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Faculty Working Papers

IS ACCOUNTING REGULATION UNCONSTITUTIONAL?

Orace Johnson, Virginia Polytechnic Institute
and State University (on leave from the
University of Illinois)

Victor DeFeo, Graduate Student, Department of
Accountancy

#589

College of Commerce and Business Administration
University of Illinois at Urbana-Champaign

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July 1979

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Summary:

The issue of whether accounting should be regulated by government has heretofore not been debated in the context of free speech as guaranteed by the First Amendment to the Constitution. This oversight needs to be corrected in considering Constitutional limitations on the government's power to regulate commerce. This article poses the issue of trade-offs between these provisions of the Constitution in relation to accounting; traces the emergence of corporation rights under the Constitution; emphasizes the neglect of First Amendment arguments when the SEC was created; surveys relevant court cases and summarizes the prospect for First Amendment coverage of financial accounting.

IS ACCOUNTING REGULATION UNCONSTITUTIONAL?

"Congress shall have power to... regulate Commerce....."

--U.S. Constitution, Art. 1, Sec. 8.

"Congress shall make no law... abridging the freedom of speech...."

--U.S. Constitution, First Amendment.

The Accounting Establishment, a report by the U.S. Senate subcommittee on Reports, Accounting and Management, was published in January, 1977. Later that year, Benston asked (although not in a context of discussing the First Amendment), "Why is it a government function to standardize data or require that corporations produce standardized data?" [p. 46] Auditing firms reacted negatively to the report's 16 recommendations that would greatly extend the control by government over the accounting profession. In its newsletter to clients, one firm argued:

"Government should no more set accounting standards than they (sic) should specify the editorial standards of the New York Times." [Peat, Marwick, Mitchell & Co., p. 5]

If that analogy is accepted, then this further warning and appeal to the First Amendment should also be accepted:

"A private association acting in consort with government should no more regulate accounting standards than they should specify the form and content of news disclosures."

Justice William O. Douglas once wrote, "...regulatory measures... no matter how sophisticated, cannot be employed in purpose or in effect to stifle, penalize, or curb the exercise of First Amendment Rights."

[Communist Party v. Subversive Activities Control Board, 1961]

However, regulation of corporate financial accounting data statements and systems (hereafter FADS) is a fact of life in the United States, Government and private agencies share control of form, content, time, and circumstances of FADS. Regulators specify which accounting statements must or must not be made available to the public, what data those statements must or must not contain, what form those statements must or must not take, when they must be published, and what internal control systems must support the statements.

Debate over FADS regulations has been directed mainly to the details of particular standards and to the efficiency and effectiveness of government regulation compared to other means of achieving (someones "social") objectives. Arguments have posed horrors of "big business" against those of "big government," and allegations of "market failure" against those of "government inefficiency." Much of the debate has been over which organization, the Securities and Exchange Commission (SEC) or some non-governmental association such as the Financial Accounting Standards Board (FASB) should be the primary regulator. Implicit in all the discussions on regulating FADS has been the assumption that government and/or non-government organizations validly possess and validly exercise authority to control the flow of financial informatin ancillary to regulating commerce.¹

Government authority to regulate the acts and interactions of persons and associations is not absolute in the United States. It is limited by the Constitution which identifies certain acts as "inalienable rights"--that is, individual behavior outside the reach

of government regulators who may not enhance their power at the expense of certain individual freedoms. The scope of Constitutionally valid government power over the FADS is not clearly understood, and therefore it should not be presumed to exist absolutely. The assumption that either SEC or FASB validly regulate FADS may be false.

The purpose of this paper is to examine some aspects of the Constitutional legitimacy of government authority to regulate corporate FADS. The procedure is to analyze and interpret legal case decisions in which relevant issues were discussed.² Such an approach is warranted because court decisions establish the boundaries within which, under the Constitution, the government may act, and beyond which, under the Constitution, private rights prevail. To our knowledge the issue of regulating FADS has not previously been explored in the light of Constitutional limitations on government behavior that constrains or limits freedom under the First Amendment. This issue was explicitly raised first by Johnson [1979, pp. 13-14] as being more fundamental than either efficiency or equity arguments about FADS regulations.

The second section comments on certain relations between the Constitution and business corporations. The third section looks at the creation of the SEC. The fourth section surveys court cases involving First Amendment rights to freedom of speech. The fifth section examines corporate FADS in the light of the prior sections. The sixth section summarizes the need for resolving the First Amendment issue and takes a brief glimpse at the prospect for FADS being protected.

II. The Constitution and Corporations

The Constitution of the United States does not speak for itself even though its words have remained the same since 1787 (except as modified by 16 amendments beyond the original Bill of Rights). It is constantly subject to evolution by all three branches of the federal government. Through formal amendment and legislation by Congress, through judicial reinterpretation by the Courts, and through administrative decision by Executive agencies, many innovations not anticipated by the 39 signatory Founding Fathers have been Constitutionalized. Two such major innovations are giant regulatory government, and giant business corporations.

Giant regulatory government has come about through Court reinterpretation, moving from a Constitution of limitations on government power toward a Constitution of government power over persons and associations. Certain legislative acts of Congress have, in effect, been Constitutional changes far more significant than some of the formal amendments. For example, the Sherman Anti-trust Act (1890), various social and labor acts (around 1935), the Employment Act (1946) and the Civil Rights Act (1964) are each the grounds for a different kind of government than was created in 1787--even though Congress presumed to act each time under express grants of authority in the Constitution. The Supreme Court "approved" all these acts (except the Employment Act which has not been litigated) on grounds that the Constitution gives Congress power to regulate interstate commerce, and the power to tax and spend for the general welfare.

The Constitution was drafted with only two entities in mind: independent natural persons, and the government. [Hamilton and Madison, 1788; and Ostrom, 1971] The Constitution does not talk about voluntary associations such as political parties, professional and labor unions, philanthropic foundations, and business corporations. However, as Tocqueville observed "An association for political, commercial or manufacturing . . . science and literature . . . by defending its own rights against the encroachments of government, saves the common liberties of the country." [Vol. II, p. 342] The reality today of large associations having economic, political and social as well as legal dimensions has been so much recognized that one scholar asserts that the Preamble to the Constitution should read, "We, the groups . . ." [Miller, p. 114]

Though the inalienable right of a person freely to choose to join or not join an association is entirely different from the asserted power of association leaders to coerce behavior of members and non-members, it is often said that "the basic unit of society has become-- whatever it may have been in 1787--the pluralistic group." [Miller, p. 114] (For a counter argument, see Ostrom, 1971.) While the right of association is grounded in English common law, and "incorporated with the manners and customs of the people" [Tocqueville, Vol. I, p. 201] the Supreme Court did not read a right of association into the Constitution until 1958. [NAACP v. Alabama]

The corporation became an artificial "juristic" person in 1819 [Trustees of Dartmouth College v. Woodward] and a Constitutional person by unanimous Supreme Court fiat in 1886 [Santa Clara County v. Southern

Pacific Railway]. Though minority opinion challenge to "corporate personality" was unsuccessful in 1938 [Connecticut Life Insurance Co. v. Johnson] and again in 1941 [Wheeling Steel Corporation v. Glander], the Supreme Court has twice interpreted First Amendment rights of human persons as prior to rights of corporations to exclude persons from real estate [March v. Alabama, 1946; and Amalgamated Food Employees Union v. Logan Valley Plaza, 1968]. While Corporations have enjoyed Constitutional protection of property since 1889 [Minneapolis and St. Louis Railway v. Beckwith], they have never gained protection of "life" and "liberty" to the extent that human persons enjoy under the Constitution. (The full question of how far Corporations should be able to claim Constitutional protection is beyond the scope of this paper. For a review of some of those issues, including the interpretation that corporations are not citizens, see the dissenting opinion of Justice William O. Douglas and Hugo Black in Wheeling Steel Corp. v. Glander, 1949). In 1978 Corporations were given First Amendment protection against abridgement of "political" speech and publication [First National Bank of Boston v. Bellotti, 1978].

We acknowledge that in the past the Court has distinguished between "religious," "political," "commercial," and "cultural" speech. [Countryman, 1977, pp. 43-45]. But we also acknowledge that in a more fundamental analysis of First Amendment protection, such distinctions may have been made arbitrarily. [Leibeler, pp. 42-44]. Our primary concern here is for so-called "commercial" speech in relation to the regulation of FADS.

III. Creation of SEC

The Securities and Exchange Commission was created by Congress in The Securities Exchange Act of 1934. The Commission was formed to replace the Federal Trade Commission in administering the Securities Act of 1933, and to administer the Act of 1934. The scope of its authority to regulate FADS is extensive. The 1933 Act enables the Commission to regulate the public disclosure associated with the initial offering of securities for public sale. The 1934 Act broadened that authority to include the regulation of publicly available periodic reports of firms whose securities are traded on national securities exchange and, by virtue of the 1964 Amendments, traded on over-the-counter-markets. The Public Utilities Holding Companies act of 1935, the Investment Company Act of 1940, and the Investment Advisers Act of 1940 extended the Commission's regulatory scope. Finally, the Foreign Corrupt Practices Act of 1977 brought the internal information systems used by firms under the Commission's purview.

Though many of the States had enacted "blue sky" laws, imposing their regulations on securities markets operating within their jurisdiction, the 1934 Act was an early effort of the Roosevelt administration to bring securities markets under the direct control of the federal government. The "New Dealers" justified this legislative measure as an ethical imperative both (1) to impose a penalty on private business because of its alleged inability to adapt its practices to those of a changing economic system; and (2) to protect the public from a recurrence of the 1929 disaster, and private investors from "unscrupulous" speculators and investment dealers. Senator Sam Rayburn said:

The Fundamental fact behind this bill [H.R. 9323] is that the leaders of private business . . . have not since the war been able to protect themselves by compelling a continuous and orderly program of changes of methods and standards of doing business to match the degree to which the economic system has been constantly changing The repetition in the summer of 1933 of the abuses of 1929 has convinced a patient public that enlightened self-interest in private leadership is not sufficiently powerful to effect the necessary changes alone--that private leadership seeking to make changes must be given government help and protection. [Congressional Record, p. 7702, emphasis added].

The Securities Exchange Act of 1934 was designed to regulate the activities of the national securities exchange. Its purpose was to establish the basic rules governing trading. FADS were among those items which it sought to regulate. Senator Rayburn said:

No investor, no speculator can safely buy and sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built upon the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price. Just as artificial manipulation tends to upset the true function of an open market, so the hiding and secreting of important information obstruct the operations of markets as indices of real value. There cannot be honest markets without honest publicity. [Congressional Record, p. 7704, emphasis added].

Congress sought to provide for "honest publicity" in securities markets through SEC authority to determine what FADS must be and/or may not be made publicly available. Honesty was to be achieved by making the disclosure or non-disclosure of certain FADS compulsory. By its act, Congress in effect deemed that some FADS should become state or common property rather than private property. [Refer to

Section 13(a)(1) in conjunction with Section 12(b)(1)(K) of the 1934 Act].

The 1934 Act was specifically designed to regulate FADS. It can be viewed as interfering with the free flow of a particular class of data on the ground that "a business that gathers its capital from the investing public has not the same rights to secrecy as a small privately owned business" [Rayburn, Congressional Record, p. 7705]. Its effect was to convey to an agency of the government, "in the public interest," the power to determine what may or may not be reported in the published, publicly available, financial accounting statements of those firms whose securities are nationally traded. It required that the SEC act "in the public interest." Rayburn said:

We want to lodge authority, power, and direction somewhere in some agency of the government as representing the people of the country, with the rights to approve or disapprove the rules and regulations of the exchanges, and with the power and authority to enforce the rules and regulations if in the public interest it is found necessary. [Congressional Record, p. 7696, emphasis added.]

But, the Act did not define either "public interest" or "necessary." It did not provide the SEC with any standards to guide its attempts to identify that interest. In effect, the appointed Commissioners were left free to decide what is and is not "in public interest," subject to an ambiguous "over-sight" by Congress.

The Securities and Exchange Act of 1934 met with significant opposition both in the public hearings, conducted by the Senate Banking and Currency committee, and in the House and Senate debates which preceded its enactment. Opponents based their criticisms on

the potential effects of the measure on small business and on small businessmen. [Congressional Record, pp. 7710-11] It was pointed out that the national exchanges--the New York Stock Exchange, in particular--had already established disclosure requirements exceeding those provided for by the Act. [Congressional Record, p. 7698] Concern was expressed with regard to the broad powers being granted to the SEC without the provision of standards to control their use. [Congressional Record, pp. 8272-8275].

The Constitutionality of the Act was questioned only in respect to the Tenth Amendment which states, "The Powers not delegated to the United States by the Constitution nor prohibited by it to the States are reserved to the States respectively and to the people." On behalf of the New York Stock Exchange, Thomas B. Gay argued both in his testimony and in a brief presented to the Senate Banking and Currency Committee [Hearings, Part 15, pp. 6586-6600 and 6647-56] that securities transactions were activities conducted within the jurisdiction of the powers of the States because corporations receive their charters from the states. He argued further that securities transactions were classified improperly as elements of interstate commerce. Therefore, he reasoned, securities transactions could not be regulated Constitutionally by the Federal government.

House and Senate discussions of the Act did not include consideration of First Amendment Rights. The House accepted without objection the assertion, made by Congressman Lea of California, that "When these market exchanges are open for the investors of the Nation, the Government has the right to expect that corporations whose stocks are listed

there and offered to the public will give truthful information and make a full revelation of the fact . . . " [Congressional Record, p. 8762] No one pointed out that the government's authority is limited and that a government's alleged "right to expect" does not necessarily imply a Constitutional right of government to prior restraint. In fact, under the common law the right to know is not recognized except in cases of fraud. [Posner, 1978, pp. 22 and 24-25] All 50 states have laws against fraud and deceptive speech. "Untruthful speech, commercial or otherwise, has never been protected for its own sake." [Virginia State Board of Pharmacy V. Citizens Consumer Council, p. 771]

In the "crisis" psychology surrounding the SEC's origin [see Mackey and Reid, pp. 10-12 and 17-19], no attempt was made during the Senate hearings or in the discussion held by the House and the Senate to determine whether FADS might be regarded as a proper constituent of the market for ideas by virtue of the information provided. Reference was almost exclusively to:

". . . a national public interest which makes it necessary to . . . require appropriate reports . . . in order to protect interstate commerce, the national credit, the Federal taxing power, to protect and make more effective the national banking system and the Federal Reserve System, and to insure the maintenance of fair and honest markets in such [securities] transactions." Security Exchange Act of 1934, section 2; [Congressional Record, p. 881]

Perhaps because everyone accepted the (arbitrary) exclusion of "commercial" speech from First Amendment protection, no one dreamed in those "crisis" times of raising the issue of whether FADS are protected. There was no reference at all to:

". . . a national public interest which makes it necessary to protect and defend the First Amendment of the United States Constitution."

Recent decisions by the U.S. Supreme Court suggest that oversight should be corrected.

IV. The First Amendment and Commercial Speech

The First Amendment to the Constitution guarantees freedom of speech and of the press. It clearly prohibits the government from interfering with or regulating the market for ideas. At least six general motivations for seeking freedom of speech have been identified. [Owen, 1975, p. 6] They are:

- (1) a simple reaction to the oppression of government control;
- (2) a means of guaranteeing that truth will emerge from diversity, with an opportunity for the adherents of alternatives to prove in practice the validity of their own ideas;
- (3) a safety valve for dissenting groups;
- (4) a check on the power of government;
- (5) a means of producing an informed and alert citizenry;
- (6) a valuable end in itself.

We believe all six reasons are relevant to the issues of SEC regulating FADS.

The status of commercial speech relative to the First Amendment protection from government restraint "abridging the freedom of speech" has been changing. Recent court decisions "do not define the outer bounds of the applicability of the First Amendment to advertising but merely mark a stage in a gradual expansion of the kinds of commercial speech which will be brought within the protection of the First Amendment by the courts." [Coase, pp. 31-2]

Less than 40 years ago, on ground that all commercial speech fell outside First Amendment protection, the Supreme Court dismissed claims that local ordinances prohibiting (1) the distribution of advertising handbills [Vallentine v. Christensen, 1942] and (2) door-to-door solicitation of magazine subscriptions [Breard v. Alexandria, 1951] were unconstitutional. However, the rationale for and the scope of those

decisions were not made clear. Apparently speech which "did no more than propose a commercial transaction" was thought to be less deserving of protection than speech of a political, religious, or cultural nature. But the Supreme Court did not specify what criteria (e.g., speaker, circumstance, time, form, content) were to be used to identify commercial speech.

Since then, books [Bantam Books v. Sullivan, 1963] and motion pictures [Freedman v. Maryland, 1965] produced to make money were not disqualified from First Amendment protection. The form of communication was considered not to be an appropriate basis for discrimination. [New York Times v. Sullivan, 1964]

In 1973, in response to a newspaper's contention that the distinction between commercial and other speech should be eliminated, the Supreme Court said: "Any First Amendment interest which might be served by advertising an ordinary commercial proposal and which might arguably outweigh the governmental interest supporting the regulation [of discrimination in employment] is altogether absent when the commercial activity itself is illegal and the restriction on advertising is incidental to a valid limitation on economic activity." [Pittsburgh Press Co. v. Pittsburgh Committee on Human Relations, 1973, emphasis added.] But at least one scholar reads the First Amendment as protecting even "speech which aids illegal conduct." [Countryman, p. 41.]

In 1975 the Supreme Court appeared to suggest that a balancing of interests might be appropriate in commercial speech cases, with advertising enjoying a degree of First Amendment protection. [Bigelow v. Virginia, 1975] However, the Court did not need to decide in that

case either (1) the extent to which the First Amendment permits advertising related to activities the State may regulate or prohibit, or (2) the extent to which constitutional protection is afforded commercial speech under all circumstances and all kinds of regulation.

In 1976, the Supreme Court held explicitly that a purely commercial advertisement was entitled to some First Amendment protection because an advertiser's purely economic interest was not adequate grounds for disqualifying him. [Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, 1976] The Court rested its decision on "the consumer's interest in the free flow of commercial information [which] may be as keen, if not keener by far, than his interest in the day's most urgent political debate." It went on to state:

"Advertising, however tasteless and excessive it sometimes may seem, is nonetheless dissemination of information as to who is producing and selling what, for what reason, and at what price. So long as we preserve a predominantly free enterprise economy, the allocation of our resources in large measure will be made through numerous private economic decisions. It is in the public interest that those decisions, in the aggregate, be intelligent and well informed. To this end the free flow of commercial information is indispensable." [Virginia State Board of Pharmacy, 1976, p. 1827]

The Court thus argued that the fundamental reason for freedom of speech is the people's right to know, and that the First Amendment assures freedom to the reader and listener as well as writer and speaker. The Court indicated that a balanced regulation of some forms of commercial speech was legitimate, for example: prohibition of false or misleading statements, advertisements of illegal transactions, and restrictions on the time, place and manner of communications.

In 1977 the Supreme Court seemed to suggest that the propriety of restrictions must be judged by taking into account available communication alternatives. An ordinance prohibiting the posting of "For Sale" signs in front of houses could not be regarded simply as a restriction on time, place or manner of advertising, since other channels of communication were less effective or more costly, and therefore not adequate alternatives. [Linmark Associates v. Township of Willingboro, 1977]

Later in 1977 the Supreme Court stated that it would be "peculiar" to deny the consumer, on the ground that information is incomplete, at least some of the information that is relevant to reach an informed decision. Such an "argument assumes the public is not sophisticated enough to realize the limitations of advertising, and that the public is better kept in ignorance than trusted with correct but incomplete information. We suspect that the argument rests on an underestimate of the public." [Bates v. State Bar, 1977] The Court also restated its position on the kinds of commercial speech regulation that would be permissible. Because advertisements are planned in advance, requirements for truthfulness would not be inappropriate in advertising complicated services.

"For example, advertising claims as to the quality of service . . . are not susceptible to measurement or verification; accordingly such claims may be so likely to mislead as to warrant restriction . . . We do not foreclose the possibility that some...warning or disclaimer or the like, might be required...to assure that the consumer is not misled." [Bates v. State Bar, 1977, p. 2709]

But "the determination by a government agency that a statement is false is completely alien to the doctrine of free speech and of freedom of the press." [Coase, p. 27] It seems likely that the law will be interpreted to allow . . . somewhat diminished powers for the various government agencies which regulate advertising." [Coase, p. 33] (For a less sanguine view of Court action in three cases since *Bates v. State Bar of Arizona*, see Liebler [1979] and Berns [1979].)

If corporate FAD reports to the public are seen to be commercial speech advertising the firm managers and firm products (including various risk/return equity claims); and if the SEC is interpreted to be a government agency regulating commercial speech, then the issue of First Amendment protection to the speaker and writer does become relevant to the relations between corporate managers and public auditors; and also between them and the government.

V. Commercial Speech and the SEC

An important type of property today is intangibles, made up largely of promises: contract performance rights, government benefits, and corporate stockholdings. Investors surely list their shares among their assets. We reason that FADS constitute a complex advertisement³ by the corporation of at least four components: corporate equities for investors, corporate goods for customers, corporate success for creditors and employees, and corporate management for managers. Although this view is unorthodox, it does have support.

In the literature of accounting, economics and finance, securities are regarded as products combining elements of risk and return, conditional claims to future consumption. Various forms of stocks, bonds, and debt contracts provide the opportunity for (expected) satisfaction contingent upon future states and actions. In these respects, securities are similar to many consumer durables. Furthermore, like tangible assets, securities are bought and sold in markets. Thus FADS may be interpreted as advertisements relating to the risk, return, and other financial characteristics of interest to both current and future customers for corporate equities.

We also reason that FADS are representations by managers to interested parties concerning the nature and quality of their performance in conducting business operations. If management services are commercial services provided by one association (corporate officials) to another (the investors) at a price established in an economic market [Alchian and Demsetz, p.], then FADS are attempts to influence the market price of those services; and therefore, FADS are advertising.

If either of these arguments is accepted as valid, then a necessary implication is that First Amendment protections available to commercial speech for limiting the power of government to regulate speech are available for corporate FADS. Thus the assumption that government may validly mandate prior restraint and public disclosure may be false, and SEC regulation of FADS may be unconstitutional.

Recent Supreme Court decisions about commercial speech have reversed the traditional assumption, and, through legal reasoning by analogy, are placing the burden of the SEC to justify its restrictions on communication. That justification cannot be based on a presumption that the investor lacks the sophistication to interpret those statements or to make appropriate use of the incomplete information they contain. It would be difficult Constitutionally to uphold any restriction which deprived investors of information enabling them to compare security alternatives. [Virginia Pharmacy, 1976; and Bates, 1977]

Though there are significant Constitutional barriers to SEC restrictions on corporate FADS, the First Amendment ~~may~~ not totally preclude the possibility that SEC might legitimately require FADS to contain or exclude certain classes of information. False or misleading statements may be subject to regulation [Virginia Pharmacy, 1976; and Bates, 1977.] But the burden of the proof under the First Amendment should still rest on the SEC to show that a particular speech or publication contained information that was in fact false or misleading. The SEC may regulate the time, place or manner of FAD communication. For that regulation to accord with the First Amendment, the SEC must be able to show that adequate alternatives are available

which are relatively equivalent in cost and efficiency. [Linmark Associates v. Township of Willingboro, 1977]

But if "adequate alternatives" are indeed available, then--
Catch 22!--why the necessity to regulate FADS?

VI. Summary and Prospect

Conflict between parties claiming different Constitutional prerogatives are unavoidable. Some speech may unjustly impair other valued behavior, and tradeoffs are inevitable. Though the First Amendment does not permit prior restraints, it does not protect statements of slander, libel, fraud, obscenity, copyright infringement, loud disturbance, invasion of privacy, and danger to national security. [See Berns, pp. 3-4; and court cases such as: Gertz v. Welch, 1974; Ginsberg v. New York, 1968; Miller v. California, 1973; Saia v. New York, 1948; Kovacs v. Cooper, 1949; Smith v. Dravo Corp., 1953; and Greer v. Spock, 1976.]

"The question in every case is whether the words are used in such circumstances and are of such a nature as to create a clear and present danger that they will bring about the substantive evils that Congress has a right to prevent." [Schenck v. United States, 1919, pp. 51-52, emphasis added] First Amendment considerations become particularly crucial in deciding whether the empirical evidence that "market failure" and "externalities" due to accounting speech not otherwise proscribed warrents blanket restrictions on FADS.

Cost/benefit balancing will be attempted by the Court whether piecemeal or, hopefully, with some underlying theory for consistency. Moore [1969] made a start toward such a theory with his economic analysis of the concept of freedom and applied it to each item in the Bill of Rights. While not citing Moore, Liebler [1979, pp. 20-44] presented an economic theory of free speech. Regardless of how much

weight the Court will explicitly give to economic arguments, the fundamental Constitutional question is this:

Shall the United States Government, with its authority to regulate commerce, use its power to impose decisions made by expanding bureaucracies; or, with its duty to protect free speech, use its power to prevent restrictions of the free flow of ideas by either government agency or private association?

In its past decisions, the Court has demonstrated a consistent willingness to strike down as unlawful abridgment of the First Amendment any regulatory measures which constitute "prior administrative restraints" on free speech. "Above all else, the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content... The essence of the forbidden censorship is content control." [Police Department of Chicago v. Mosley, 1972, pp. 95-96] In light of the Court assertion that the government "thus carries a heavy burden of showing justification for the enforcement of such a restraint," [Organization for a Better Austin v. Keefe, 1971] the SEC should be required to show that the prior restraint on FADS represented by its censorship regulations is a warranted limitation on commercial speech because of the greater benefit actually provided or greater harm actually avoided when compared to the expectation of what otherwise would have occurred. Mandated uniformity, by damming the free flow of information, not only does not assure clean flow, but also may make the overflow muddier than ever.

We do need the Supreme Court to decide (1) the extent to which the First Amendment permits advertising in relation to regulated or prohibited activities and thereby permits corporate management freely to

choose among FADS; and (2) the extent to which the First Amendment protects commercial speech under all circumstances and all kinds of regulation. But the courts do not act on their own initiative. Under the Constitution, protection must be applied for through action after the fact of alleged injury, past or prospective.

We might be able to expect some amelioration without litigation if the SEC Commissioners and Staff were to become convinced that prior restraint of FADS is unconstitutional. Among the past actions of the SEC that seem to constitute prior restraint in violation of First Amendment protection are the following: cash flows, current values, forecasts, sinking fund depreciation, direct cost of inventories, estimated quantities of natural resource reserves, pro forma statements with estimates of savings from mergers, and all non-GAAP accounting.

Even if all hints of prior restraint were eliminated so that corporations could disclose as they wish any data in addition to mandated uniform reports, regulators would still be in the business of making and selling regulations--spending public funds in the "public interest." In the aftermath of the Virginia Pharmacy, Bates, and Bellotti cases, litigation is still probably necessary and desirable to control the overreaching of the regulators who can be expected systematically to underestimate the total costs and exaggerate the benefits of their actions.

We are still in need of a corporation willing to finance an expensive case to test whether FADS, as commercial speech, have First Amendment protection.

Footnotes

¹ Elliott and Schuetze [1979] posed in a negative way one kind of objection to that prevalent assumption. In a priority of five pre-requisites for adopting federal regulation, they listed last the issue of whether the "regulatory remedy is in violation of laws of constitutional rights" [pp. 10-13]. In their presentation, four other criteria were more important: the extent of social damage, the frequency of undesirable behavior, the existence of alternative private sector remedy, and the effectiveness of the governmental regulatory solution. In Table 2 [p. 11] they presented 12 "pre-regulatory situations" to illustrate the sequential application of their priorities. They identified only one situation, "companies use non-uniform financial reporting standards," for which the regulatory remedy (SEC control) is in violation of laws or constitutional rights and for which, they say, a private remedy (FASB) is available [pp. 12-13].

They did not address in a positive way the Constitutional issue raised in this paper, which is the question whether non-uniform accounting is protected as commercial speech under the First Amendment. More importantly, they did not discuss the probability that if FADS are protected, then prior restraint is unconstitutional whether attempted by the SEC, the FASB, the AICPA, or state agencies.

² Our research efforts to identify those Supreme Court decisions relevant to the issues we wished to consider were facilitated by our access to the LEXIS system. LEXIS, a computer based, key work search, visual display system enabled us to scan the large volume of Court

decisions and to identify, quickly, those that were of particular interest.

The following is one example of sequential search actually conducted using LEXIS:

<u>Sequential Level</u>	<u>Key Words</u>	<u>Number of Cases</u>
1	Securities Exchange Act OR Securities and Exchange Commission	461
2	. . . AND First Amendment OR Fourth Amendment	23
3	. . . BUT NOT Fourth Amendment	19

Since LEXIS contains a full text of all the decisions, it provides immediate access to all or any of the bases identified at each level of key work screening. Our total search, and cases actually used in our study, went beyond LEXIS to include both (1) recent decisions that have not been placed in the system, and (2) cases prior to 1938, the earliest date for cases in LEXIS.

³ For one example see the special edition of Gulf & Western's 1978 Annual Report that was published as a 64-page advertising section (43%) of Time magazine, February 5, 1979, (150 pages total). The financial statements in the labeled advertisement were audited by Ernst & Ernst.

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