October 7, 2005

Jonathan G. Katz
Committee Management Officer
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

Re: File No. 265-23

Dear Mr. Katz:

Enclosed are excerpts from the book, The Aggressive Conservative Investor by Martin Whitman and Martin Shubik. These excerpts can be posted on the website of the Securities and Exchange Commission Advisory Committee on Smaller Public Companies. The book is scheduled for release on October 21st and is an update of the original volume published in 1979.

The excerpts attached hereto cover two topics:

1. Disclosure
2. Sarbanes Oxley

Sincerely yours,

Martin J. Whitman

Enc.
MJW/aem

The Disclosure Explosion

The improvements in disclosure since 1979 have been dramatic and far reaching. This has happened in two areas – substantive disclosures and improved delivery systems. As a consequence, there is a vast improvement in the amount and quality of disclosures, especially documentary disclosures, available to those using the safe and cheap approach. <u>The Aggressive Conservative Investor</u> seems to have understated the degree of knowledge one can obtain about a company and the securities it issues by relying solely on the public record. The book, however accurate for the disclosure environment in 1979, inadequately describes the quantity and quality of disclosures available in 2005.

The role of disclosure ought to be to provide outside investors the same level of disclosure that is provided to an investor with clout (e.g., commercial bank lenders) who are able to undertake “due diligence.” The Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) seem to have done a pretty good job on this from the point of view of the safe and cheap investor.

For the vast majority of issuers – excluding Enron and Worldcom – disclosure documents seem to be prepared on the basis that companies, their officers, and their directors do not want to be sued, and especially not sued successfully. Thus, there is a tendency in public documents to disclose all admissions against interest, however remote. Such “laundry lists” give safe and cheap investors an “unweighted for probabilities” inventory of what could conceivably go wrong. Almost the first question any safe and cheap investor asks is what could go wrong. Having a carefully prepared “laundry list” of risk factors helps answer that question. This “laundry list” of risk factors is contained for U.S. issuers in Form 10-K, Form 10-Q, Form 8-K, prospectuses for the cash sale of securities, merger proxy statements, exchange of securities documents, and cash tender offers. They are also contained in the footnotes to financial statements which comply with GAAP.

Chief Executive Officer letters and other communications to Stockholders seem to have become more comprehensive, more complete, and, in many ways, more honest in terms of what management thinks about long term promises and problems. Admittedly, most management communications do seem to focus on the immediate earnings outlook, something not of much interest to the safe and cheap investor. Nonetheless, communication seems to have vastly improved since 1979. Top management communications are contained in Annual Reports to Stockholders, Quarterly Reports to Stockholders, Teleconferences, Investor Conferences, and one on one meetings.

Principal new disclosures since 1979 that have been a boon to safe and cheap investors both as put forward by the SEC and FASB include the following:

- Integrated disclosure between the Securities Act of 1933 and the Securities and Exchange Act of 1934.

- Disclosure of earnings forecasts under rules which provide forecasters a “safe harbor” from liabilities for forecasts, which while honestly made, turn out to be wrong.

- Expanded Proxy Statement disclosures that include i) Existence and functions of various committees; ii) Attendance record of directors and committee members; iii) Expanded transactions detailing relationships between the company and its insiders; iv) Resignations of Directors/and Top Officers.

- Environmental disclosures.

- Reserve Recognition Accounting (“RRA”) for exploration and production oil and gas issuers.

- Management Discussion and Analysis of Financial Condition and Results of Operations (“MDA”) implemented and eventually expanded. This is a quarterly filing.

- Expedited use of form 20-F for Foreign Issuers (Equivalent of a Form 10-K for a U.S. domiciled issuer).

- Summary Sections in Prospectuses and Merger Proxy Statements.

- Shelf Registrations.

- Disclosure of Rating Agency Ratings.

- New real estate guidelines.

- Edgar and other electronic communications – a virtual revolution in delivery systems benefiting mightily safe and cheap investors. In 1979, obtaining documents filed with the SEC but not mailed to securities holders, (Forms 10K, 10Q, 8K) tended to be cumbersome and/or relatively expensive.

- Electric and Gas Utility Guide.

- Financial Reporting Requirements for Banks and Bank Holding Companies.

- Consolidating Financial Statements distinguishing between guarantor subsidiaries and non-guarantor subsidiaries.
- Increased disclosure of management backgrounds.
- Sales and Income by Industries Sector disclosures.
- Sales and Income by Geography disclosures.
- Basis for accounting estimates disclosures.
- Cash flow reporting.
- Expanded Form 8-K Reporting.
- Reporting Comprehensive Income.
- Disclosure of Information about Capital Structure.
- Accounting for Income Taxes.
- Accounting for Leases.

Increasingly there has been disclosure of "non GAAP financial measures" regulated by the SEC under Regulation G. Non GAAP financial measures include periodic cash flow data and various appraisal values. Hopefully, disclosures of non GAAP financial measures, used as a supplement to GAAP, rather than as a substitute for GAAP, will continue to grow. In any event, what has been done so far in disclosing non GAAP financial measures has been a boon for safe and cheap investors.

Some new regulations are not particularly relevant for safe and cheap investors. In "safe and cheap" little or no use is made of esoteric derivatives. The safe and cheap investor cares little about the timing of disclosures. Regulation FD is designed to assure that material information is distributed to all of the "Street" simultaneously. A characteristic of safe and cheap is that such investors are usually "the last to know." The secret to success in safe and cheap investing is not to obtain superior (or earlier) information, but rather to use the available information in a superior manner.

Generally Accepted Accounting Principles, i.e., GAAP, are most useful when the following conditions exist:

- Financial statements should be directed, first and foremost, to meeting the needs of long term creditors, not stock market speculators.

- The company is a stand-alone, separate and apart from its shareholders and its management.

- The accounting statements are governed by the modifying convention of conservatism.

- Principles are more important than rules. Principles are things like the modifying convention of conservatism. Rules are things like FASB 133, Accounting for Derivative Instruments and Hedging Activities

- GAAP Financial statements are useful because they give the trained user the only objective benchmarks he or she are likely to have, not truth. An approximation of truth might sometimes be contained in non GAAP financial measures, a supplement to, not a substitute for, GAAP.

- GAAP Financial statements are most useful when they are consistent and reconcilable.

In the United States there are various types of accounting systems promulgated for the purpose of meeting the needs of specific constituencies. In the insurance industry, Statutory Accounting is directed toward policy holder protection; in regulatory accounting for broker/dealers, the goal is to meet the needs of customers for financial protection; and in income tax accounting, the goal is to determine what a taxpayer's tax bill ought to be.

It is a fool's errand to think that GAAP ought to be designed to meet the perceived needs of stock market speculators. A stock market speculator is defined as anyone, or any institution, who believes, for whatever reason, that their income and fortunes are vitally affected by day to day securities price fluctuations. The exception to this definition is the risk arbitrageur. A risk arbitrageur is someone who invests based on the probabilities that there will occur a relatively determinate workout event in a relatively determinate period of time. A good example of a risk arbitrage situation is where there has been a public announcement of a merger between two companies. Risk arbitrage does not exist where one invests in the common stock of a going concern with perpetual life where the investment is based on a view that near term earnings per share will increase. GAAP can't protect short run stock market speculators effectively simply because GAAP can't tell them the truth. Rather the goal of GAAP ought to be to meet the needs of long term creditors who look to get to get their obligations from the company repaid with interest either from the internal resources of the company itself or from the company remaining credit worthy enough to refinance. To achieve this, long term creditors rely on getting a lot more information from GAAP than just periodic Earnings Per Share as reported.

As a matter of law, stock market speculators do, of course, deserve disclosure protection, the same as all OPMIs involved in the financial community. To protect them, however, it makes much more sense to us to have them rely on non GAAP financial measures. These non GAAP financial measures do not need the objectivity and relatively strict rules and principles of GAAP. Rather, non GAAP financial measures can make use of, say, subjective management judgments whose scope would be limited to statements which would be given a "safe harbor" under an expanded Regulation G. The Current Value Accounting of the early 1980s is one example of a productive use of non GAAP financial measures.

All GAAP figures are important in a safe and cheap analysis. There is no Primacy of the Income Account. Primacy of the Income Account means that corporate wealth is created only by flows, i.e., having positive earnings, and/or cash flows for a period. In addition, we believe that corporate wealth is also created by resource conversion activities (e.g., mergers and acquisitions) as well as access to capital markets on a super attractive basis. While Income Statement and Balance Sheets are integrally related in safe and cheap investing, there usually is no basis for assuming that Income Account Data are more important than Balance Sheet Data.

We learned a great lesson from the "Current Value Accounting Supplements" of the early 1980s. Here inflation accounting was supposed to help the analyst appreciate that because of inflation many corporate depreciation charges were woefully insufficient to provide a reserve for replacing aging and obsolescing equipment. The Current Value Supplement, however, could in no way account for the benefits to a company because inflation might make it prohibitively expensive for new entrants to come into the industry to compete with the company which had very modest "sunk" costs. Deciding what the net effect of rampant inflation might be on a company is a decision best left to a trained analyst, not a preparer of GAAP financial statements, albeit the non GAAP disclosure of "Current Value" was helpful to the safe and cheap analyst trying to make investment judgments.

Disclosure and GAAP

GAAP provide objective benchmarks, not truth, except in several special cases. For example, see Toyota Industries ("Industries"). Over half of Industries assets at market prices are in a portfolio of marketable securities, principally Toyota Motor Common. For GAAP purposes, Industries reports only dividends and interest received from portfolio companies since in no instance does Industries own as much as 20% of the common stock of a portfolio company, and in no instance does Industries exercise control over a portfolio company. On a GAAP basis, Industries Common is selling at around 22 times earnings as of mid 2005. If Industries income account is adjusted to include Industries' equity in the undistributed earnings of portfolio companies (a non GAAP financial measure), Industries Common is selling at less than 8 times earnings. GAAP for Industries is a good first approximation of periodic cash flow. Picking up the equity in undistributed earnings of portfolio companies is a good first approximation of the periodic wealth creation being created for Industries and its common stock. What actual cash flows were and what actual wealth creation took place in a period is something for the safe and cheap analyst to decide, using the objective data provided in financial statements as a starting point for the analysis.

Every GAAP number is derived from, modified by, and a function of, other GAAP numbers.

Troublesome Regulatory Problems

In 1979, we wrote in The Aggressive Conservative Investor, p.15 "This book suggests that the role of Generally Accepted Accounting Principles (or GAAP) in disclosure should be limited to giving security holders objective bench marks, and that it is silly to attempt to equate accounting with Truth or Value." We also suggested that there was no need to make GAAP as complex as the Internal Revenue Code.

Boy did we lose that battle and that war, and while one would like to rail against the system, it is hard to gripe in the sense that disclosures are now so good that safe and cheap investors can operate more comfortably than ever before.

In the area of disclosure, it is our view that the best investor protection is to give investors the facts – all the facts with a conservative bias – and then let the investor decide what is truth and what weight to give specific facts. GAAP can provide no more than objective benchmarks. This is going back to old days. It is impossible to spoon feed investors items which purport to be truth and accuracy. In the end, the investor has to decide for himself what is truth and accuracy.

It is our view that Sarbanes-Oxley (SOX) is grossly counter-productive. SOX regulates as if all issuers were Enron and Worldcom. This is not realistic. SOX is inordinately expensive. Some believe that it costs most companies anywhere from $2 million per annum to $7 million per annum just to comply with Section 404 in 2005. Section 404 deals with internal controls or managerial accounting. We have been relatively successful investors sticking to our style for over 50 years relying for our accounting information only on GAAP and, of late, various non GAAP financial measures. Before 404, managerial accounting was never on our radar screen and if it were we doubt it would have prevented the one or two accounting frauds in which we were victimized – out of the thousands of investments we have made.

SOX detracts from the appeal of U.S. capital markets for foreign issuers. SOX is also encouraging a multitude of mostly strongly financed smaller companies to either go private or go dark. Both seem sad and unnecessary losses for equity markets in particular. We have and do support many aspects of regulation but not at the cost of a total lack of common sense and a political inability to make basic economic distinctions at a great cost to the productivity of our system.