PUBLIC RELATIONS COUNSEL AND THE FEDERAL SECURITIES LAWS

Address of

Edward N. Gadsby
Chairman
Securities and Exchange Commission
Washington, D. C.

New York Chapter of the American Public
Relations Association
New York, New York
April 8, 1958

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It is an honor and a privilege to talk with the members of the Greater New York Chapter of the American Public Relations Association today. As I told your Program Committee, I assigned as the topic of this discussion the question of "Public Relations Counsel and the Federal Securities Laws." I was not too sure of what was covered by the term "Public Relations Counsel" and I asked one of my educated assistants to do a little research into the matter. He came up with a number of suggestions, all of which indicated that your organization and our Commission have some problems in common that would bear discussion between us.

As you may or may not know, the Securities and Exchange Commission was established to administer certain statutes passed by Congress as the result of several Congressional and other investigations of the stock market in the late 1920's and early 1930's. The first of these Acts is the so-called Truth-in-Securities Act, professionally described as the Securities Act of 1933. One of the fundamental purposes of this legislation, as indicated by its popular title, is to make sure that investors are furnished with true and complete information concerning the corporations which seek to tap the savings of the American people. Right here we find an interesting sidelight on our mutual relations which I trust is not truly descriptive of the functions of the Public Relations Counsel of today, assuming that the term "press agent" is to a degree descriptive of your work. My learned assistant found in the files of the Congressional Library that some years ago, one individual described the activities of his group with a refreshing candor. He said "Ordinarily, the business of a press agent is not the decimation of the truth, but the avoidance of its inopportune discovery."

The second Act of this series under which we operate, and probably the last in which you and I have any mutual problems, is the Securities Exchange Act of 1934. This legislation in general

extended the scope of Federal regulation to the stock exchanges and to brokers and dealers in securities. The particular area in which we have mutual interests under this Act involves the jurisdiction of the Commission over proxy contests, since we are required to supervise and review the proxy solicitation material circulated among holders of securities which are listed on a national stock exchange.

The Securities Act of 1933 is based upon the postulate that the stockholders and, for that matter, the general public are entitled to know all of the material facts regarding a publicly-held corporation which might influence their judgment as to the value of the securities of the company. This is all a part of a broader concept that directors and officers of corporations are, after all, only fiduciaries as respects a stockholder and employees as respects a corporation, that the stockholders own the corporation, and, consequently, that the beneficiaries of their trust and the owners of the property which they are managing are entitled to an accurate and complete accounting with respect to the company's affairs. In accordance with this approach, and as a result of some rather bitter criticism which has from time to time been directed against corporations in this country, I understand that it is fairly common practice for a company to retain such skilled professional help as is represented by you gentlemen who are here today.

Let me make clear to you, however, that under the Securities Act, the Securities and Exchange Commission does not supervise or have any interest in the affairs of any corporation except insofar as they are associated with or involved in the issuance or sale of securities to the public. Nor do we have any power to pass on the merits of any securities issue, or to control its price or to control the corporate morals in any respect except as regards corporate securities. Unless the corporation or a controlling person or someone in its behalf is issuing or about to issue its securities to the public, ordinarily you need pay no particular attention to our Commission under the Securities Act.

However, once your corporate client decides that it must go to the public for financing, then the broad scope of your otherwise perfectly legitimate and praiseworthy activities in publicizing its affairs must be reviewed in the context of the provisions of the Securities Act. This is true because of the nature of the mechanics by means of which the Congress has directed the Commission to supervise these securities issues. Section 5 of the Securities Act, when read with other Sections of the Act, forbids a corporation to offer to sell its securities before it has filed a so-called registration statement including a form of prospectus with the Securities and Exchange Commission. Once it has filed such a registration statement and until some later date when that registration statement becomes effective, the corporation, or its underwriters, may offer to sell but may not actually sell such securities by means of certain specifically defined material consisting of the prospectus either in preliminary form or in condensed form. After the registration statement is effective, which may be anywhere from twenty days to an indefinite period after filing, firm offers to purchase and binding sales of such securities may be made for the first time. However, for forty days after the effective date or until the underwriters have cleared their shelves of the securities, the purchaser must be furnished with a copy of the prospectus, although other material may accompany it. At the end of that time, things go back to normal and you need pay little attention to us.

The catch in this situation, so far as you are concerned, lies in the question of what is an offer to sell or, to put it another and broader way, what activity of the corporation constitutes a part of the selling effort. Any release by the corporation's Public Relations Counsel which might be considered to fall within the definition of these terms might seriously and adversely affect the corporation's financing plans.

There have been a number of such incidents which have resulted in embarrassment both to the issuing corporation and its underwriter and to those responsible for releasing the information. As with many generalities which look perfectly simple in theory, the practical analysis of various situations involves very great

difficulties. Nevertheless, a study of the Commission's activities over the years reveals certain ground rules which, if followed, will probably avoid any question being raised.

A corporation cannot, as I have said, begin to offer a security to the public prior to the filing of a registration statement nor can its officials or employees engage in a publicity campaign prior to the filing which is part of an effort or plan having for its purpose the sale to the public of a non-exempt security. This does not mean, of course, that a corporation which is planning to bring an issue to market must dismiss its Public Relations Counsel, close its advertising department and gag its officials and employees. Most certainly an issuer may continue the normal conduct of its business and may communicate with its security holders and customers prior to the filing of a registration statement or during the so-called "waiting period." Thus, it may continue to publish advertisements of its products and services without interruption. It may send out its quarterly, annual and other periodic reports to its security holders. It may publish its proxy statements, send out its dividend notices and make routine announcements to the press and to employees without objection from the Commission. Normally, we do not regard these activities as any of our business nor do we wish to be concerned with them. However, when, shortly before the filing of a registration statement or during the pre-effective period, public communications of various sorts begin to appear which discuss such aspects of a business as its finances, its earnings or its growth prospects in glowing and optimistic terms, stressing the favorable over the unfavorable, I think we may be pardoned if we are so unkind as to suspect that this activity may not be entirely motivated by the desire to sell soap or machine tools or what have you.

The questions relating to corporate issuers which are of the greatest interest to you and which are most frequently presented to us concern press releases and publications by corporate officials and articles about the corporation during the pre-filing or pre-effective periods. A press release by a corporation announcing some event in its business would not seem to us to present any particular problem. Nor would the

announcement of a dividend, the receipt of a contract, the settlement of a strike, the opening of a plant or any similar event of interest to the community in which the business operates cause us any particular concern. However, that does not mean that purported news items which tout the company's securities or which dwell upon the financial aspects of the business ordinarily associated with the sale of securities shall be viewed in the same light. It would be well for Public Relations Counsel to be on speaking terms with the financial officers of their corporate clients in order that they might be aware when the company contemplated going into the securities markets to secure additional financing.

Once it appears that this is the situation, I can do no more than recommend that you work very closely with counsel for your client and counsel for the underwriters in order to make sure that you do not throw a monkey wrench into their machinery.

As I indicated when I began, the second area where we have mutual interest is in the field of proxy solicitation. If there is no proxy fight in sight, the material which is submitted to us is generally drawn up by the lawyers and is pretty much cut and dried. When management is threatened with ouster by disgruntled stockholders, however, the situation very often takes on an entirely different aspect, and we have found that both management and its opposition have called in skilled assistance from members of your own profession.

Some of these proxy contests have been rather spectacular. You will all recall the successful attempt of the late Robert R. Young to gain control of the New York Central Railroad in 1954 and the bitter struggle that was involved in the unsuccessful attempt of Louis Wolfson to get control of Montgomery Ward in the Spring of 1955 and the unsuccessful attempt of Leonard Silberstein and the Penn-Texas Corporation to gain control of the Fairbanks-Morse Company. Right now we are in the midst of the so-called proxy season and currently we have twice as many contests on our hands as we did

at this time last year. These contests are carried on under certain proxy rules which have been adopted by the Commission in accordance with the Congressional directive contained in Section 14(a) of the Securities Exchange Act of 1934. This section essentially makes it unlawful for proxies to be solicited in connection with a security which is registered on a national exchange in contravention of such rules and regulations as the Commission may prescribe.

The proxy rules to which I have alluded require certain specific disclosure in respect of various corporate matters such as the election of the directors, the various rights of the security holders, the remuneration of management and other important matters, all of which information must be embodied in a proxy statement and the shareholder must be furnished a form of proxy which will allow him to vote for or against any specific matter for which his approval is sought. Similar disclosure is required of soliciting material filed by persons other than the management and the original proxy soliciting material for each party must be filed ten days prior to its use. Any supplemental material must be filed two days before its use. The Commission can go so far as to apply to the Federal Courts to enjoin the solicitation of proxies in violation of the rules or to compel their resolicitation or to restrain the voting of proxies illegally solicited.

It is important to understand that in proxy contests, the Commission must be, and always is, scrupulously neutral; it never takes sides or plays favorites. In examining the proxy material of participants, the role of the Commission is that of an objective, impartial umpire. It is not unusual in such a contest for each side to feel that the Commission favors the opposing group, since each side is sensitive to and aware of the Commission's adverse comments on its own soliciting material and at the same time is unaware of the equally strong censure applied by the Commission to the material of the opposing group. This stems from the fact that it is not the Commission's practice to advise one side what it has required to be stricken from the preliminary material submitted by the other group.

One feature of the proxy contests of recent years has been the extensive use by the contending parties of all modern

media of opinion formation and communication. Frequently Public Relations Counsel are retained to determine the general strategy of the campaigns. As a result, the appeal for the stockholder's votes has been increasingly made by means of radio, television and the press. The use of the press release, the press conference and speeches before stockholders themselves and before groups having an important influence upon stockholders have become a normal part of the tactics of such contests. Reprints of published material tending to favor one group or the other have also been used. Moreover, in many cases the opposition groups have attempted to conceal financing devices in connection with the purchase of shares both by themselves and by others whose support they seek. Such agreements have included arrangements by the contestants to purchase shares of others after they have been voted, agreements to guarantee profits on the purchase of shares by those willing to vote for such groups, agreements to guarantee against loss and other contractual arrangements for financing. Disclosure of these financing arrangements is necessary to enable stockholders properly to evaluate the purposes of the group which engages in them. If such financial arrangements exist, the Commission's present rules require their disclosure.

A large number of the more difficult problems in any proxy contest result from the fact that a considerable proportion of the corporation's outstanding shares are often held in street names and their ownership is constantly changing. No longer can participants in a proxy contest rely on being able to communicate with the beneficial owners indirectly through the solicitation of stockholders of record. As a result, the use of paid advertisements, prepared press releases, press conferences, and radio and television broadcasts, has become common in attempting to reach stockholders and to sway the opinion of the public and persons who may advise or influence stockholders with respect to giving, revoking or withholding proxies. Whether such statements are written or oral, or are prepared in advance or are spontaneous, they nevertheless constitute a part of a continuous plan to influence stockholders and are deemed subject to the Commission's standards of fair disclosure and specifically to the rule prohibiting false and misleading statements.

Since it would be impractical for the Commission's staff to scrutinize in advance of publication all statements made to the general public by participants in an election contest, the proxy rules require that copies of soliciting material in the form of speeches, press releases and radio or television scripts must be filed with or mailed for filing to the Commission not later than the date such material is used or published. If the participants so desire, such material may be filed in advance, and if filed, will be reviewed by the Commission in advance of use as an administrative convenience to the parties.

All advertisements used as soliciting material in a proxy contest are required to be filed with the Commission prior to publication. Reprints or republication of any previously published material used in soliciting proxies also must be filed prior to use, together with a statement identifying the author and any person quoted in the article, and disclosing whether the consent of the author and of the publication to use it as proxy soliciting material has been obtained and if any consideration has been, or will be, paid for its publication or republication.

The most important point for you to remember about the Commission's proxy rules is the statutory standard, expressed in the rules, that no solicitation shall be made by means of any proxy statement, or other communication written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary to make the statements therein not false or misleading. This is the fundamental theme running through various specific provisions of the Commission's proxy rules already discussed.

The Commission's proxy rules contain examples of statements which, in the heat of bitter proxy fights, may be made and which, depending on the particular facts and circumstances, may be misleading within the meaning of this rule. These include:

(a) Predictions as to specific future market values, earnings, or dividends.

(b) Material which directly or indirectly impugns character, integrity of personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

At least one leading firm of professional proxy solicitors, with wide experience in proxy contests, makes it a practice of advising corporate clients anticipating a proxy fight to list their securities on a national securities exchange in order to bring themselves and the opposition within the purview of the S.E.C.'s proxy rules.

Too often in the past the Commission has found patterns of misrepresentation in heated proxy contests which focus upon the primary issue of the comparative managerial ability and integrity of the two groups. Mention must be made of three particular categories of misrepresentation that have too frequently occurred in past contests. The first is the use of unfair statistics to mislead, through the use of unwarranted statistical comparisons or statistics selected to distort the true facts. Secondly, a particularly unfair and misleading device is that of imputing guilt by association -- often the most remote type of association. The third misleading and unfair device is the rhetorical question based on an assumption for which no foundation in fact is laid. This is the "When did you stop beating your wife" type of question.

The standard by which statements in soliciting material should be judged is not whether the most astute investor would be

misled. Statements are not necessarily adequate merely because a lawyer or a trained financial analyst could recognize the falsity and not be misled by them. Presumably, soliciting material would not contain misleading representations if it were not intended that the deception would be successful. The Commission's position has been that if an uninformed investor could reasonably be deceived, the manner of the fraud is immaterial, whether it takes the form of a direct lie, or a half truth, or a question, or an innuendo. In this, the Commission has been sustained by the courts.

If Public Relations Counsel are to play an important role in the financial arena in proxy contests, they should subject their material to careful legal scrutiny, because it is the lawyers who have been trained to advise their clients as to legal liabilities and they are accustomed to the responsibility of assisting them in compliance with the proxy rules and the Federal Securities Laws.

In the past, it has been argued that the clash of debate and the charges and counter-charges of the opposing two groups in a proxy contest will bring out enough of the facts to enable shareholders to form an adequate judgment as to the merits of the contending parties. Therefore it has been contended that intervention by the Commission is unnecessary. This very argument was made in the Libby, McNeill & Libby proxy fight in 1955 and the Court held that this was not the policy of Congress as contained in the Securities Exchange Act.

The end result of the proxy rules, insofar as the Public Relations Counsel is concerned is to circumscribe his activities within very definite limits. If those limits are exceeded, he may be subjecting his client to being enjoined from using the proxies which his activities have helped to bring in, and he may be opening up his client to other and even more serious proceedings. This is no light responsibility which rests on your shoulders at such a time, and it is one in which you are not only justified in seeking the most astute legal counsel, but in which you are undergoing extremely grave risk in not doing so.

It is not very often that our Commission has had an opportunity to discuss these problems with a representative group of Public Relations Counsel. I may not and doubtless have not covered all of the fields in which you are interested, and I doubtless have failed adequately to cover those which I have discussed. I assure you that I should be very happy to answer any questions which you may have either on the material I have covered or on any other matter relating to our work.