

from the desk of

MILTON H. COHEN

11/20/79

Harold --

This is a copy of a letter that I sent several weeks ago to Louis Loss and others of the group who have been meeting with the Commission on the Code. (Actually, the two pages that I handed you at one of the meetings, dealing with the commodity contract question, were ripped out of a copy of the letter.) After considering various alternatives, members of our group seem to be in basic agreement with the modus operandi suggested in my letter, particularly the program outlined on pp. 5-7.

I have just learned from Louis of his conversation this week with Ralph. I still believe the approach outlined in my letter would ~~be~~ be worth pursuing in light of that conversation.

I hope that two or three of our group (including Louis, of course) can meet with you shortly to discuss future procedure.

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EXCH. COMM

cc L. Loss

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October 9, 1979

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EXCH. COMM

Professor Louis Loss  
The Law School  
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Dear Louis:

At the meeting on September 26, everyone seemed to agree (or at least no one disagreed) that 90 to 95% of the Code should have basic Commission support, either because it does not change existing law or it clarifies and confirms existing law or it improves existing law from the Commission's viewpoint.

As to the remaining 5 to 10%, you have put a good deal of emphasis on the number of items, saying that a bill could still carry an ALI-ABA imprimatur with 10 or 12 changes but not with a much larger number. I understand your point but, based on discussions to date, I do not see how we can realistically expect to get down to anything like 10 or 12. In developing a modus operandi for the next phase, I think we must pay more attention to the kinds of differences and the most constructive (or the least destructive) ways of dealing with the various kinds in the legislative process.

The 33 "issues" and 90 or so sub-issues listed by the Staff can be categorized in several ways. First, they obviously include some that are very important or even "critical," some that are quite minor or even trivial, and everything in-between. Second, they include some proposals for changes in existing law, some instances where the Staff opposes changes in existing law (in substance or in language), and some instances where, although the Staff basically favors a new statutory pattern (e.g., continuous disclosure and all its corollaries), it objects to particular features of the pattern as embodied in the Code. Finally, probably with greater relevance to our posture than the Commission's, the changes proposed by the Staff include some matters that were extensively discussed by the consultants-advisers, the ALI and/or the ABA (and in some instances the State Commissioners), some that were passed over without discussion, and some that were never really involved in the drafting or reviewing processes because particular problems seen today (e.g., the "commodity contract" question or the revenue bond question) had not really surfaced when the pertinent parts of the Code were under consideration.

# SCHIFF HARDIN & WAITE

Professor Louis Loss

October 9, 1979

Page Two

It may be useful to consider three quite different items that were covered during our September 26 meeting:

- (1) definition of "security," with particular reference to "commodity contract,"
- (2) definition of commercial paper,
- (3) the one-year registrant concept.

## 1. Definition of "security" -- "commodity contract."

The Code would change (and certainly improve) existing definitions of "security." As to clause (b)(8), a comment would say, among other things, "This reflects the case law.... The question whether any such 'security' is within the preemption language of §(2)(a)(1) of the Commodity Exchange Act is not affected by the Code." When this was written and considered by the various groups, the controversy as to SEC vs. CFTC jurisdiction over "commodity contracts" involving exempt (or even non-exempt) securities or indices based on securities -- which is now seen to be highly important, potentially heated, and certainly politically charged -- had not even surfaced. I personally feel (with a client bias, to be sure) that the Staff is absolutely right, and I have little doubt that the advisers-consultants, ALI and ABA groups would have come out the same way if the question had been posed in the way it is now posed.

What is involved here, in other words, is not a policy difference at all but really a problem of timing. Unavoidably there has been a long interval between the time when many parts of the Code took "final" form and the time of the Staff's review, and there will unavoidably be a further substantial interval before any version of the Code is enacted. In the dynamic securities world there inevitably have been and will be many business developments calling for reconsideration, during the legislative process, of particular Code provisions as drafted -- just as, after the Code is enacted into law, there will be many future occasions to consider possible amendments to that law.

The Commission obviously will (and I think should) fight for legislation to clarify its jurisdiction over all securities-based instruments, either before, during, or after the legislative effort to enact the Code; but the Commission should neither depend on the Code to accomplish this change nor let its support of the Code be dependent on accomplishing the change. (The Commission may also feel that, in the absence of any clear-cut legislative expression in its favor, it will be better off fighting for jurisdiction over the contested



# SCHIFF HARDIN & WAITE

Professor Louis Loss

October 9, 1979

Page Three

area under the existing statutory language than under the Code language. I doubt that this is a realistic hope, but we may have to take it into account in future negotiations.)

On our side ("our" referring to the group of us who are meeting with the Commission to discuss the Staff's list), it would be absurd to take an unyielding position, possibly jeopardizing the prospects for the Code, on the basis of what is really a timing problem rather than a difference in substantive views on this important question. Instead of giving the impression of resisting this particular change, we should be able to assure the Commission that, as individuals and without purporting to speak for the ALI or the ABA or anyone else, all or most of our group would certainly be willing to make clear to the Congressional Committees that we do not oppose the proposed change but in fact endorse it.

Another, more-or-less similar, item is the proposed treatment of tender offers. The Staff is dissatisfied with the law as it stands and with the Code's relatively minor changes, but they are only at the beginning of the process of spelling out a legislative program. When it is spelled out, that program will have to be considered on its merits, whether or not a bill embodying the Code is pending. The legislative process, and our posture during the legislative process, must accommodate this supervening development; but it should be to everyone's interest to make clear that the fate of the Code cannot hang on the essentially accidental fact that the need for a new look at tender offers happens to have been perceived in the interval between the end of the drafting process and the beginning of the legislative process.

2. Commercial paper. This item in the Staff's list typifies many items at the other end of the spectrum -- where there are genuine differences in judgment that must be reconciled but that no one conceivably considers important enough to jeopardize the Code's prospects. We came up with a \$50,000 limit, for what seemed to us to be good reasons; the Staff wants \$100,000 for what they consider good reasons. Except for the risk of losing ALI-ABA sponsorship each time the Code is changed, we have no reason to be doctrinaire on this detail (or a hundred other details: 35 persons, exemption for social clubs, 95% vs. 98%, etc., etc.); nor is it reasonable to think that the Commission's support or opposition will ultimately depend on these sorts of differences.

# SCHIFF HARDIN & WAITE

Professor Louis Loss

October 9, 1979

Page Four

The Commission may be persuaded to drop some, but probably not all, of these relatively minor objections. For those that are not dropped, I think it would be a great tactical and psychological mistake to count them as resulting in a large number of differences instead of only 10 or 12. There will be no harm in a much larger number than 10 or 12 if the Commission makes clear to the Congressional Committees that it basically supports the codification effort and the ALI Code but that it intends to propose a number of amendments of varying degrees of importance, including some that may be "critical" to the Commission's ultimate support; and if we (in the sense defined above) make clear that, although we basically support the Code as an integrated whole that has had the blessing of the ALI and ABA, we would have no difficulty in acquiescing in, if not actively supporting, a substantial number of the Commission's proposed changes in detailed provisions.

3. The one-year registrant concept. This concept is a by-product of the Code's emphasis on continuous disclosure, which the Commission obviously endorses since it has been attempting for the last several years to accomplish the result without a solid statutory basis. In the course of drafting the Code we felt that an issuer's having been under the continuous disclosure system for a full year (as distinguished from having been under it for less than a year or not at all) should have significance for certain purposes, and that an issuer's having been under the system for at least three years (as distinguished from only one year or less) should have significance for other purposes. I think the judgments we made were basically sound but I would have to agree that there is no magic in the precise lines we have drawn and I would certainly be open to persuasion as to what the precise details should be.

Here, however, we (in our present role) are most constrained by the ALI-ABA sponsorship of the Code, because the one-year registrant concept, while perhaps not focused on in respect of every detailed application, was directly involved in their consideration of the continuous disclosure pattern, which in turn certainly was central to their total evaluation of the Code. But we can certainly make clear to the Commission that we will be willing to make clear to Congress that, if the Commission proposes particular amendments, we will be prepared to agree that some of their suggestions might improve the Code or at least would seem to us to be acceptable alternatives; or, at worst, we will explain to Congress why we consider certain suggestions inadvisable and/or out of keeping with the spirit of the Code and leave the resolution to Congress.

# SCHIFF HARDIN & WAITE

Professor Louis Loss

October 9, 1979

Page Five

This item broadly exemplifies a considerable number of items on the Commission's list, where there may be agreement on all sides that the body of laws would be improved by making more specific what is presently too general, more explicit what is presently only implied, etc., and there may also be widespread agreement as to the general shape of a new statutory pattern, but there may still be genuine differences as to specifics. What we can neither overlook nor escape is that some of these differences may be so important in the Commission's eyes that it would rather stay with the present laws with all their uncertainties than move to certainties that it does not like.

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As I indicated at the beginning of this letter, I believe it is not realistic to expect that the current discussions with the Commission can result in a single "agreed" bill with only 10 or 12 significant differences from the official ALI Code version. However, I remain optimistic as to the chances of enacting a Code reasonably similar to the ALI version, not by starting with an "agreed" bill but by starting with "the" ALI Code as the basic bill and proceeding with efforts to identify, evaluate, narrow and ultimately resolve differences -- not only with the Commission but with everybody else -- during the legislative process.

I would suggest the following changes in our immediate approach:

1. Assume that the only bill to be originally introduced will be the ALI version, and persuade the Congressional people -- partly through the measures suggested below -- that this is the sound way to proceed and not a waste of their time.
2. Complete the process of discussing identified differences with the Commission. Sit down promptly with the Chairman or his representative in an effort to (a) categorize the items discussed with the Commission in the terms mentioned in the third paragraph of this letter (i.e., which are more important or less important in their thinking and in ours; which would amount to changing the status quo, preserving the status quo, or addressing problems that surfaced after particular Code provisions were drafted; and the nature and extent of consideration by ALI, ABA, State Commissioners, etc. -- not as bearing on whether we unofficial "custodians-spokesmen" for the



# SCHIFF HARDIN & WAITE

Professor Louis Loss

October 9, 1979

Page Six

Code are flexible but as bearing on the chances of retaining or losing basic support of these other groups) and (b) sketch out the contents of the communications described in the next three paragraphs.

3. Prepare as promptly as possible two upbeat, difference-narrowing communications, one from the Commission and the other from our group, to be addressed to the Congressional Committees:

(a) The Commission's communication would start with a general (and we hope strong) endorsement of the bill but would go on to say that the Commission nevertheless is proposing a number of (enclosed) amendments. It would be hoped that, while such a communication would candidly state that certain (identified) amendments are deemed so critical that the Commission might have to withdraw its support for the bill without them (if that is the Commission's position), it would equally candidly state that some (identified) amendments are designed to change the existing laws in ways that the Commission deems essential apart from the Code but which the Code should reflect, whether or not previously enacted as amendments to existing laws, and that still other (identified) amendments are designed to correct what the Commission considers to be significant flaws in the bill or to accomplish significant improvements in the bill.

(b) Our communication would start with an explanation of who "we" are, including our (particularly your) past role in drafting the Code and shepherding it through the ALI, ABA and State Commissioner groups, but emphasizing our lack of standing to speak officially for those groups. It would also say that we strongly support the bill as it stands but acknowledge that it is not perfect or untouchable; that we believe that 90 to 95% of the bill has the support of all the groups that have considered it but that unfortunately the 5 to 10% may differ from group to group; that we cannot hope to arrive at a final bill that will satisfy the Commission or anyone else 100% without incurring the strong opposition of others, so the effort must be to arrive at the best possible compromise that will retain the basic support of the Commission as well as industry and professional groups; and that we individually and collectively volunteer our services in helping the Committees to evaluate proposed amendments, resolve differences, and assist in drafting so as to maintain the integrity of the Code. To the extent possible, our communication might comment on the Commission's

SCHIFF HARDIN & WAITE

Professor Louis Loss

October 9, 1979

Page Seven

proposed amendments, saying which of them we or some of us individually would support or not oppose, which we or some of us individually would disagree with, and why.

Sincerely yours,

  
Milton H. Cohen

MHC:jp

cc: Messrs. Demmler, Garrett,  
Harris, Henkel, Kripke,  
Kroll and Sommer