Proxy Solicitations under the Revised Proxy Rules of the Securities and Exchange Commission

address by

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After two years of intense study, in January 1956 the Securities and Exchange Commission adopted revisions of its proxy rules designed to clarify and make more specific the intent of the rules as they relate to contests for the election or removal of directors. 1/ The revision constituted amendments to the Commission's Regulation X-14, adopted under Section 14(a) of the Securities Exchange Act of 1934, applicable to corporations, the securities of which are listed on national securities exchanges.

Prior to these amendments adopted by the Commission in January 1956, the proxy rules did not contain provisions specifically directed to the many disclosure problems arising in proxy contests for control of listed corporations. The more general disclosure requirements of the rules, which were primarily directed to solicitations for the usual meeting of security holders for the purposes of electing directors or for taking other appropriate corporate action, were applied on a case-by-case approach to the problems which arose in proxy contests.

When I addressed your annual meeting a year ago at Bretton Woods, I told you how our work in revising the rules was going forward. I will review that briefly and tell you of our progress since that time.

At the end of the 1954 proxy season in August of that year, the Commission directed that the proxy rules be reviewed by the Division of Corporation Finance from the point of view of the problems presented by proxy contests and that proposals for amendment be submitted for its consideration. It was felt at that time, however, that additional experience to be gained under the rules then in effect during the 1955 proxy season would assist in the development of the new rules for proxy contests which would be suited to the changing patterns of proxy solicitations, particularly in contests for control.

A proxy rule revision proposal was first announced by Commission release in August 1955 2/, but prior to that time I had discussed the problems and some of the proposals in February 1955 before your Chicago Chapter, and also in June 1955 in my statement to the Subcommittee on Securities of the Senate Committee on Banking and Currency. Following the public announcement in August 1955, we had the benefit of many well-considered and constructive comments from the public. We received and reviewed comments submitted in writing upon the

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1/ Securities Exchange Act Release No. 5276, January 17, 1956.
2/ Securities Exchange Act Release No. 5212, August 23, 1955.

original August 1955 amendment proposal and the modified proposal published December 14, 1955, and those advanced orally at a public hearing held November 17, 1955. We also considered all of the testimony, proceedings and reports of the Senate Banking and Currency Committee, and its Subcommittee on Securities, bearing on the proxy problem and resulting from that Committee's 1955 Stock Market Study. Thus the Commission's action in adopting the revision in January of this year was the culmination of several years' concentrated study and review of soliciting material filed in connection with proxy contests during that period.

The amendments reflect in large measure codification of the administrative interpretations and practices of the Commission in the proxy contest cases under the general rules as they had been in effect. In addition, the rules were amended more precisely to define and to elicit detailed information about persons deemed to be participants in a proxy contest.

In announcing the adoption of the revision in January, I stated my belief that the amendments of the proxy rules represented an important step forward under the Federal Securities Exchange Act for protection of investors in securities listed on national securities exchanges. Proxy fights for control of corporate management represent contests for the power to direct the use and disposition of significant aggregations of capital represented by corporate assets and credit. These, in turn, are represented by billions of dollars of outstanding securities held by public investors. The savings of the public investors, channelled through our capital markets into the securities of corporations, have provided the capital funds by which the American system of free private enterprise has been built and developed. As owners of the corporate enterprises, public investors should have the right at the very least under our free enterprise system to be fully and fairly informed about the interests which seek to elect directors and about the nominees who offer themselves or are offered by others to assume responsibility for management.

As owners of the businesses, with billions of dollars of savings invested, public investors have a great stake in the outcome of all corporate elections. The careful and intelligent exercise of their voting rights is of the utmost importance if persons best qualified, by reason of background, experience and ability, to advance the

best interests of the corporation and its stockholders are to be selected. This is particularly true in proxy contests, as opposing factions vie for the stockholders' favor and statements and counter-statements, charges and counter-charges, sometimes are more confusing than enlightening.

The revised rules are designed to aid and protect public investors in the exercise of their voting rights by assuring detailed factual information about the participants, both the nominees for election as directors and those actively participating in their election campaign. This includes information about their identity and background, their interest in securities of the corporation, and certain other important information having a bearing upon the contest.

The revised proxy rules established for the first time uniform ground rules governing pre-proxy statement solicitations, a significant development of recent years, and defining in more precise terms than did the prior rules the types of disclosure required in contests for the election or removal of directors.

Under the new rules, in a proxy contest, no solicitation of proxies by an opposition group may be commenced unless a statement concerning each participant in that solicitation is first filed with the Commission and each national securities exchange with which any security of the corporation is listed. This statement must set forth the detailed information required by a new schedule provided by the rule (Schedule 14B). If the solicitation is by management in opposition to another group or in anticipation of opposition by another group, the information required by the new Schedule 14B with respect to management participants must be filed promptly after the first solicitation. The term "participant" includes, in addition to the corporation and its directors, and any nominees for directors, all persons and groups primarily engaged in, financing and responsible for, the conduct of the proxy solicitation. Those taking the initiative in organizing a stockholders' committee or group or contributing more than $500, or lending money or furnishing credit for the purpose of financing or otherwise influencing the contest, are included in the definition of participant. These provisions should make available to the security holders information about the background and the financial and other interests not only of all persons who are nominees for election as directors, but also of all persons

who may represent the real interests behind the formal nominees, and should reduce substantially the difficulty we have had in the past with undisclosed principals, or "fronts".

Each participant is required to disclose, in the document filed in response to Schedule 14B, his occupational background and personal history, the amount of the corporation's securities he owns, the transactions in which the securities were acquired, the circumstances under which he became a participant in the solicitation, and any arrangement or understanding respecting future employment or other transactions with the corporation. A summary of this information concerning participants must be included in the respective proxy statements of the contesting groups.

These disclosures are vitally important for the protection of investors in contests for corporate control. When persons seek to be appointed fiduciaries of the property interests of security holders, conflicts of interests should be identified and disclosed. In the past, participants in proxy contests have sometimes attempted to conceal their background, financial interests in the corporation and activities in the solicitation for proxies.

In contests for the election of directors, the proxy statement is also required to include a description of the methods of solicitation and the material features of solicitation contracts, the anticipated cost of solicitation, and whether reimbursement for soliciting expenses will be sought from the corporation.

Many of the more difficult problems in any proxy contest spring from the fact that a considerable portion of the corporation's outstanding shares are often held in street names and their ownership is constantly changing. Participants in a proxy contest no longer can rely on being able to communicate with the beneficial owners indirectly through solicitation of the stockholders of record. Therefore, the widespread use of paid advertisements, prepared press releases, press interviews, and radio and television broadcasts, has become common in attempting to reach security holders and to sway the opinion of the public and persons who may advise security holders with respect to giving, revoking or withholding proxies. Whether statements are written or oral, are prepared in advance or are spontaneous they nevertheless constitute 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. 3/

It would be impractical for the Commission to scrutinize in advance of publication all statements made to the general public by participants in an election contest. The new rules require, however, that copies of soliciting material in the form of prepared speeches, press releases, and radio and television scripts must be filed with the Commission promptly after their use. As an administrative convenience to the public, such documents may be filed, and if filed, will be reviewed by the Commission, in advance of use.

The new rules continue to require that all advertisements used as soliciting material in a proxy contest be filed with the Commission prior to publication. Reprints or republications 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 the material has been obtained, and if any consideration has been, or will be, made for its republication.

The annual financial report of a corporation to its security holders is not usually considered to be proxy soliciting material and is not treated as a "filing" with the Commission. However, if any portion of the annual report discusses the solicitation of an opposition group, that portion is made subject to the proxy rules by the 1956 amendments and must be filed with the Commission prior to distribution.

The basic theme, flowing through specific provisions of the type I have mentioned, is the statutory standard, expressed in the rules, 4/, that no solicitation shall be made which contains 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 a material fact necessary to make statements made not false or misleading.

The Commission has given examples of statements which, in the heat or proxy fights, may be made and which, depending on the particular facts, may be misleading. These include:

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

3/ Rule X-14-A-9

4/ Rule X-14-A-9

(b) Material which directly or indirectly impugns character, integrity or 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.

In the heat of bitter struggles for control, argumentation of this type in proxy soliciting material may tend to confuse and mislead security holders and the public and impair the free and fair exercise of the corporate franchise.

The statutory authority of the Securities and Exchange Commission to regulate the solicitation of proxies, as well as Commission rule-making and administrative policy in this respect, has become increasingly important and the subject of much discussion, in the Congress, in the press, and generally. In part this has been caused by the public interest in a number of highly publicized and bitter contests for control of several large, well-known corporations. So it is appropriate for me again to state the role and function of the Commission. The Commission, as a bipartisan independent regulatory agency of the Government, objectively and impartially scrutinizes the proxy material of participants for the purpose of enforcing the standards of fair and adequate disclosure to investors which are clearly set forth as primary objectives of the Federal securities laws. The Commission makes no attempt to guide, control or interfere in the strategy of participants in a contest for control. The Commission does not undertake, in fact we avoid, any attempt to shape or define issues except as they may be a by-product of fair disclosure. These are matters for the parties themselves to choose and develop. The Commission is and must be scrupulously neutral; it neither takes sides nor plays favorites in proxy contests. The objective of the Commission in prescribing rules under the Securities and Exchange Act to govern proxy solicitations is to obtain for investors and stockholders the fair disclosure of material facts and to prevent, by seeking appropriate injunctive relief in the Federal Courts as the statute provides when necessary, the dissemination of false and misleading statements.

It has been suggested, in proceedings connected with our administration of the rules, that in view of the apparent similarity of proxy contests to political campaigns the clash of debate, the charges and counter-charges, rebuttals, and sur-rebuttals of the opposing groups will bring out enough of the facts to enable the shareholders to form an adequate judgment as to the merits of the competing parties. There has been challenge in the Courts of the Commission's jurisdiction in cases of stockholders' disputes with management. The argument has been advanced that in such cases the various groups soliciting proxies should be free to engage in the same type of "campaign oratory" as that of participants in a "political contest."

The legislative history of the Exchange Act indicates that the Congress was concerned with the abuse of proxies by seekers of corporate power as well as by management. One of the Congressional reports states that "the rules and regulations promulgated by the Commission will protect investors from promiscuous solicitation of their proxies, on the one hand, by irresponsible outsiders seeking to wrest control of a corporation away from honest and conscientious corporate officials; and, on the other hand, by unscrupulous corporate officials seeking to retain control of the management by concealing or distorting facts." 5/

In this connection, it is also interesting to note the recent decision of the United States Court of Appeals for the Second Circuit, rejecting such contentions. The Court of Appeals affirmed an order which granted the Commission a preliminary injunction against a group soliciting proxies in opposition to the management, enjoining further solicitations in violation of the proxy rules by means of false and misleading statements and without disclosing all of the persons on whose behalf the solicitations were being made. 6/ Although these proceedings were brought under the Commission's proxy rules as in effect prior to the January 1956 revision, the Court held, among other things, that Schedule 14A of the rules requires disclosure of all persons who in fact are leading factors in the opposition group's formation and activities notwithstanding the circumstance that some of such persons are not technically designated committee members or nominees.

5/ Senate Committee Report No. 1455, 73d Cong., 2d Sess., page 77.
6/ S.E.C. v. May, et al., C.A. 2, January 11, 1956.

Two paragraphs of the opinion of the Court of Appeals are most important. The first is as follows:

> "Appellants argue that Section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. Section 78n(a), and regulations adopted thereunder are unconstitutional as unauthorized delegations of legislative power and otherwise, but these contentions have no merit. American Power & Light Co. v. S.E.C., 329 U.S. 90; Yakus v. United States, 321 U.S. 414. Furthermore, the Commission's proxy rules as applied either to management or to insurgent stockholder groups are clearly authorized by the statute."

The word "otherwise" refers to appellants' contention, made in the argument before the Court, that the proxy regulation provided for "censorship" by the Commission and abridged the constitutional guarantee of freedom of speech. This the Court rejected.

The second paragraph of its opinion I want to emphasize says:

> "Appellants' fundamental complaint appears to be that stockholder disputes should be viewed in the eyes of the law just as are political contests, with each side free to hurl charges with comparative unrestraint, the assumption being that the opposing side is then at liberty to refute and thus effectively deflate the 'campaign oratory' of its adversary. Such, however, was not the policy of Congress as enacted in the Securities Exchange Act. There Congress has clearly entrusted to the Commission the duty of protecting the investing public against misleading statements made in the course of a struggle for corporate control."

It was particularly pleasing to me to have this decision rendered by a Court of very high standing sustaining our rules against the challenge that they violated constitutional guarantees of freedom of speech and press because of fears expressed in the press, which I believe have now been allayed, that the Act of the Congress imposing standards of fairness and accuracy of disclosure with respect to certain corporate acts such as proxy soliciting in some way impinged on these traditional and deeply cherished constitutional liberties.

Legislation 7/ now pending in the Congress would extend the financial reporting, proxy solicitation, and "insider trading" provisions of the Securities Exchange Act to about 1,205 corporations, the securities of which are not listed on a national securities exchange but in which there is a substantial public investor interest. Generally, the corporations which the bill would bring within these provisions of the Exchange Act are those which meet Federal jurisdictional requirements and which have 750 or more stockholders of record of a class or debt securities of $1 million outstanding in the hands of the public and total assets of $2 million. Of the 1,205 companies, 963 have more than $5 million of assets and 673 have more than $10 million of assets. The aggregate assets of the 1,205 corporations is over $35 billion.

In connection with this legislative proposal, the Commission has made a study with respect to the financial reporting and proxy soliciting practices of these corporations. This study developed the fact that the proxy soliciting material and practices of most of the corporations which would be subject to the bill are wholly inadequate to furnish investors with the information necessary to exercise an informed vote when judged by the standards of disclosure established by the Commission's proxy rules under Section 14 of the Exchange Act. This deficiency in information is particularly striking in connection with the election of directors. Typically, only a notice of meeting and a form of proxy are furnished their security holders by these corporations, and nothing resembling a proxy statement is provided. In three-fourths of the cases, not even the identity of nominees for election is disclosed, let alone pertinent information concerning them. In many cases where proposals are submitted for stockholder action, no ballot is provided on the form of proxy by which the stockholder can vote for or against the proposal.

Taking into consideration the data contained in our report to the Senate Committee on Banking and Currency on the study, and on the basis of our continuing study of the problem, we have advised the Congress that we believe enactment of the bill, subject to certain changes we have suggested, would be in accord with the basic purposes of the Federal securities laws and that the principles and objectives of the bill are sound. The legislation would provide additional protection to investors in corporate securities, in which there is broad public investor interest and which are sold and traded in the interstate securities markets, by requiring fair disclosure of the business and

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7/ S. 2054, H.R. 7045.

financial facts pertaining to the corporations issuing them, thus contributing to the stability of the markets and the protection of investors against fraud and deception.

Parenthetically, I should say that we have recommended that the Congress defer the extension of Section 16(b) of the Exchange Act to these corporations until further information can be developed on the effect which the application of this section, which provides for the recovery by the corporation of profit from short-swing (6-month) trading by directors, officers and 10% stockholders, would have upon the maintenance of adequate over-the-counter trading markets and new capital markets for the securities of these corporations. 8/

Another problem of the regulation of proxy solicitations involves the giving of proxies by brokers and dealers for listed securities registered in their names but owned by customers.

Section 14(b) of the Exchange Act makes it unlawful for any such member, broker or dealer to give a proxy with respect to a listed security carried for the account of a customer in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. The Report on Stock Exchange Practices which was issued by the Senate Committee on Banking and Currency at the time when the Securities Exchange Act was passed, in referring to this provision, states:

> "The rules and regulations /of the Commission/will also render it impossible for brokers having no beneficial interest in a security to usurp the franchise power of their customers and thereby deprive the latter of their voice in the control of the corporations in which they hold securities." 9/

Section 14(b) has never been implemented by rule.

8/ Report of the Securities and Exchange Commission on S. 2054 to the Committee on Banking and Currency, 84th Cong., 2d Sess., (Committee Print, May 25, 1956).

9/ Senate Report No. 1455, 73d Cong., 2d Sess., page 77.

The Commission is seeking to develop a workable rule which will prevent brokers from assuming or usurping their customers' voting rights and which at the same time will not interfere with the orderly solicitation of proxies and the voting of shares.

We are considering the adoption of a rule which would set out the conditions under which members of a national securities exchange and brokers and dealers who do business through members, may give proxies covering securities listed on an exchange and carried for the account of customers.

The Commission first circulated for public comment a proposed rule, X-14B-1, on this subject in May 1955. Many thoughtful and helpful comments were received. After consideration of these comments, a revised proposal was circulated in April 1956. The revised proposal clarified and simplified the proposed requirements and covered a number of practical problems raised in the comments. Further suggestions have been received and we are now considering them. A good deal of careful thought is going into our effort to achieve a workable rule which will give the owners of stock held in the names of brokers and dealers a more effective voice in the affairs of the corporation in which they have invested.