishing the contours of SEC and private enforcement of the most important weapon in the securities fraud arsenal. To be sure, the Supreme Court, after the initial ebullient period marked by such cases as *Cady, Roberts* and *Borak*, has notably curtailed aspects of Rule 10b-5 enforcement. But since 1962 no serious question has been posed as to the applicability of Rule 10b-5 to all transactions, including those executed over a stock market. This was the revolution that Bill Cary and *Cady, Roberts* decisively wrought.