

## SEC Historical Society

### Fireside Chat on SEC Division of Corporation Finance

February 24, 2009

**THERESA A. GABALDON:** Good afternoon and welcome to today's broadcast of the Fireside Chats presented by the Securities and Exchange Commission Historical Society and broadcast on [www.sechistorical.org](http://www.sechistorical.org). I am Theresa Gabaldon, Lyle T. Alverson Professor of Law at The George Washington University School of Law and moderator of the Fireside Chats.

The SEC Historical Society preserves and shares the history of securities regulation through its virtual museum and archive at [www.sechistorical.org](http://www.sechistorical.org). The museum is free and accessible worldwide at all times. The virtual museum and archive as well as the Society are separate from and independent of the U.S. Securities and Exchange Commission. They receive no government funding. We are thankful for the gifts and grants from the many institutions and individuals who make possible the growth and outreach of the virtual museum and archive.

Today's program launches our 2009 broadcast season and is one in a series of Fireside Chats looking at the distinctive history and work of many of the major SEC divisions and offices. This series is part of the Society's commemoration of the 75<sup>th</sup> anniversary of the SEC this year. Last year, the Fireside Chats focused on the work of the SEC Office of the General Counsel, the Office of International Affairs, the Regional Offices, the Division of Enforcement and the Office of Compliance, Inspections and Examinations. The Society's Annual Meeting examined the Division of Investment Management. All of these programs can be accessed again in the Online Programs section of the museum.

Today's Fireside Chat looks at the SEC Division of Corporation Finance popularly known as "Corp Fin." I am delighted to welcome Alan Berkeley of K&L Gates, who is joining us by telephone from London, and Martin Dunn of O'Melveny & Myers. Their remarks today are solely their own and are not representative of the Society. They cannot give legal or investment advice.

Before we begin, however, I would like to take a moment to commend the work of the Corporation Finance advisory group which has been working together since 2003 to ensure that the history and people of the SEC Division of Corporation Finance have been included in the museum's collections. This group is led David Martin and Mickey Beach and includes Paul Belvin, Edward Green, Justin Klein, William Morley, Peter Romeo and Richard Rowe. Elisse Walter, now an SEC Commissioner was also active with the group. We are grateful for their input in developing today's program. Alan and Martin, welcome.

**ALAN BERKELEY:** Thank you.

**MARTIN DUNN:** Thank you.

**THERESA A. GABALDON:** First I would very much appreciate it if you each take a moment to describe your respective personal histories with Corp Fin.

**MARTIN DUNN:** I will start and then let Alan do next because he's much older than I am, it will take him longer. I started in Corp Fin in 1988 right out of law school as an examiner. I was reviewing filings for a couple of years and was lucky enough to move over to the Chief Counsel's Office which I very much enjoyed and I was Chief Counsel there and basically held a bunch of different jobs for the next 20 years and left in 2007. I was Deputy Director when I left.

**ALAN BERKELEY:** I read off the list of people on your Advisory Committee from Corp Fin. I fully recognized that I am not one of them and perhaps that's because I have never worked at Corp Fin. I think I am one of those few securities lawyers, particularly in Washington, who practiced before the Commission and with the folks in Corp Fin for around 40 years now and have never been employed by SEC in any capacity whatsoever. That's notwithstanding the fact that any number of staff people have objected to my comments ascertaining that I had stated contrary views when I was at the Commission.

**THERESA A. GABALDON:** I would appreciate it if one of you could get us rolling along by describing in general terms the mission of the Division.

**MARTIN DUNN:** I have always thought that it's very basic. The Division of Corp Fin is all about disclosure. That really is what it comes down to. The entire role is geared towards making sure that companies are able to comply with the registration process of the disclosure requirements; a lot of time is spent helping them comply, in reality. And so the focus is making sure that investors get information from those companies at the time when it's useful and that is the primary focus. It's not merit based, it's nothing else, it's based on disclosure.

**THERESA A. GABALDON:** When the SEC first came into existence, was there a Division of Corp Fin?

**MARTIN DUNN:** Alan may have been there but I wasn't there at the time. But the Division of Corporation Finance, from what I can gather came about during the Second World War. There are some annual reports there where the division name disappears for a couple of years so I was never sure if it was '42 or '43. Before that it was called the Division of Registration and it moved from that to being Corp Fin. I always think of that as the division that became Corp Fin is because the director stayed the same, between the two. Some of the jobs were split up in different places before but I always considered that to be the place it started from.

**THERESA A. GABALDON:** You said that it's all about disclosure. Could you be a little more specific about what the average attorney in the Division of Corp Fin does if there is such a thing as an average attorney?

**MARTIN DUNN:** They are all above average. It is split up. If you take the division probably 80% of it does that core work that I just talked about, reviewing registration statements, revealing 10Ks, revealing proxy statements, really looking at disclosure from an accounting and from a legal side and making sure it complies, it's got everything that's supposed to be in there. Making sure it's clear, all the things they do. Interestingly that's the bulk of the work and that is truly the genius of the division is that part and yet the part everybody wants to talk about is the flip side at conferences, the rule making part, the interpretive part, the M&A group or the international group or the Chief

Accountant. And really those are support offices that help the main function. The main function is the disclosure entity. That is the operating groups that are run by an assistant director and have the industries in them and just review filings.

**ALAN BERKELEY:** I think that it's important to recognize that Corp Fin is in many respects the public face of the Commission to the vast bulk of lawyers and company executives who are in the process of raising capital or comply with the public in the compliance process. My guess would be that the staff lawyers in Corp Fin have more exposure to the real world and to companies than the staff of any other division of the Commission expect maybe Enforcement where it's at least we could hope a smaller subset. The result of it is that Corp Fin's staff conducts itself in a way that needs to conduct itself and does conduct itself in a way that gives confidence of its capabilities to the counsel and the companies and accountants with which it deals. And in a lot of respects I think are the, on the disclosure side particularly really the most important part of the Commission, because of that public face. It leads to some of the frustrations that the bar has. When you asked a moment ago what's the mission of the division, I almost said it's to make life miserable for the securities group. That's not the case because the mission of the division is to be the public face and to make life easier to securities lawyers who were attempting to comply with the rules.

**MARTIN DUNN:** I would agree, the amount of time even as a very new attorney or a new accountant you spend on the phone with people is much more than you anticipate when you go in and it is a great teaching device. You have to be confident enough to have a conversation on a topic that is one of 20 things you are dealing with and you are having it often times with two, three, four, five people on the phone who are focused very much on this and you have to have the confidence to get up there and explain where you are coming from and where you want the outcome to be and how to work towards it. And having had that confidence you got to learn very quickly and I enjoyed that a lot. I didn't always win all the battles, that's the nature of the game. But I think that also teaches you part of how to get to the practical solutions that the division is pretty well known for.

**THERESA A. GABALDON:** It sounds as though the mission has been consistent within your respective experiences, 20, 40 years, whatever. Is that where you see anything different about the Commission's mission today than it was some number of years ago?

**MARTIN DUNN:** For the division, I think it has always been about the one thing which is the disclosure. I think it has taken on responsibilities that go around that. As I said the interpretive part, more day to day stuff you see the division doing maybe during 30 or 40 years ago, more interpretations were made maybe by the Office of General Counsel or the Chief Accountant's Office made more decisions that affected day to day stuff more. I think you have seen the division grow in day to day interpretations around that and the GC and the Chief Account's do more broader pronouncements and less day to day stuff. But really the core function is always the same and nobody else does it, it needs to be there.

**ALAN BERKELEY:** There's no question at all that one of the gravitational pulls in recent years has been towards rule making. As Marty and I were chatting some time ago, we are doing with the statute that is 75 years old or thereabouts, that has not been significantly amended in terms of its conceptual underpinnings and yet the world has changed, the needs for the review process have changed and the division has

responded remarkably without any statutory changes to adapt to the new world, often in ways that are very creative, very clever, sometimes controversial, sometimes they work better than other times. But there has been a remarkable degree of creativity and flexibility really I would guess probably over the last 25 years.

**THERESA A. GABALDON:** I can think of a couple of instances of true creativity and the one that comes first to my mind was a long time ago, that was the custom of the delaying amendment. Would one of you be able to talk about what that is, how it came about and would there be some other way to get to the same place?

**MARTIN DUNN:** Well, the delaying amendment is a very cool thing and when you look at the statute as Alan said, they really haven't changed much. And the statute was really built towards the notion of a registration statement coming in, it getting a thumbs up or a thumbs down and then 20 days later it's done. You know within 20 days it gets a thumbs up or a thumbs down. Everybody realized that that just wasn't going to work; you were going to wind up giving so many thumbs down because it wasn't quite right. So, they developed this practical process whereby you would get comments and then every 19<sup>th</sup> day you would file an amendment which restarts your 20 day clock. And then, so people realized, well, let's just find a way where you automatically do that. And so they adopted the rule that deems if you put this certain language on the cover, it will be deemed to automatically be amended every 19<sup>th</sup> day and restart the clock. And the beauty of that is, the 20 days is the outside, so you can always be shorter, you can request acceleration. The company requests acceleration. So once you get to a process where the only way it can really go effective is through this request for acceleration. Then, you have created this interactive process where the company and the staff have to get on the same page and realize and come to an agreement that they have gotten where they need to be in order to have it go effective for it to work. And so I think delaying amendment is a lot like other things that you will see in rule making where it starts out of a staff process and then it gets codified as you go on. I mean there is so many places with 430A and part of the 415, the shelf stuff or even parts of 444 that have been added as years have gone on. What you have is, the staff takes what's there, figures out a way that it works and then once that all gets set and some of the kinks are worked out then it becomes a rule. How many rules do you see where it's codifying staff interpretations? Something like that and so I think delaying amendment is a classic example of taking statutes and saying this doesn't work but we can't shut everything down and say every 20 days you get a stop order from everybody. Now remember back in those days every registration said no to the Commission for a vote up or down before being effective and imagine trying to do that now, the thousands that come in. Just couldn't happen. So, the realization of that and creating a process that then became codified in rules is exactly what the division does and does pretty well. And it's a good way to do it because you get to work the kinks out beforehand instead of after.

**ALAN BERKELEY:** Don't forget that says from the issuer side, there's always the option of pulling the delaying amendment. A threat made far more frequently than ever executed on. But there are circumstances in which the frustration level in dealing with the division and trying to get something through for whatever reason has broken down, the frustration level is high and it's a good attention getting, its like a temper tantrum. It's a very good attention getting device. Just send the letter in and file it and pull the delaying amendment. At that point the division's got 20 days to make a decision whether they are going to put in a stop order, seek a stop order or they are going to let it go effective by the passage of time.

**MARTIN DUNN:** Right. And the acceleration point, another part of that, that I find to be brilliant and it is. Technically, the staff can't deny an acceleration request, it can only grant it. So, if a company comes in and says, "No, I want the acceleration tomorrow." It's only the Commission that can deny it. Does that ever happen? No. Because the process has developed such that it works. It works from both sides. The staff realizes what their responsibilities are and companies, the vast majority realize that the process is there to get them to the end. And so it works very well. But I don't think a lot of people realize that on the acceleration part. If push came to shove the staff can't actually say no. They can say, well, let's think about it, they can work through the process but it makes it an interactive process which is what this needs to be.

**ALAN BERKELEY:** Marty, talk a little bit about interactive processes. What about bed bugs and what about those situations where something comes in and the staff thinks it's simply inadequate to meet the statutory requirements.

**MARTIN DUNN:** The bed bug letter and there are a lot of different stories about where it comes from. I am not going to pretend to know that. But that's the process where a registration statement comes in and the first round of comments is simply, we are not even going to comment. You are not even close enough for us to start. And I think that's an important part of it because the staff is there to help but the staff is not there to write the thing for you. And if a registration statement comes in with no financials in it. What's the sense in raising a bunch of comments when you have to start over again? So the process of saying, this is so bad we are not even going to start. I think you need to have. How it got the name the bed bug letter, I don't know. But I think it has become very descriptive. Nobody knows what it is. But it's an important part of it. And it's all because it's a process and if one side is going to break down you need to be able to draw the line.

**ALAN BERKELEY:** Do you have a sense that the bar has learned and that the issuer community has learned and that there are fewer and fewer totally inadequate filings?

**MARTIN DUNN:** You don't see many bed bugs letters at all. It's much more the exception than the rule. I mean you couldn't imagine the small number. You would think that there would be a lot more but you got to be pretty bad to get that one.

**THERESA A. GABALDON:** This sounds like something of a celebration of collaboration between the division and the practicing bar with perhaps the occasional temper tantrum thrown in. But I want to press you a little on that. Would you describe the attitude as one of collaboration?

**ALAN BERKELEY:** The answer is no. Let me start that way particularly to be provocative. I think that there is historically and years ago when I started even, especially in the review process, there was a very high level of collaboration, high level of trust between the... frankly the practicing bar and the staff, a very good exchange of ideas and concerns and issues and actually I think over time some very good and close working relationships. My sense is that over time that has broken down and that we are of late and now are in a period where there's a high level of distrust of the bar by the staff and a higher level of frustration by the bar in dealing with the staff because of a lack of a flexibility and understanding and the bar would often say training and creativity on the part of the staff and an unwillingness to work with each other. I can recall situations

some years ago where it was fairly routine for outside practitioners to come to the Commission and teach securities regulation to the Corp Fin staff and be part of a series of seminars or a series of programs where you check your client at the door, they check their client at the door and you sit and you have a discussion about the process and the law and how it works. My guess is that something like that hasn't occurred for years and years and years. My sense at least is that this level of hostility was probably overstated but frustration and distrust really has developed in the last 20 years, let's say and shows no sign of decline now. And I think that's terribly, terribly, unfortunate and I can't put my finger on the source of it or where it began. But I do know and I do feel very strongly that it has broken down in that relationship. I have some sense that it broke down initially on the rule making side and not on the review process side but I am not entirely certain about that.

**MARTIN DUNN:** My experience was that maybe I was there 20 years, so maybe it started breaking down I showed up but is, when I first got there, the folks on the staff were much more willing. I can remember being in a lot phone calls where we would just call people who used to be on the staff. And if we had something we weren't aware of, we would have a real discussion saying, what are people doing? You know, how are people doing this? How are people on the outside perceiving this requirement? How are they complying with it? We don't want to be making things up as we go along. We want to be figuring it out. And those conversations were not infrequent. And I think Alan's right. You started in seeing in the early '90s and in the mid '90s on a lot of the rule makings, the comment letter started coming back from the bar with less of helpful, here's how we think this fits within the statute. We don't think this furthers the purpose of the statute. Those kind of comments and you started getting more and more of, give us more. It became a rule representing our client in this comment rather than we are working on getting to what is the right answer and the purpose of the statute. And I sense frustration on that. I do know that on the side of interacting between the staff and the bar you see a huge change in my mind during the dotcom bubble because all of a sudden you go from, everybody is trying to get good disclosure out there. We are trying to get the right answer to, oh, come on, you are just in the way, everybody's making money. And so the staff is trying to keep doing its job but everybody is viewing it as in the way of their making money, now it turns out if they had actually read what they had been reading they might have realized it. But I know at that point in time, one, the quality of the lawyer got a lot worse because everybody was doing it. Funds were stretched so thin they were putting in people with no experience. So the quality of learning from outside was bad. It was not as good. There were so many filings the staff was stretched thin and the bar just saw us as in the way and I had more than one conversation during that period of time when I was told things I knew that weren't right. And I knew that they were just either telling me what they wanted me to hear or telling me what they thought I wanted to hear and wanted to move on. And also at that time you saw a break down in the gatekeepers who used to perform a function. The underwriters used to value a company, put a value on it. All of a sudden it became a company's worth whatever its worth, just put the thing out there. Sell it. And I think you saw a real problem that came out of that period of time because you saw the staff pushed to its limits and not always helped. And I think that that hasn't completely gone away. And you still see all the time now the notion of, "Yeah, that's what they told me but do I believe it?" Whereas when I started there was much more of an interaction and maybe it was a smaller universe, so people you knew better or whatever but, I don't want to... I think Alan goes a little far.

**ALAN BERKELEY:** It would sound like a couple of fuddies.

**MARTIN DUNN:** I think Alan goes a little far saying that it's not a good relationship. I think it's still a good relationship but I think the level of trust has decreased a little bit. And I think that's the way the world. You know there's a lot of money to be had. There's a lot of people after it and the staff is trying to do its job.

**ALAN BERKELEY:** Marty, I think you have triggered something that I thought of occasionally over the years and that is how the role of the underwriters, the investment bankers has changed starting maybe at some point during the dotcom or whichever bubble it was. My recollection in the old days speaking like an old fuddy duddy, was that it was always the underwriter and the investment banker who was busy putting caution in the registration statement and concerned about over speaking and overstating and somewhere... and the company would be fighting with the underwriters to get in to tell their story and to sell the securities. And I kind of noticed over the '90s a shift in that to where the underwriters were the go-go guys and the companies and management were the people sitting there, saying, "Hey, I am the one who has got liability for this." And were being more cautious. I don't if that's something that the staff would have picked up during that period or not but...

**MARTIN DUNN:** I definitely picked it up.

**ALAN BERKELEY:** It's evolution over the years.

**MARTIN DUNN:** Well, and you also saw right around that period of time when the underwriters were pushing the staff to allow them to circulate prospectuses without a price range in it.

**ALAN BERKELEY:** Right.

**MARTIN DUNN:** And I think that was a big change. Once you went from, you have to have a range that you have to live with to well, you can kind of circulate so long as you come back with the range and enough time before you go effective. All of a sudden their notion of valuing a company and putting it out there at that price went away and it became, it's a need based society, its worth what you pay me and then we will set the range after we know what the people will pay us. And I saw that as a very big change and you know you saw changes at the same time that led to FD along the lines of, companies were giving all the analysts and the like information that they then had an advantage over everybody and that seemed unfair and still bothers me that that became just the way of the time. And so it's easy to be a genius when you already know the answer and I really found at that time changed a lot of things enough for the better.

**THERESA A. GABALDON:** In retrospect do you think that there is anything that the Division of Corp Fin might have done to avert the dotcom bubble?

**MARTIN DUNN:** The thing I think we could have done, as I said, allowing people to circulate without ranges, I think was a problem but at the same time there was just so much money to be had and as I said were about disclosure and not about merit. We wouldn't have stopped them as long as the disclosure was complete. And you know what, the disclosure was complete. They were saying, we don't really do anything, we have an idea. Give us a \$100 million. And so I think there could have, a few little things that we could have done there. I think it would have been more towards making the

gatekeepers do their jobs a little bit more than they did. But there was so much going on so fast I couldn't think of.

**ALAN BERKELEY:** I would probably agree. There are always going to be these bubbles. You know there's a long history of them and you sit there and say, "You are going to have this kind of excitement and exuberance and quick money and it comes and it's very little that the staff or the Commission can do about it." Nor is it particularly the Commission's role to try to inhibit capital formation because they just want to slow it down and think about it a little bit more, if the disclosure is good. The issue in the '90s, I think was that the prospectuses probably weren't so bad and they weren't so sloppy. They may have had a certain cookie cutter mentality to them but people wanted into those deals, they wanted to make the money. They wanted the transactions. A lot of people made a lot of money in them. And you can't sit there and say that it was a problem in the prospectuses. I can remember when training was coming on board I was assigned on some program to argue the side against plain English.

**THERESA A. GABALDON:** And what did you say?

**ALAN BERKELEY:** Which was a sort of fun in a NASAA convention where I had a very sympathetic audience as you can imagine. I was given that side to argue but the essential point was that nobody reads it and in fact we are writing prospectuses in that era as in any other. For Mom and Pop sitting around a Franklin stove in Nebraska when they are not reading it and probably nobody is reading it. And if anybody is reading it or was reading it, it was the analyst who was looking at the technology and making a decision on their own as to where they thought it had a future. So I don't pin the dotcom bubble on the Commission any more than frankly I pin Enron on Corp Fin.

**MARTIN DUNN:** And that was one of the frustrating parts of being in the division at that time. Everybody was on us to get out of the way so people could make their money and then as soon as it went bad everyone was on us asking us where we were and why we weren't more in the way.

**ALAN BERKELEY:** I do think the Enrons of the world and some of these other offerings of hybrid and derivative securities really do trigger an issue and that is, does anyone understand them? And can the comment process begin to address, is the staff adequate? And now it's sufficiently knowledgeable to address some very, very complicated securities when frankly I am not always certain that the people who create them fully understand the implications of them.

**MARTIN DUNN:** The interesting thing with the derivative securities is the people who create them and talk about them, I am not sure, I mean some of them are quite brilliant and understanding but certainly all the folks who use them and are not fully aware of their risks and the worst part about it is the folks who create them and use them, use a different language than a Securities Act or an Exchange Act language. They refer to things as longs and shorts instead of buys and sells and they use terms that are not Corp Fin terms and the difficulty is walking through and translating the language and I don't think there are enough people who are capable of translating the language and make sure that everybody understands them. I couldn't agree with Alan more, I think if there was a pot of money that somebody went to Corp Fin and said, "Spend this the most useful way." I think the most useful way would be to find people, I mean there are some people out of work right now, would be to find people who truly understand



derivatives and truly can get into particularly at the financial institutions and the folks that have used more derivatives than others and truly get into that disclosure. And translate the language, make sure and then retranslate it back out, make sure that the disclosure adequately reflects the risk. The requirements are there to discuss the risks and the staff pushes people on it all the time. But I think that and this not an uncle's staff, it's the general nature of the industry, people don't understand derivatives as well as they should and so the disclosure isn't as good as it could be. And that is the one place I truly think that there could be money well spent because what causes things to break down now? It's a systemic breakdown that people are worried about and where you don't fully understand the extent of risks is where you don't understand the potential for systemic problems. I think that's one area where everybody could get a lot better.

**ALAN BERKELEY:** On the other hand, do you think that's an issue for Corp Fin or an issue for whatever they call Market Reg these days?

**MARTIN DUNN:** I actually think it's both. You have got to worry about the markets, you have got to worry about market risk but at the same time Corp Fin's job is to help companies give people the information they need to understand the risks involved in an investment. And so I think that is part of their obligation is to really get to that credit risk and the potential for a small amount of what looks like a small thing on a balance sheet to exponentially effect a company.

**THERESA A. GABALDON:** It's interesting that you talk about the disclosure of risks in the same conversation as you are also talking about exuberance et cetera and certainly something I read many times over the years is that the division forces registrants to take a negative tone and the prospectuses are far more negative now than they ever were in the past. Do you think that's true and if so why has it happened?

**MARTIN DUNN:** I will let Alan talk.

**ALAN BERKELEY:** I don't think that's true at all. I think when I started and started writing prospectuses, they were the most negative, ridiculous figure in the whole world. And you could not even talk about anything other than past history. It was absolutely, positively forbidden to put into a prospectus any expectations, any business plans, any hopes. You simply talked about the past. And you asked investors to make an investment decision based upon what had occurred previously. That has changed radically into the '80s and since then where we now value and enforce forward looking information and trends and uncertainty disclosure. So that I think that it is not nearly so negative as it was 30 years ago and before. Having said that, let's be candid and recognize that a prospectus under 10K are liability documents. And if you are going to say it you got to have a very high degree of confidence in the accuracy of what you are saying and properly build a proper cautionary language to deal with those parts that are forward looking. But I think we have come a very long way. I can remember slightly off to this question but I can remember being chewed out as badly as I have ever been attacked by a regulator because I had the temerity to put on the front cover of a preliminary prospectus, the company's logo.

**MARTIN DUNN:** What were you thinking?

**ALAN BERKELEY:** It was 10 point unleaded plain white paper. I was a young lawyer and I thought my license is going to be taken away and they are going to shoot me at the

back of the building. Today you can pick up a prospectus if there are any these days and they are in multicolor and they have got pictures and they have got logos. I think it's a liability document that I think we have come a very long and positive way in the last generation or so.

**MARTIN DUNN:** I would say and the interesting part about it is I was very involved in plain English when we were doing that. And one of the debates in plain English was the need to repeat information over and over and over again and make the document virtually unreadable or to have a million risk factors even though they might not apply and not very clearly spelled out and our role on the staff was always, chop down the risk factors for the ones that apply. Don't repeat the document in the summary. Make it a readable document. Unbelievable amounts of pushback, "Oh, we will get sued if we don't disclose it until page 30." Where does it say that? Nowhere. So the Commission had to come out and say, "We won't sue you if it's not until page 30 and in fact we will defend you if somebody does." We had to do things like that. It is just the nature of lawyers. The staff encourages MD&A, you can argue, it requires forward looking information. So you get the Reform Act that gives you the safe harbor, it speaks caution. And the notion of the safe harbor is, you put in a good introductory language, cautionary language that says, here are forward looking statements, here's why they might not be true and then say whatever you want. You have warned people you can go forward as soon as you have some basis for it, right? Well, what happened? You didn't get more forward looking statements, you got huge cautionary languages, in case, God forbid, I accidentally made a forward looking statement. So, part of the nature of it is, I think the negativism is the class actions, the litigation stuff. I don't think it's the staff at all, really. I think the staff would much prefer if the documents were much more easily read. We fought tooth and nail for plain English and in some ways succeeded and in some ways failed but it was a non-stop fight to get lawyers to change things from the way it had worked. And once something works we can always be a little safer and then it accretes and then it accretes and it accretes and you have got these documents that tell you why everything in it might be wrong and doesn't really tell you as much. That's an overstatement of course, there's a lot of information there. But I don't think it's the staff making negative. Now when the staff reads something and it says in the footnotes of the financial statements, we will be bankrupt in a month. And you don't read that anywhere else, well, they will make you say that. But for the most part I don't think they are really focused on negativism and in fact I spent a great deal of time and a lot of people spent a great deal of time trying to get folks to remove risk factors because they are really generic and don't apply. And the companies will say, well, what if it comes up and we have taken it out? Look what you have done to say? And so they won't. So I think I wouldn't put that on the staff.

**THERESA A. GABALDON:** Would you say that the staff had a strong position with respect to this bespeaks caution safe harbor?

**MARTIN DUNN:** I was in the Chief Counsel's Office when the Trump Casino decision first came out. I remember thinking that was about the worst thing that had ever happened. You know just in my mind, just thinking, they told you it might be wrong so then you are not liable if it's wrong. Oh my God, this is horrible. I remember thinking, that's going to get overturned. Nobody will ever buy that. That's just crazy talk. And you know what, looking back on it, it's really the things, you should read the documents. You should read the whole thing. If you have a basis and you have told people why things might not occur that way. Isn't that better disclosure than not giving them forward looking

disclosure? Not saying, here's what we think will happen. And that's the revolutionary change Alan was talking about is the change towards put information in and explain it. There is so many sources of information now. It was a lot easier in the '60s and '70s in a way when that was the only document. Now, you have got bloggers, you have got analysts, you have people putting out information, here's what we see the company going. And to say the company is not able to say it sees where it is going. I don't think the tension in that couldn't work any more. And I think it speaks caution is a good way to try to encourage people to do more. I know it's to encourage them to do more, it's to encourage them to speak more. But hopefully it's had the positive effect.

**ALAN BERKELEY:** Remember too that the courts are the ones that developed to speak caution not the Commission.

**THERESA A. GABALDON:** Yes indeed.

**ALAN BERKELEY:** Essentially it's playing catch up in the rules in order to build it into the rules because that's what the courts will find.

**THERESA A. GABALDON:** Alan, do you have a strong view as to what brought about the shift towards forward looking information?

**ALAN BERKELEY:** Do I have a strong view? No. I think you put in forward looking information into prospectuses and then disclosure documents generally its time had come and the old view essentially just didn't make sense any more. And Marty is right, with the additional sources of information it became less and less relevant. And recognize also that the courts did beat the Commission to the battle on that.

**THERESA A. GABALDON:** Well, you both mentioned I think that the division has been quite responsive to changes in the outside world and outside pressures. And I am interested in your views on whether, what changes the Internet have brought?

**MARTIN DUNN:** The Internet makes it very difficult to regulate. It really at the beginning of it trying to figure out in the Internet world what's a public offering versus a private offering? Who is speaking? There's a lot of details that that the Commission has tackled and it takes time to figure it out as you go and you don't want to get it too wrong because it's tough to go back. But they have tackled all that and they are all over it. I think the realization is, we had a choice when Internet came along. Do you want to ignore it and give up and say we can't regulate that? We can't fit it in our system. It's the Wild West. Or do you want to find a way to say, we recognize this as different? Let's find a way to fit it as best way we can within where we are and be practical about it? So, I think you have seen that on the regulatory side. On the reality side, I think the ability of just so many sources of information has, as we talked about it before, changed the Commission's view that there shall be one document you shall read when you make your investment decision. They recognize that there are other pieces of information out there. And to say, this is the one document and you can't say things in it, just doesn't make sense. And so I think you have seen an expansion of what the staff will allow folks to put in documents, allowing free writing prospectuses means you should allow that information in the prospectus itself. And so that opens everything up so I give the Commission staff a great deal of credit for not giving in to the Internet and saying, this is too big for us, we can't handle it. Because there were some calls to do that. I remember that at the time, just say, ooh, the Internet's out there. And I think took time, time went over their mistakes in

fits and starts. But where Corp Fin is on the Internet coming out of the securities offering reform and the free writing prospectuses and their general view of how it fits with general solicitation. I think they have done a very nice job of dealing with it and I don't think it's going to lag. So I think they do well. Am I wrong, Alan?

**ALAN BERKELEY:** You are never wrong, Marty.

**MARTIN DUNN:** Oh, thank you.

**ALAN BERKELEY:** No. I wouldn't disagree with that at all. One of the things that we haven't dealt with in the Internet era is having a basic, core document that's available to the public, presumably on EDGAR or IDEA or whatever it is these days that one can turn to and one document in which one can have a high degree of consonance that this is the issue we are speaking and God willing this is the truth. And I have some sense that in the rush to financing and demand financing era of the '90s, the dotcom period and the pressure to get deals through and the Internet and the multiple sources of information and frankly incorporation by reference has made it increasingly difficult to have that one place that you can go and know you are getting the gospel truth or we hope it's the truth but getting it out of the issuer's mouth. I think we have lost that to some degree. We have got a multiplicity of sources, we have got an endless numbers of blogs and commentators but it's increasingly difficult to go to the horse's mouth.

**THERESA A. GABALDON:** Was that an expression of at least mild regret about incorporation by reference?

**ALAN BERKELEY:** I just think its time had come. It certainly makes life easier but it is a mild regret that because it makes it more difficult to pick up one document each year and say, here is what, here is everything I need to know.

**MARTIN DUNN:** That is the challenge because even the one document is supposed to be the 10K, it's the source for everything. But even the realities and again the Commission is to be credited for looking at the realities and they do it is, when you do your 10K it comes in at a set period of time and then part three which is the exec comp and all that doesn't come in until the proxy and it gets incorporated into the 10K. And so there is never that one piece. EDGAR makes life so much easier that it's all there and it's not one document but you can find it all.

**ALAN BERKELEY:** And it's searchable.

**MARTIN DUNN:** I think EDGAR is perfectly searchable. But I mean it's pretty predictable and you know where to look for documents, the full text search is incredibly helpful. I think incorporation had to happen, Alan's right. Incorporation by reference but I think more and more you can find everything online that you need to find and its on IDEA and if I can just say one thing. Get rid of the name EDGAR, please. It's EDGAR, it should be EDGAR and I would like to just go back to that but nobody asked me so I am going to do that.

**THERESA A. GABALDON:** I am also curious about how the electronic age has affected the division's own transparency as far as getting its stated word into print and into electronic form is disseminated amongst the eager populus. Has that been happening and if so is it a good thing or a bad thing?

**MARTIN DUNN:** I will start. I remember there used to be something called the telephone interrupts mainly. And it was a notebook that had a bunch of pages stuck in and you xeroxed stuff on top of it and it was purely a paper document and it was available in the public reference room and it was available in Corp Fin, we had it. But not a lot of people knew it was there and some of the interrupts looked like they had been carved in stone and copied in there. They are very old. And it wasn't why we disseminated. And so in the mid '90s one of the first things we did is we put them all into a word document, organized them all and put them online and put them up on the web when the web was very new, the SEC website. And we all thought, isn't this a great idea. Now they don't have to call and ask. They have got all the answers; everybody has them. Everybody's got the same library. What happened is we actually had more questions, because people started asking us questions about the interrupts and said, what did you mean by this and what did you mean by that? So transparency, obviously a good thing but it doesn't have the effect you want it have, which is by giving everybody all the information, it doesn't make it any easier for everybody. It has this unintended consequence of causing people to work towards these interrupts and forget what the bigger picture is. Because the staff have to live with interrupts. Go ahead Alan.

**ALAN BERKELEY:** Let's stop and go back. One of the things that the division has done which is absolutely remarkable in one sense is to develop and make public and make transparent various tools and various interpretations over the years. So we have got what Marty was just talking about with the telephone interrupts. We have got staff legal bulletins. We have now got comment letters. We have no action letters. There was a time when a no action letter was totally private, then it was public, then it was public, what 30 days later, then it's public instantly. So, we have got a situation where the staff has over the years made its thinking and right up to the comment letters and responses almost immediately available to everyone. One of the unintended consequences of leveling that playing field and making all that information available to anyone who wants it is that, everybody plays to the big test as Marty said at one point. Everybody sits there at the staff side and the bar side, counsel side and sits there and says, here's the information, this is what I have to do. And instead of attempting to craft a creative solution or to deal with the one off problem, I think both the inside and the outside of the building, particularly inside of the building, now has to stick with the established rule principle comment whatever that's been handed down in recent years. The result and I was thinking it helps the working relationship either, the result is that you get less and less thoughtful response because you have got people responding simply based on what's in the book and I think that's unfortunate and I think it frankly works to the detriment of the staff in a lot of respects because they are not forced to think. They are forced to look up and recite the answer that they can find in the book.

**MARTIN DUNN:** I would agree that the level to which the staff has put us thinking out there is really remarkable. I mean you go to the Corp Fin website and you can find just about everything they have said on anything. It's really an amazing success story. The difficulty with it is, it's the same as when the SEC adopted safe harbor. Used to be people argued who's an underwriter, now they argue, does this comply with 144. So when people come to the staff, to the staff's great credit, they are willing to already said what they say, be willing to stand by and yet try to come up with an answer for what's going on. Yet they are being held to what's always there and they know that any answer they give is now going to be out there. So people used to always refer to it, oh, this is one off, it's the one off situation. Its unique, it's strange but it fits in this situation. Now if

you do a one off and it's in the phone interrupts or you do a one off and it gets in a blog and then a here and a there. Suddenly you have got to live with it. And in every situation where you don't want to give what you just gave, you don't have to explain why not. And that's a lot of pressure when you are just trying to come up with the right answer and so I think the transparency, if you were to balance positives and negatives, it's hugely positive. The difficulty though of the pressure that puts the staff under, it's not to be ignored and it's a real stressful part of it. And the fact that they are still able to give as many answers as they do imply ahead shows that they know what's going on and are very good at knowing why those answers were there. But when you are on the outside reading, you just read the answer and you are like, why didn't you give me this? Why won't you give me this again? I think it's had its downsides.

**THERESA A. GABALDON:** You both mentioned a couple of times I think the offering reforms. I assumed that you were thinking at least in part about the changes adopted back in 2005. At least some people have written that they have greatly complicated understanding in the federal securities laws. It may be simpler for issuers to live within practice to actually understanding what's going on maybe more challenging than ever before. Were those changes basically driven by a game of catch up with the outside world in what's going on with the Internet or was there indeed something loftier and more theoretical going on?

**MARTIN DUNN:** The latter. There is something more lofty, I would hope. There was a lot of effort if it wasn't but the reality of that was that there are certain levels of offerings in which Section 5 doesn't really provide the benefit it needs to be there to do, the advanced staff review doesn't provide. And so really in that it was a look at in what areas and it was much more than sand in the gears but some of it was just sand in the gears. At what areas are we throwing sand in the gears for no resulting benefit? And also the bigger picture of all that was, there were two things to the 2005. One is, we got the sand in the gears out. But I truly think the most important thing that came of that was Rule 159, which says, you know when you access liability for your disclosure to somebody, we will make it easier for you to disclose. We will give you free riding prospectuses. We will allow incorporation by reference. We won't make you satisfy Section 5 in certain circumstances. But when someone makes the investment decision, that's when whatever you have given them will be judged for liability purposes. Not after, not stuff you make up in a final, not all that and so saying, let's ease this process, let's throw this much more wide open for the largest of companies but say it's a real process liability wise in 159. That I think was the loftier piece, was saying, ease process but make the liability lines clear and give people the benefit. I always thought that was the best part of the 2005 piece. And as far as being more difficult, there's some safe harbors in there that you really got to get into 5A and 5C and get all through that but I think for the larger companies more than anything it didn't really make it harder.

**ALAN BERKELEY:** I couldn't agree more. It didn't make it harder for the companies that have to deal with it. It makes it harder to read and understand securities laws because it's complicated and there's a lot of referencing back and forth. It's not the world's finest example I suppose of making it user friendly. But it works. And it's for the companies to which it was directed, it's an incredible boon and simplifies their lives. I have always thought that in addition to 159 the introduction of real scalability in securities offering reform. We have always had small business forms, we have long had small business forms but this was really the beginning of an era of scalability in terms of what four

different levels at least are what companies could do and what levels of flexibility they had in the offering process and I think that's been a major plus.

**THERESA A. GABALDON:** Does that mean that there's not just a double standard that maybe a triple or a quadruple standard?

**MARTIN DUNN:** No, there is a triple maybe a quadruple standard but it maybe deserved. I mean the fact of the matter is at the end of the day that the division's mission is disclosure. You look to see where the risk is and where the disclosures are necessary and where the more complete and correct disclosures required and you are looking at where the fraud is, frankly. And when you do that I think you conclude that scalability works and maybe having a double standard or a triple standard or a quadruple standard makes some degree of sense. It is unquestionably the case that the small business community feels put upon because it never gets a break and it clearly feels that way and it clearly feels that the big boys with the high power lawyers come in and get all the breaks. On the other hand I think there's a flip side to that which is where the problems are.

**THERESA A. GABALDON:** You mean with the smaller shores?

**ALAN BERKELEY:** What I really mean is, when the staff sits back and says, "Where should we add some flexibility in the process? Can we do this? These people want general solicitation, they want this, they want that, whatever it is at any given moment." The staff had to sit back and say, "What are the risks to the investment community of allowing this additional flexibility?" I think when you were dealing with the tier one companies you conclude that there's not much risk to the investment community. When you are dealing with other companies further down in that quadruple level, maybe the staff sits there and looks at the data and statistics and concludes, "You know we better not loosen up here because we need to hold these folks speak to the fire." I have never been in that meeting but I wouldn't be surprised if that's what happens.

**MARTIN DUNN:** No. Then my experience in the 1990s was, there is a big push to do small business reforms and we created new forms and we created new disclosure requirements and everything else, we eased up on Regulation D, 504 particularly and, really, oh, great idea, great idea, great idea. And then within three years there's a hearing on the Hill about what are you doing about micro cap fraud? And I think the reality was small businesses is there is no perfect line. You can never hit it quite right because depending on how the economy is and everything else that line keeps moving. I think the best you can do is hope to hopscotch over it and keep getting closer because no matter what you are never going to be right depending on the economy.

**ALAN BERKELEY:** And let's be candid about it, depends on swings back and forth.

**MARTIN DUNN:** Absolutely. Both political and economic.

**ALAN BERKELEY:** Politically, economically we have the staff and the leadership in the Commission feels at any given moment and it swings back and forth between encouraging finance and not trying to chase business offshore and opening... look at 144a which basically was as I understand it, say it was a reaction to the concern that there was a lot of flight capital going out of the U.S. So you sit there and say, you go

from one era to a much more highly regulatory environment. Not a surprise and probably a reasonably healthy tension that will continue over the years.

**THERESA A. GABALDON:** Alan, Marty got a shot at this earlier to say what he thought Corp Fin should do if it suddenly had all the money in the world.

**ALAN BERKELEY:** Declare a dividend.

**THERESA A. GABALDON:** Is that really what you would say if I gave you the same question?

**ALAN BERKELEY:** No. Probably not, I would think that probably training and I am probably with Marty on it, I think staff training. I think maybe but maybe salary increases to increase the retention rates, so we had more career and experienced people in the division and better trained people in the division I think would be critical. I have heard many complaints lately about technology but I do think that keeping good people is extraordinarily valuable. I don't get the feeling and I haven't looked lately but I haven't got the feeling that the number of lifers in the division today is what it was some years ago. It will be good for a few years now given the economy. But having a senior staff who are there and as who are effective, as who are more motivated and who are well compensated and well trained and experiences are enormously valuable.

**THERESA A. GABALDON:** Alan and Marty, both of you, thank you for sharing your invaluable insights into the work of Corp Fin with us today. This program is now added to the important collection of materials on the work of the SEC Division of Corporation Finance, already in the virtual museum and archive, including the March 2004 program on safe harbors, the June 2007 program on regulation of global securities offerings, and oral history interviews with former Corp Fin directors and staff including Mickey Beach, Ed Greene, Alan Levenson and Richard Rowe. Today's program can be accessed again on demand in the Online Programs section of the museum in both mp3 and transcript format.

Next month, I'll moderate a special online program on International Financial Regulation, on Tuesday March 10<sup>th</sup> beginning at 3 PM Eastern Time with two of my fellow professors, Lawrence Cunningham and Arthur Wilmarth. This program will be broadcast in place of the previously scheduled March 12<sup>th</sup> program.

In April, the Fireside Chats will return with the April 21<sup>st</sup> chat on the Office of the Chief Accountant with John Albert of the SEC staff and Gary Previts, Professor at Case Western Reserve University. Both programs will be free and accessible worldwide without prior registration. Please plan to join us again on [www.sechistorical.org](http://www.sechistorical.org) on March 10<sup>th</sup>. Thank you for being with us today.



