Liabilities imposed upon professional men subscribing to registration statements filed under provision of the Federal Securities Act, unless amended, will place the distribution of securities in the worst possible hands, said George O. May, New York certified public accountant, in an address in Chicago last night.

Mr. May, a member of the American Institute of Accountants and just appointed chairman of a committee on the development of accounting principles of that organization, was the guest speaker at a meeting of the Illinois Society of Certified Public Accountants. His address, in part, follows:

“No one who has watched closely the developments of the past ten years can wonder that a securities law should be enacted, nor even be greatly surprised at the form which it has taken. Nor would it occasion surprise if more recent revelations should prove to have made it difficult to bring about modifications in the Act, or perhaps have created a demand for still more drastic measures. But to say that legislation was natural, and perhaps inevitable, is not to approve all its provisions; and while the Act possesses many merits, the wisdom of some of its provisions (notably those provisions relating to the liability of underwriters, directors, officers and experts) is open to serious question in the minds of those genuinely interested in the protection of investors.

“It is a commonplace that extreme measures defeat their own purpose; but people are seldom willing to give practical effect to this commonplace. Fifteen years ago, we adopted a constitutional amendment designed to put an end to admittedly great evils. When legislation enacted in pursuance of that amendment proved ineffective, we passed more severe measures; but as the law became more drastic, its enforcement became more and more impossible. Yesterday, we took the final step to reverse the well-intentioned but unwise action of fifteen years ago. We all realize, however, that it will take years to eradicate the evils which that unwise action brought into existence. Surely there is a lesson here for those who seek to regulate the issue of securities.
“Many who originally supported the prohibition movement, including, as I particularly recall, a bishop of the church, finally became convinced that it should be repealed on the simple ground that it placed the distribution of liquor in the worst possible hands. In the same way, a too drastic securities law will place the distribution of securities in the worst possible hands.

“I cannot believe that a law is just, or can long be maintained in effect, which deliberately contemplates the possibility that a purchaser recover from a person from whom he has not bought, in respect of a statement which at the time of his purchase he had not read, contained in a document which he did not then know to exist, a sum which is not to be measured by injury resulting from falsity in such statement. Yet, under the Securities Act as it stands, once a material misstatement or omission is proved, it is no defense to show that the plaintiff had no knowledge of the statement in question or of the document in which it was contained, or that the fall in the value of the security which he has purchased is due, not to the misstatement or omission complained of, but to quite different causes, such as the natural progress of invention, or even fire or earthquake. The Securities Act not only abandons the old rule that the burden of proof is on the plaintiff, but the doctrine of contributory negligence and the seemingly sound theory that there should be some relation between the injury caused and the sum to be recovered.

“It is frequently suggested that the Act follows closely the English law; but as one who has followed the development of the English law for nearly forty years I am bound to say that whether this statement be regarded as praise or censure, it is unfounded. None of the departures from ordinary legal principles to which I have referred finds its counterpart in the English law. The right of recission is enforceable only against the issuer, and before the purchaser can recover from a director or other person concerned in the issue he must show that he relied on the prospectus, and then can recover only for injury due to the untrue statement which he proves.

“The answer of Congress to those who urged that the English law should not be followed because it was too severe and tended to check the flow of capital into industry, was that of the son of Solomon, who, refusing to listen to the elders and following the advice of the young men, said: ‘My father hath chastised you with whips, but I will chastise you with scorpions.’ And you will remember that the cry was at once raised, ‘What portion have we in David? . . . to your tent, O Israel . . . and the biblical narrative concludes with the statement, So Israel rebelled
from the house of David unto this day.’ So, too, there is reason to fear that responsible people will refuse to accept the unfair liability imposed on them by Congress under this Act, and will continue to refuse until juster provisions are enacted. If they do so, their action can only be regarded as the course dictated by common prudence, and not as indicating factious opposition to the main purpose of the Act.

“It is difficult to see, however, upon what principle of justice the accountant or other expert whose good faith is not challenged, but who is held to have failed to live up to the high standard of care required of him, can fairly be called upon to do more than make good the injury attributable to such failure for the benefit of a purchaser who perhaps did not even know of his existence at the time of the purchase, and took no pains whatever to investigate the security he purchased.

“The functions of the accountant in connection with a new issue, are, broadly, to report upon statements relating to the financial position and operations of the issuer.

“The fallacious view is quite widely held that the work of the accountant is purely a fact-finding function, and that when his work is completed he is in a position (if it has been properly performed) to make findings of definite and incontrovertible facts.

“But whatever they have been represented or supposed to be, accounts are not mere statements of fact, but represent the application of facts of judgment and accounting principles. Truth in accounts is not, therefore, a simple matter of correspondence between fact and statement -- accounts are true if they result from the application of honest judgment and reasonable accounting principles to the relevant facts. The question that should really be put to the accountant is not whether the balance sheet is true, but whether it is fair -- fair in the accounting principles on which it is based; fair in the way in which those principles are applied; to the facts and fair in the way in which the results are presented. These are matters of opinion.

“The Act stresses the obligation to state every material fact necessary to make the registration statement not misleading, and among the material facts in relation to any accounts none is more material than the fact that the accounts themselves and the certificate required from the accountant in relation to those accounts are, and must of necessity be, expressions of opinion. Indeed, the Act, in speaking of truth in accounts without some such qualification is itself calculated to mislead investors, in the same way as was Professor Ripley’s reference to a balance sheet as an ‘instantaneous photograph.’
“Clearly, only action by Congress can remove the fundamental and, as I feel, insuperable obstacles to the free acceptance of appointing under the Act by accountants which have been created by the imposition of a liability bearing no relation either to the injury caused by the accountant or the compensation received by him. If, however, this major difficulty could be removed, the remaining problem could probably be solved by judicious use by the Commission of the powers conferred on it under Section 19.

“Under that Section, the Commission has power for the purposes of the Act to define accounting terms used therein and to prescribe the method to be followed in the preparation of accounts. It seems to me highly desirable that under the provisions of this section the Commission should define what constitutes a ‘true’ balance sheet or a ‘true’ profit and loss statement. Such definition would, I think, necessarily follow the general line that I have indicated. Accounts would be held to be true if they represented the application of honest judgment and acceptable methods of accounting to all the relevant facts which were known or ought to have been known to the person preparing or certifying them at the time of preparation or certification.

“I am convinced that to make the Act practicable in its working it is essential that some general ruling as to what constitutes truth in accounts along the lines I have suggested shall be put forward by the Commission. As I have indicated, such a statement would serve the double purpose -- first, of tending to prevent the investing public from attaching undue significance to accounts; and, secondly, of preventing accountants from being harassed or penalized through unduly technical interpretations of the provisions of the law.

“In conclusion, I desire to say that I am in full sympathy with the general purposes of the Act, and that the criticisms which I have offered of some of its provisions are not merely inspired by a narrow self-interest, but rest upon the profound conviction which I expressed at the beginning of this address, that unduly drastic measures defeat their own purpose, and are not in the ultimate interest of those whom it is sought to protect. I should be extremely sorry if the effect of the Securities Act should be to place the distribution of securities and all the work attendant on such distribution in the least responsible hands.

“I think, also, that we, as accountants, owe a duty to small investors in any discussion of the Act to point out that the ordinary vicissitudes of business make commercial securities necessarily hazardous and unsuitable for the investment of small savings, and that even
if a securities act diminishes the hazards in some respects, it cannot change their essential character. A realistic view would recognize the necessity for some governmentally fostered system for the safe investment of small savings; a broad market, subject to requirements for frank disclosure with penalties not unduly drastic attaching thereto, for what may be termed ‘business investments;’ and some medium, entirely divorced from the idea of investment, for the gratification of the seemingly ineradicable instinct for gambling.”