BOOK REVIEWS

THE SECURITIES MARKETS: OPERATIONS AND ISSUES.

Robert H. Mundheim †

The publication of Professor Sidney Robbins' most recent book makes one of my tasks as a teacher of law school courses in Securities Regulation and Corporate Finance much easier. I now can assign material in one book—and it is a very readable book—which will give my students some background about the securities markets and how they operate as well as some feel for the goals which the process of regulation is (or should be) seeking to accomplish.

In his excellent book Professor Robbins deals with many of the important problems emerging in the securities field. He explores the ability of a market which becomes increasingly dominated by large institutions and large broker-dealer firms to supply capital to small, relatively untried ventures; the pressures on the minimum commission rate structure of the New York Stock Exchange and the diverse consequences which would result from changes in it; the growing importance in the equity market of institutional investors and their impact on trading practices and on the prices of stocks in which they are particularly interested; and the opportunities for more efficient market operation and closer regulatory supervision presented by developments in computer techniques. However, Professor Robbins is not content with identifying problem areas. He also offers solutions—often tentative—to many of the problems he raises. For example, he points to the continuing concern with the effect of a market break upon the economy. Since the government has developed far reaching controls over economic conditions directly, through the use of public expenditures, and indirectly, through fiscal and monetary policy, he sees no reason for it to shy away from developing controls to arrest accelerating market declines. Professor Robbins' program for dealing with the "tobogganing side of market prices" includes, among other things: providing the Securities and Exchange Commission with the personnel and computers necessary for it to make continuing analyses of the market and at appropriate times to issue "dispassionate and accurate" appraisals of market conditions; Commission consultation with institutions so that they can be persuaded to use their economic power selectively to stem market movements which are not justified by the facts; and use of across the board suspension of stop-loss orders and, for short periods, market sell orders,

† Professor of Law, University of Pennsylvania. A.B. 1954, LL.B. 1957, Harvard University. Member, New York Bar.
to provide a cooling off period when trading becomes hectic. Although his discussion of other areas is not as dramatic (or as controversial) as his discussion of the mechanisms which might be used to forestall a market break, all of these discussions suggest that the regulatory challenges of the decade to come can be successfully met only if those who toil in the field—regulator, regulated, teacher and student—are willing to abandon the traditional tendency to view the process of regulation as being almost exclusively tied to the application of disclosure techniques and the articulation of expanded fraud concepts.

Although Professor Robbins stresses the need to consider regulatory solutions which go beyond disclosure, he does not minimize the usefulness of disclosure as a regulatory tool. He points out that one of the principal functions of the securities market is the efficient allocation of the capital resources of the country. To the extent that investors are not well informed about the enterprises competing for available capital, or do not use the information available in deciding the terms, if any, on which such enterprises shall receive capital, the ability of the market to perform its allocational function is impaired. "Disclosure," concludes Professor Robbins, "is the keystone of intelligent investing . . . ." (P. 52.) Thus, one of the continuing regulatory responsibilities involves requiring business enterprises promptly to disclose information about their activities and financial status, and to make that information "available to the investors." (Pp. 52-53.)

Professor Robbins' analysis of the role of the securities markets in allocating capital resources assumes that business managers will be subject to the discipline of the securities markets in deciding whether or not to invest in a particular project. However, as he points out, corporations satisfy the major portion of their equity needs through reinvesting earnings rather than through direct sales to the market. This suggests that managers may often be insulated from the discipline of the securities markets. Professor Robbins argues that they are not insulated because "the willingness of stockholders to defer dividends in the expectation of a higher return through capital gains establishes both the volume and cost of the capital raised." (P. 48.) Although the market price of the stock establishes the firm's cost of capital, there is no assurance that management will make the cost of capital as reflected by the market price of the stock the determining factor in deciding between retaining earnings for investment and distributing them to shareholders. Perhaps there is sufficient evidence in the economic literature to satisfy Professor Robbins that business managers now

1 The reaction to these suggestions has not been enthusiastic. Professor William L. Cary, former Chairman of the SEC and the author of the Foreword to the book, remarked that these suggestions—though provocative—were impractical in the context of present day Congressional attitudes and political pressures. (See P. viii.)

consistently utilize this standard as a key to their decision-making (thus enabling them to adhere to the precept of financial management that managers should act only in ways which are consistent with maximizing the net worth of their shareholders). However, it would have been useful—at least to his lawyer audience—if Professor Robbins had supplied the documentation for this conclusion. Since there is a substantial difference between the literature which has formed the traditional reading staple of economists and lawyers, it is not surprising that questions whose resolution seems obvious to one group may be troublesome to the other. This barrier to communication should be kept in mind by those who, like Professor Robbins, undertake the difficult, but necessary, task of stimulating a dialogue between lawyers and economists because of a belief that the approach offered by each is “vital in order to understand the operations of the securities business and to insure its continued usefulness in the economy.” (P. 80.)

Professor Robbins' analysis of the economic function of the securities markets poses the regulatory problem in a very clear and helpful way. If, as Professor Robbins argues, efficient allocation of capital resources is a major function of the securities markets and that function can be accomplished only if the markets are dominated by intelligent investing, the problem to which the regulator must turn his attention is the creation of an environment which will minimize the number of non-intelligent investment decisions made. Can this environment be created by the use of disclosure techniques alone?

In coping with this problem, the regulator must consider, among other things, the wide range of investor sophistication. Material which is useful to some investors is incomprehensible to others: material simple enough to be comprehended by most investors may be misleadingly simple (or at least not sufficiently informative) for many of them. Although there have been great strides in improving the amount and quality of information available about companies whose stock is traded, considerable concern has been expressed about the extent to which such information is effectively disclosed to the non-professional, unsophisticated investor. In an opinion involving stop-order proceedings against a real estate corporation, the SEC said:

The standards of disclosure imposed by the Securities Act require that the essential characteristics of a security be clearly understandable. We have previously noted that a registration statement, which contains all the facts necessary for the sophisticated investor who has the time and training to make an independent analysis of the information furnished may, nevertheless, 

---

3 One useful discussion of the elements shaping investment decisions appears in a Committee print of the Joint Economic Committee. Joint Economic Comm., 87th Cong., 2d Sess., Variability of Private Investment in Plant and Equipment pt. II (Joint Comm. Print 1962). The material contained in that document indicates that rapid increases in the use of scientific management techniques have occurred in recent years. However, it also suggests that in many instances firms are not sensitive to capital market conditions.
be misleading to investors who are unable to ferret out the significant facts from the complexity and detail of disclosures dispersed among the numerous portions of the prospectus. It is particularly important in connection with an offering such as is here proposed where there is only a limited record of earnings, where management is inexperienced, where the underwriter is new to the business, and where the proposed enterprise is subject to special risk, that these speculative features of the offering be made plainly evident to readers of the prospectus. In other cases we have held that the statutory standards require that the speculative risk features of the registrant's business and securities be set forth in prominent and summary fashion at one place in the early part of the prospectus under an appropriate heading.4

Even the prospectus for the mutual fund—the investment vehicle designed for the unsophisticated investor—was found wanting as an effective disclosure tool in the Special Study of Securities Markets of the Securities and Exchange Commission.5 Consequently, the Special Study recommended that:

Prospectus requirements should be further refined to assure that basic information is brought clearly and conspicuously to the attention of the prospective investor. The Commission should require a summary on the cover, or as prominently as possible at the beginning of each prospectus, of the sales charges, expense ratios, advisory fees, performance objectives, and other basic information, and should require disclosure of any special or extra compensation arrangements for the sale of particular funds by mutual fund salesmen or of the fact that the salesmen can only offer a particular fund or funds.6

Although the SEC has shown some fondness for the technique of enlightening unsophisticated investors by supplying them with a reader's digest version of the prospectus, no empirical studies have been undertaken to test the impact of this method of disclosure on the quality of the investment decisions made by the segment of the investing public to which it is addressed. If, as I believe, disclosure techniques cannot be sufficiently developed to make the unsophisticated investor an intelligent investor,7 a well-conceived regulatory program should supplement the continuing effort

6 Ibid.
7 I do not mean to suggest that efforts to improve disclosure for the unsophisticated investor should be abandoned. The Survey of Mutual Fund Investors conducted by the Wharton School of Finance and Commerce discovered that “mutual fund buyers had little knowledge of alternatives.” Roughly three-quarters of the purchasers of funds which had normal sales charges were unaware of the existence of no-load funds. H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. 4, at 344 (1963). These findings suggest one path which the attempt to improve disclosure could fruitfully explore.
to provide the sophisticated investor with better and more accessible information along two lines: 8

1. Investors should be encouraged to use and rely on professional advice in the making of investment decisions. Such advice may be the custom-tailored advice provided the individual account or the mass merchandized investment advice offered by mutual funds, insurance companies, banks and other institutions or enterprises which offer the public interests in pools of securities.

2. Increasingly rigorous standards of professionalism (both in terms of competence and responsibility) should be imposed on all persons offering such advice.

Some steps in this direction were taken by the Securities Acts Amendments of 1964, 9 which contained provisions raising qualification standards for persons engaged in the securities business and strengthening and refining disciplinary controls over such persons. The Commission's long-awaited report on mutual funds may provide a clue about its desire to take further steps toward developing a regulatory program along these lines. Any regulatory suggestions made in that report should, as Professor Robbins repeatedly urges, be developed against the background of an analysis of the function of mutual funds in the securities markets. For example, the important question of what limits, if any, to place on the financing of the sale of fund shares 10 can hardly be answered without first attempting to reach some conclusions about the desirability of encouraging the distribution of such shares.

However, the Commission's willingness and ability to deal with such central questions obviously concern Professor Robbins. For example, he concludes his discussion of the history of the regulation of the New York Stock Exchange commission rates with the comment that:

[D]uring a period of some thirty years of Commission interest in the rates charged by the member firms, the most tangible progress has been the development by the [New York Stock] Exchange of some statistics dealing with costs and profits, which have been used principally to justify rate increases. No real effort has been made by either the Exchange or the Commission to formulate a theory of rate determination in the securities business, although some modest whispers on this subject have been heard. (Pp. 69-70.)

---

8 Although this analysis focuses on the inability to make the unsophisticated investor an intelligent investor, I recognize that the efficiency of the market as an allocator of capital resources may also be impaired by those persons whose "investing" is nothing more than a willingness to gamble on stock market reactions. The basis for such investing is not the collection and careful evaluation of information about the company whose stock is being traded.


10 The specific questions relating to the financing of fund share sales cover a broad area. They include the size of sales loads, their collection through the front-end load system, the use of reciprocal business to reward selling efforts and the subsidy of sales efforts by the profits earned on managing fund assets.
Professor Robbins explains the failure of the Commission to undertake a thorough study of these problems and to reach some conclusions with respect to them as resulting, at least in part, from its preoccupation with every-day legal, enforcement and judicial responsibilities. He also suggests that part of the explanation can be traced to the dominance of lawyers and legal thinking in the membership of the Commission. Professor Robbins views lawyers as inveterate patchers who tend to seek remedies "by the issuance of a corrective rule." (P. 70.) Their outlook is in marked contrast to that of economists who, he says, prefer to find their cure for revealed deficiencies "in the development of a theory which may lead to institutional changes." (P. 79.)

There are other reasons. Wrestling with a problem, the answer to which may require a change in substantive regulation, costs a great deal in energy—and the amount of energy available to any institution is limited. Part of the energy drain results from the sharp opposition which proposals for changes in substantive regulations typically arouse. The Commission's attempt in late 1963 and early 1964 to ban or greatly to restrict floor trading by members of the New York Stock Exchange precipitated what was described as the "biggest fight between the Big Board and the . . . Commission since New Deal days." The fight involved an activity which accounted for a very small fraction of the total transactions executed on the New York Stock Exchange. It resulted in a compromise which, among other things, sought to confine the activities of the newly-created class of registered traders to transactions which contribute to the orderliness of the markets and to prevent them from engaging in transactions that have disruptive market effects. Although the new rules reduced the number of on-floor purchases and sales substantially, Professor Robbins questions the significance of this victory to the more efficient operation of the market.

11 When he was Chairman of the SEC, William L. Cary voiced a similar complaint:

While the Commission sought to maintain its standard of competency, it scarcely had time to see the direction in which the industry that it regulated had been changing. Without additional personnel and without fiscal support, the only choice was to meet the day-to-day grist of tough financial problems on an ad hoc basis. At times in the course of administrations whether Democratic or Republican, the only—indeed the highest—goal expected of any agency seems to be that it conduct its day-to-day work honestly and thoroughly without getting into any trouble. In a political world even that may be high praise, but it offers to the agency only a dusty road for its horizon.


12 There are also limits to the political capital which an agency such as the Commission possesses.


14 N.Y. Stock EXCH. R. 111.

15 For the twelve months ending July 31, 1964, on-floor purchases and sales on the New York Stock Exchange represented 2.48% of total transactions. In the twelve-month period ending July 31, 1965, after introduction of the new provisions, on-floor purchases and sales represented only 0.66% of total transactions. (P. 204).
On the other hand, important disclosure-oriented proposals have been adopted without struggles of similar proportion. One of the important recent developments in the regulation of investment companies was the introduction of a revised annual report, Form N-1R. This new annual report called for greatly expanded disclosure in a number of areas and has proven more costly to prepare than the old report. Perhaps most important, Form N-1R introduced some new ways of looking at the investment company industry. For example, prior to the adoption of Form N-1R, in answering questions concerning the compensation of officers and directors of an investment company, it was traditional to look only at the compensation derived from the particular company reporting. However, it is not unusual in the investment company industry to find that an investment company is part of a complex of investment companies, all of which are advised and/or underwritten by the same persons. All the investment companies in the complex typically have identical or nearly identical boards of directors and sets of officers. Their remuneration may come from anywhere within the complex: the reporting investment company, sister investment companies, affiliated advisers, principal underwriters or brokers. Item 1.12 of Form N-1R requires each investment company to report the total remuneration derived from the investment company complex by each member of its board of directors or advisory board and each of its three highest paid officers, whose aggregate compensation from the complex exceeded 30,000 dollars. The theory underlying Item 1.12 raises some interesting questions which apparently have not yet been widely asked inside the investment company industry. Should management fees paid to investment advisers be negotiated (and judged as to reasonableness) on a complex rather than on an individual investment company basis? Would it be more reasonable to relate scale-downs in the advisory fees charged to an investment company to the size of the assets of all the investment companies in the complex, rather than calculate it solely on the size of the assets of the particular investment company? Although the changes in the advisory fee structure which may (indeed, should) flow from this new disclosure requirement will be much more significant to the investing public than the changes resulting from the conflict involving floor-traders, this disclosure-type change did not stir up the kind of protest generated by the proposals to change the rules governing floor-traders. However, if the Commission had attempted to adopt a rule requiring investment company directors to negotiate advisory fees on a complex rather than on an invest-

17 The purpose of the expanded report is to aid the Commission in its inspection program and to bring to the attention of those responsible for the management and operations of the investment companies information which would enable them to determine whether the company is complying with the statutory requirements and therefore contribute to a program of self-inspection.
19 Compensation from the adviser, principal underwriter or broker need only be included if 50% or more of the aggregate gross income of such adviser, principal underwriter or broker derives from the investment companies included in the complex.
ment company basis, a storm of protest would probably have arisen. Although it is not clear why disclosure-type reforms or solutions are often relatively acceptable, it may, in part, be that they are not quite as successful in changing patterns of conduct as is sometimes believed.\footnote{Disclosure may serve as a way of securing sanction for conduct that might otherwise be successfully challenged. For example, the use of shareholder ratification in publicly-held corporations may effectively insulate transactions, in which management has an interest adverse to the corporation, from the closer and more careful scrutiny which a court might provide.}

Although disclosure is a very flexible tool which can be used subtly to help effect changes without creating unnecessary alarm, its very flexibility may contain a danger for the regulatory process. It permits the Commission to handle successfully immediate, concrete problems and thus shields it from facing important underlying substantive questions which must be answered if the regulatory process is to achieve its maximum effectiveness. This danger is illustrated in the recent Commission opinion in Imperial Financial Services, Inc.\footnote{For a discussion of the extent to which disclosure can be a useful device for raising standards of conduct, see Cary, The Direction of Management Responsibility, 18 Bus. Law. 29 (1962). Even if a disclosure-type reform or solution presages a change in patterns of behavior, it usually leaves time within which persons can accommodate themselves to the changes which have to be made.} The opinion was written in connection with a broker-dealer revocation proceeding. The Commission charged that the broker-dealer, who was the investment adviser and principal underwriter of a mutual fund, Imperial Fund, Inc., caused the filing and use of materially misleading prospectuses in connection with the sale of the fund’s shares. The underlying issues in the case, however, involved the proper operation of a mutual fund. The Commission’s immediate problem concerned removing the existing management of the fund and securing new management for it. The Commission solved this problem. However, its success in this aspect of its regulatory responsibilities permitted it to avoid facing some of the industry-wide problems which appeared to be raised by the facts of the case.

The first issue discussed in the opinion concerned representations about the investment research staff of Imperial Financial. The fund prospectus stated that there was available: “Skilled and seasoned management for utilizing potentials of opportunity. Manpower to take the work out of following hundreds of securities daily.”\footnote{Securities Exchange Act Release No. 7684 (Aug. 26, 1965), CCH Fed. Sec. L. Rep. ¶ 77,287, at 82,455 (1965).} The opinion then demonstrated that Imperial Financial’s staff did not live up to the expectations created by the statements made in the prospectus. The question posed by the facts set forth in the opinion is much broader than the Commission’s treatment suggests—it relates to the standards which should be erected to judge the adequacy or competence of the investment management provided by an investment company. Surely the answer to that question should not turn on disclosure. Suppose the Imperial Fund prospectus had said nothing  

\footnote{22 Id. at 82,458.}
about the caliber of the investment management which it would provide or had simply disclosed that the research department consisted of one full-time analyst and some part-time help. The basic question is whether or not shares in such a fund should be sold—or, to frame it in existing statutory terms, whether the directors of the fund have a duty under the Investment Company Act of 1940 not to permit the sale of fund shares to the public unless they have been able to secure investment management services of a minimum level of quality. These questions could perhaps have been tried in a proceeding against the directors of Imperial Fund under section 36 of the Investment Company Act, which permits the Commission to bring an action to enjoin a director from continuing to serve a fund if he has committed a gross abuse of trust.

Further along in the opinion, the Commission considers the role of a mutual fund’s unaffiliated directors, and concludes that the prospectus of Imperial Fund was deficient because it failed to disclose that the fund’s unaffiliated directors were not adequately informed as to transactions involving substantial portions of the fund’s assets. After detailing the facts supporting this conclusion, the Commission commented that the unaffiliated directors “would have been well advised to probe more deeply and specifically into the facts and rely less on assumptions that others were doing what they should be doing.” The kind of inquiry that unaffiliated directors should (and apparently did not) make appears to be the crux of this aspect of the problem—not the adequacy of disclosure in the prospectus.

The Commission’s focus upon deficiencies of disclosure to handle what are, in essence, substantive problems concerning the regulation of investment companies may be justified on the ground that the Commission does not have adequate power to proceed directly under the Investment Company Act to handle them. The Commission has had some disappointments in its litigation of section 36 cases in the lower courts. However, its

25 Another approach might have been an action to enjoin the performance of the advisory contract under § 15 of the Investment Company Act. 54 Stat. 812 (1940), 15 U.S.C. § 80a-15 (1964). As suggested later, there is considerable question about the Commission’s ability to prevail in such litigation. See note 28 infra and accompanying text.
27 For another example of this technique, this time in the context of a stop-order proceeding, see Managed Funds, Inc., 39 S.E.C. 313 (1989).
28 For example, in SEC v. Continental Growth Fund, Civil No. 63-2252, S.D. N.Y., August 9, 1963, the court made the following findings concerning the activities of three unaffiliated directors of a fund whose principal affiliated person had embezzled and converted fund assets:

Jacobs’ [the principal affiliated person] unlawful activity was facilitated by Joy—without the latter’s knowledge—who had presigned the Officers Certificates never questioning Jacobs’ use of them, and by Franklin whose violation of the Custodian Agreement without intent made possible Jacobs’ embezzlement. . . . Deacon, Devine and Joy permitted Jacobs to maintain sole control over the operations of the Fund. They were inattentive, neglectful and failed to recognize and perform their fiduciary duties as directors.
rebuffs in these cases should not be construed as precluding it from dealing directly with the Investment Company Act problems raised in Imperial Financial. For example, it would have been appropriate for the Commission to publish a release detailing its conception of the obligations which unaffiliated directors have under the Investment Company Act in connection with the securing of adequate portfolio management and the making of investment decisions. If, on the other hand, the Commission does not think that it has adequate power to provide meaningful regulation of investment companies in these areas but that some degree of regulation is necessary, it has an obligation to ask Congress for additional power.

There was one issue raised in the Imperial Financial opinion which the Commission completely avoided. Part of Imperial Fund's portfolio transactions were in stocks traded exclusively in the over-the-counter market. Imperial Financial effected these transactions on a net basis and then confirmed to the fund as agent, charging one per cent of the transaction price or, if lower, the New York Stock Exchange minimum commission rate. It was stipulated that the market makers with whom Imperial Financial dealt would have dealt with the fund directly on the same basis as they dealt with Imperial Financial. The practice of interposing a broker-dealer in an over-the-counter transaction had been flatly condemned by the Special Study:

While some reciprocal practices in the mutual fund industry are justifiable under the existing commission structure, the over-the-counter give-up in its various forms, including interpositioning, is in flagrant conflict with the duty of a fund and its adviser to obtain best terms in its securities transactions unless the advantages of any such give-up can be clearly demonstrated.

By refusing to deal with the problem of interpositioning presented by Imperial Financial's activities, the Commission missed an important opportunity to spell out appropriate standards of conduct to which all fund directors could require adherence.

and officers. This facilitated Jacobs' misconduct and gross abuse of trust. . . . The Directors knew that Management had no research facilities and that, in effect, Jacobs was the entire organization . . . . Management rarely presented to the Board any written analyses or reports on securities to be purchased or sold by the Fund. Nevertheless the court refused to find that the unaffiliated directors had committed a gross abuse of trust and did not issue the requested preliminary injunction against them. The case was later settled. See 31 SEC ANN. REP. 126-27 (1965). See also SEC v. Midwest Technical Development Corp., Civil No. 62-192, D. Minn., July 5, 1963, CCH Fed. Sec. L. Rep. ¶ 91,252 (1963).

During the years 1960-62, Imperial Fund paid Imperial Financial $169,883 in brokerage commissions in connection with over-the-counter transactions. A sister fund, Imperial Capital Fund, Inc., paid Imperial Financial $284,369 in such commissions during this period.

The Commission's success in disposing of immediate problems with *ad hoc* solutions and the many factors supporting its avoidance of substantive regulation make Professor Robbins apprehensive about its ability to respond properly to the major regulatory problems which he has identified. He is convinced that successful regulation by the Commission depends on its willingness to relate its regulatory program to carefully considered economic goals. Thus, he urges that at least one of the Commissioners be a person whose principal training has been in economic or financial areas and whose interest lies in long-range planning studies for which he would be primarily responsible. In addition, Professor Robbins sees the need for maintaining a permanent staff unit whose responsibility would be the conduct of basic continuing studies.\(^{32}\)

Professor Robbins also cautions against insulating the Commission from the kinds of external pressures which would force it to face developing regulatory problems. He recognizes that although the Commission's concern with the minimum commission rate structure may have been prompted by the conclusions of the *Special Study*, the pace of its activity in this area has been quickened by the prosecution (or threat of prosecution) of a number of law suits challenging various aspects of that structure under the anti-trust laws. The Commission has argued that it, rather than the court, is the appropriate agency to achieve a reasoned accommodation between the policies of the securities and anti-trust laws. Professor Robbins agrees with that judgment—but only as long as the Commission can demonstrate that it is rigorously pursuing its regulatory responsibilities. I think Professor Robbins is right. I would add that the publication of books such as his will help focus Commission thinking on the proper questions and provide some additional stimulus for the development of meaningful answers.

**SEXUAL BEHAVIOR AND THE LAW.** BY SAMUEL G. KLING.

Frank B. Baldwin, III \(^{†}\)

Books about sex and the law are by no means rare, though some of the earlier works continue mysteriously to disappear from library shelves.

---

\(^{32}\) In 1965, the Commission created the Office of the Chief Economist and is now developing a staff of professional economists.

One of the principal functions of Professor Robbins' staff unit and the long-range planning studies would be gathering the data which is needed before a sensible regulatory program can be constructed. Prior to the Special Study, the Commission had an amazing lack of knowledge about how the securities markets operated. There are still large gaps in its knowledge and Professor Robbins describes many areas in which the first objective should be the accumulation of relevant facts. The problems of data gathering are immense—particularly because frequently it is difficult to formulate the questions around which the data should be assembled.

\(^{†}\) Assistant Professor of Law, University of Pennsylvania. A.B. 1961, Harvard University; LL.B. 1964, University of Pennsylvania; LL.M. 1965, University of London. Consultant to the Delaware Governor's Committee for Revision of the Criminal Law.
Mr. Kling's addition to this popular literary genre is bound to be much coveted. It contains a wealth of explicit information about the acts which American penal laws prohibit—information sorely needed in a world which can still tolerate statutes which characterize homosexual intercourse as "the crime against nature." 1

The book is written by a practicing lawyer primarily for laymen. It seeks to inform the public about a field which abounds in the most alarming contradictions. A lay reader might well ask why adultery goes unpunished in California but is subject to a five-year sentence in Connecticut (P. 15.), or why rape merits the death penalty in North Carolina but only a five-year prison term in Rhode Island. (P. 212.) Mr. Kling cannot, of course, provide the answers to such paradoxes. But he has done well to suggest that rational answers ought to be demanded.

As an informative work the book deserves a high rating. The chapter on homosexual behavior (Pp. 97-129.) is particularly valuable, because it contains a condensed and easily understood summary of current medical views about homosexuality as well as a description of the acts which constitute an offense. This pattern is repeated throughout the book's sixteen chapters, which range from rape to birth control.

On the other hand, it is not a particularly useful tool for scholarly research (nor was it meant to be). There are few citations of authority, and, sad to say, a number of inaccuracies. 2 The lawyer, practicing and academic, will be more interested in this book as a barometer of the changing climate of public opinion. Not long ago a popular rendition of our nation's sex laws would have had a cold reception indeed. Now it seems likely that public opinion is gradually beginning to favor the idea of modernizing the laws about sexual behavior. There is very little to show as proof of this change. The Model Penal Code's recommendation that penal sanctions be removed from consensual sodomy and adultery has still only one important follower, 3 though a large number of new criminal codes are in the works, and some may contain changes in the old law.

But despite the hopeful signs of reform, Mr. Kling's book and much else that has been written in the area leave me with the strong feeling that we do not yet have the right answer—indeed, that we are not always even looking for the answer in the right places. Some of the writing in the field has a strong "Playboy Philosophy" flavor, which is distasteful to those who are seeking practical and politically palatable reforms of the substantive criminal law. Kling and others propose too facile solutions to problems with very deep emotional, political and moral roots.

We know that large numbers of people violate criminal law provisions relating to sex. This has led many writers to call for repeal. It has even

---

2 As one example only, he reports that rape is punishable by death in Delaware. (P. 212.) That penalty was abolished for rape in 1958. See Del. Code Ann. tit. 11, § 781 (Supp. 1964).
seemed to some that this fact signals a desirable break between criminal law and "morals," whatever that term may be thought, under the circumstances, to mean. But the point is, we just do not know what this fact, standing alone, may signify. Does the present law have desirable effects short of strict and uniform obedience? Or, on the contrary, is it conceivable that the present law has made the wrong moral choices? Most people have not thought those questions worth asking, and, with a few obvious exceptions, they have not been put to anyone who could provide an expert answer.

Criminal law is not amoral. Its very substance is moral choice, sometimes conscious and sometimes intuitive. In reforming the substantive law we need somehow to find out what moral choices must be made in order to achieve a desirable state of social order. Do we find such answers by guessing? Or by public opinion polls? Or do we need, rather, to consult opinions which could be called expert in making moral decisions: learned philosophic opinion on the one hand and informed scientific and medical opinion on the other? The Reporters of the Model Penal Code have led the way in the direction last mentioned. But now the battle has shifted to the state legislatures, and it is there that a modern attitude toward the role of the criminal law will have to be molded.

No certainty or permanency is going to be achieved. People twenty-five or fifty years from now are going to disagree with the choices we make. But we can get much further with the task of modernizing the criminal law if we do more than simply declare that the old morality is dead. We need to create a new morality, and hope it will serve us better than the old. My feeling is that criminal law is so intimately associated with morality that its existence apart from morality is futile. To me, it follows that conduct is to be excused from criminal liability not because the law cannot be enforced, but because the conduct is right. Nor, incidentally, do I find it difficult to say that some acts which our ancestors condemned are now quite moral. The begged question is the meaning of "moral." This is not the place for an elaborate answer to any such question, nor even to add to the tentative suggestions above as to where the answer might be sought.

Another aspect of the present stir in substantive criminal law, particularly sex law, is unmentioned by Mr. Kling. What if legislatures refuse to move? The New York legislature recently rejected the thoughtful proposals of its Temporary State Commission on Revision of the Penal Law and Criminal Code to withdraw criminal penalties from adultery and consensual sodomy. Thus the latter act, which is lawful in Illinois, is a misdemeanor in New York and a felony in Delaware. If this inconveni-

---

5 N.Y. REV. PEN. LAW § 130.38 (Effective Sept. 1, 1967).
6 DEL. CODE ANN. tit. 11, § 831 (1953). A similar progression can be worked out for adultery, which is a felony in Arizona. ARIZ. REV. STAT. ANN. § 13-222 (1956).
sistency is not enough to raise doubts about constitutionality, perhaps the fact that many of the consensual sodomy statutes purport to cover acts between married partners now makes them unconstitutional.\(^7\) If not, would a court find them invalid in the light of overwhelming medical opinion that homosexuality is a relatively incurable condition and that many acts formerly considered "unnatural" are widely engaged in, sometimes by individuals who are able to partake of no other form of sexual experience? Recent constitutional decisions may point in that direction.\(^8\) The right to be free from penal sanctions for acts which are widely done, sometimes unavoidable, and arguably moral, in any meaningful sense of that word, is a right which we should not too hastily relinquish to state regulation.


Gilbert M. Cantor †

This study provides astonishing breadth and depth in a single volume. It is an aid to practicing lawyers, a handbook for foundation people and a guide to law reformers.

The entire subject is first placed in the perspective of history: traced from early Egyptian, Greek and Roman records, carefully charted through the centuries of English experience and brought down to today's American foundations with their "substantial capital assets and purposes characterized by a wide freedom of action," our "freest enterprise." The focus of the current interest in foundations is primarily on devising means to assure that foundations are accountable to the public without sacrificing their basic freedom of action.

The law of charitable dispositions is summarized in an early chapter, and consideration is given to the question of the means by which the law assures that perpetual charities will continue to be of public benefit in a changing society—particularly through the several versions of the delicate doctrine of cy pres. The two legal forms in which foundations are usually created, corporations and trusts, are treated in separate chapters. The chapter on "Foundations as Trusts" provides in thirty pages as good a restatement of the entire law of trusts and the duties and powers of trustees as one could desire.

Having provided the background material, the author proceeds to furnish a critical analysis of existing provisions for state registration and supervision and the role of attorneys general. There are field reports on

\(^7\) See Griswold v. Connecticut, 381 U.S. 479 (1965).

ten states which have programs aimed at following charitable activities closely, and the British experience in supervising charitable trusts is also presented. Of the Uniform Act for Supervision of Trustees for Charitable Purposes—which provides for the registration with the attorney general of trustees subject to the act, periodic reporting to the attorney general, investigations by the attorney general to ascertain whether property held for charitable purposes is being properly administered and enforcement by the attorney general of proper administration—Mrs. Fremont-Smith observes that "with the exception of its poorly drafted definition and exemption sections, it contains the basic elements for the establishment of an effective supervisory program." (P. 271.)

Attention is given the relevant federal tax provisions, including those dealing with operational and organizational tests, unrelated business income, feeder corporations, accumulations and misuse of income, prohibited transactions, donor control and foundation "abuses." Of the attempt to provide regulation of charities through tax laws, the author observes: "The heart of the problem actually lies in the fact that the tax laws are being relied on to police activities in a manner for which they are not suited. . . . The process of the revocation of exemption and the subsequent taxation of foundation assets assures that the federal revenue is not depleted, but it does not further in any way the legitimate community interest in the preservation of funds devoted to philanthropy." (P. 189.) The author goes beyond the substantive tax laws and depicts the roles of Congress (which considers, drafts and adopts tax legislation); Congressional investigations (e.g., The Cox Committee, the Reece Committee and the Patman Investigation, whereby legislators acquire information and public opinion is formed and directed); the Treasury (which formulates, drafts and "pushes" proposals reflecting the President’s policies, and also directs the operations of the Internal Revenue Service, which in turn issues rulings, collects information and enforces the tax laws); and the courts (to which appeals may be taken from decisions of the Internal Revenue Service).

Suggestions are put forth for increased federal and state cooperation. The author emphasizes two needs. The first is for the promulgation of an Executive Order by the President to enable state attorneys general to obtain from the Internal Revenue Service information regarding charitable organizations in their states in order to assist them in their enforcement duties. The second is for the establishment of more direct methods of communication between the Service and attorneys general.

In an excellent concluding chapter on "Prospects and Recommendations," Mrs. Fremont-Smith returns to the basic antithesis between the need of foundations for freedom ("Their unique contribution . . . is directly related to the diversity of the programs they have developed and supported." (P. 428.)) and the need of the people, through government, to be assured that the funds are being devoted to the purposes for which they were donated, that those who manage the funds are acting in the public interest and that the funds of foundations whose purposes are no
longer socially useful are directed into fields where they will continue to serve society. Among her suggestions are: "the adoption by legislature or judiciary in all states of provisions whereby all charitable gifts, unless subject to a specific limitation valid for only twenty-one years, would be subject to alteration whenever they become 'obsolete, useless, prejudicial to the public welfare, otherwise sufficiently provided for, or insignificant in comparison to the magnitude of the endowment,' to use the language of the Education (Scotland) Act of 1946" (P. 432.); legislation providing that no settlor may relieve a trustee or director of a charitable trust or foundation from his duties of loyalty nor from the use of reasonable care, skill and prudence; and legislation or judicial action eliminating differences in the duties of charitable fiduciaries based on differences in the forms of foundations.

In the area of federal control, which is exercised now through the Internal Revenue Service, the author suggests the establishment of a separate federal agency to supervise foundations, or even all charitable activities, or, as a less desirable alternative, expansion of the activities of the Internal Revenue Service. Sensibly, the author prefers improved state programs of supervision, which can be less formal and less rigid, and under which the supervisory authorities can afford to charitable trustees greater opportunities for advice and consultation. "[I]t is surely desirable to attempt to improve state performance before abandoning it in favor of exclusively federal supervision." (P. 440.) The two major alternatives for the improvement of state programs are presented and analyzed: first, the enactment of legislation to increase the attorney general's enforcement powers and supplement them with machinery for obtaining information and administering an active supervisory program; alternatively, the creation of an independent state agency to replace the attorney general in his supervisory activity and to carry out a program similar to that of the English Charity Commissioners, which provides for registration of charities, investigation and drastic remedies for the correction of misconduct or mismanagement.

The proposal that foundations develop a "code of ethics" for their self-regulation is also discussed, and the author makes this balanced and cogent observation:

Despite the difficulties of implementation, it must be concluded that there is great value in any and all public indications by foundations that they recognize their favored position and accept their public responsibilities. The public must, in a similar vein, accept the proposition that a certain latitude is essential for any institution whose value lies in its ability to experiment and pioneer in the entire range of problems facing mankind. (P. 459.)

Interested lawyers and laymen are greatly indebted to Mrs. Fremont-Smith and to the Russell Sage Foundation, which supported and published this work as part of its continuing program of studies in philanthropy.