CURRENT SEC PROBLEMS AS THEY AFFECT THE CORPORATE SECRETARY

Address of

James C. Sargent
Commissioner
Securities and Exchange Commission

before the
Detroit Chapter of the
American Society of Corporate Secretaries, Inc.
Detroit, Michigan
May 3, 1960

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At the outset, I would like to say that it is a great pleasure for me to visit with members of one of the chapters of the American Society of Corporate Secretaries. The Detroit Chapter is the fifth chapter of this fine organization which I have been privileged to address. In the past, I have discussed Securities and Exchange Commission matters with your New York, Houston, Chicago and Pittsburgh chapters.

Since joining the Commission in June, 1956, I have not, until today, made an official visit to your beautiful city which is so well known as the capital of the automobile business of the world. When accepting Mr. Pridmore's kind invitation to be here this evening, I told him that I would like to select a topic which would give me fairly wide latitude, so as to permit me to discuss with you the many facets of Securities and Exchange Commission functions which bear upon your activities as secretaries to American corporations. You will no doubt note that in selecting this topic I have given myself a good deal of leeway.

I am sure that you realize the high esteem in which the Commission holds your organization. The many appearances of members of our Commission before various local chapters is a testimonial to this fact. Without any hesitation, I can tell you that in all cases your organization has been most helpful and constructive in directing its activities towards lending its assistance to the Commission in almost all spheres of our responsibilities.

It almost goes without saying that Detroit is, from the standpoint of a Securities and Exchange Commissioner, a most exciting city to visit. As the center of the automobile manufacturing business, the economic health of this city is vitally important to all. To a very large extent, the economic well being of the entire country is dependent upon the success of the very industry which emanates from this city.

In an attempt to ascertain which of the many problems facing the Commission would be of interest to the corporate secretary, I have come to the conclusion that all of our current matters affect you in some way. However, it would be impossible for me to attempt to discuss all of them, so I have been as selective as possible. For this reason, my talk may seem a little disjointed but, I felt, that it is important for me to try to present to you as many of our problems as possible.

One of the more important issues confronting the Commission at the present time is the staff proposal of a new Rule 155. This proposal was circulated on September 2, 1959, and, in response to our request for comments, I must admit that we were swamped. It would be an understatement to say that the comments were somewhat less than favorable. As you know, the proposal deals with private placements of convertible securities and the effect of Section 3(a)(9) of the Securities Act of 1933. It requires that registration be effective when recipients of convertible securities in a private placement make a public distribution thereof, assuming that the securities are immediately convertible at the time of issuance. In addition, it requires that registration be effected when such a holder converts and then wishes to distribute the underlying securities, unless the stock was acquired under such circumstances that the holder thereof would not be deemed to be an underwriter. Under Section 2(11), an underwriter is defined, among other things, as "any person who has purchased from an issuer with a view to, . . . the distribution of any security. . . ."

The staff's proposal is based largely on the assumption that a convertible security carries with it a continuing offer of the underlying security by the issuer. Since the issuer has this continuing connection with the security, so long as that offer continues, the entire transaction of offer and sale is therefore open and incomplete until the public offering and sale of both securities are completed, or the proposal of a public offering is terminated. Therefore, an issuer contending that there will be no public offering in the entire transaction assumes a difficult burden of proof. In fact, in the ordinary case of the private placement of a convertible security, it must be presumed that it will be the intention of the ordinary purchaser to distribute the underlying security, either by a public offering of the convertible security, or by a distribution of the underlying security following conversion if and when the market price of that security and the convertible price make it possible to do so. Therefore, under these assumptions, the staff believes that the purchaser of a convertible security in a private placement may be a statutory underwriter for a subsequent distribution by him of either security because of his participation in a distribution. Under proposed Rule 155, the staff would define the phrase "transactions by an issuer not including any public offering" in Section 4(1) of the Act, as not including (1) any public offering of an immediately convertible security by any person who purchased the security from an issuer as part of a non-public offering of such security, or (2) any public offering by such a person of the underlying security, unless the convertible security was acquired under

such circumstances that the persons were not underwriters within the meaning of Section 2(11). Although it has been charged that this proposal has the effect of destroying the so-called private offering exemption, the staff does not believe that this was the intent or the purpose of the proposal. It was merely intended to deal with one particular area which has been troublesome to the Commission. As you know, this proposal has not as yet been adopted and, I can assure you that all of the comments that have been received will be given careful consideration by the Commission before any ultimate action is taken on the proposal.

In connection with the private offering aspects of proposed Rule 155, it should be noted that the Commission has been deluged with requests for no-action letters in connection with persons who are attempting to dispose of unregistered stock. These persons either claim that they purchased the securities from the issuer with an investment intent which has now been altered by a "so-called change of circumstances," or that these persons are not in "control" of the issuer and, therefore, there is no need for registration. It is in these areas that the Commission is facing some of its toughest problems. It is always a difficult problem to determine whether or not a change of circumstances has come about so as to permit persons who purchased securities from the issuer to sell them to the public without a registration statement in effect. A recent example might illustrate the problem.

Immediately prior to leaving the company, an officer exercises certain options that have been granted to him. Had these options not been exercised, they would have been terminated. Subsequent to leaving the company, the individual makes substantial investments in valuable oil and gas properties and in a large farming and cattle-raising operation. At the time of these investments, this investor is in a fairly liquid cash position. However, his financial obligations, as a result of his investments, mount and he finds it necessary to invest more money in them in order to protect his rights, and an impassioned plea is made that unless he buys adjoining properties, his oil investments will be depleted. At this time, he decides that he must dispose of the stock which he recently acquired pursuant to the options. Of course, no thought is given to the possibility of disposing of his other valuable assets. In spite of the "hardship" which this individual attempted to convey to us, the Commission refused to grant a no-action letter. It was our belief that an individual may not initiate the change of circumstances which he is claiming, so that the stock which he took as an investment may then be sold.

It is difficult to determine in advance what kind of a change in circumstances would be sufficient to permit a sale of securities without a registration statement. Although the lapse of a considerable length of time would be an important element, it is by no means determining. It is important in this area that the Commission continue to approach the problem on an ad hoc basis so that after an examination of all pertinent facts an intelligent determination can be made.

An even more troublesome problem exists when an officer, director or important stockholder of a company desires to sell securities without a registration statement being in effect. The problem arises because of Section 2(11) which states that with respect to the term "underwriter" an issuer shall include "in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer." Although the Commission many years ago decided that the mere fact that an individual is a director of a corporation does not establish a prima facie case of control, certainly, a directorship indicates the possible existence of at least some control or controlling influence. In the large corporation, where no one man usually owns a controlling block of stock, the problem becomes even more acute. It is in this area that the Commission must determine whether a person is in indirect common control with others, so that he would not be entitled to sell absent a registration statement. Some of the elements which must be considered are his position in the affairs of the company, the historical family control, if any, the amount of stock that is owned or controlled by him or persons closely related to him, and whether or not there are any other persons who might be considered controlling influences. Assuming arguendo that the Commission accepts the argument of a director that he is not in control because he is only one director of a board consisting of say ten directors, it is conceivable that similar plausible arguments could be made by the other nine directors which would indicate that the company was controlled by nobody or no faction. In fact, the ten directors in such a situation are probably all in common control. Most companies today are not managed by individual factions. A board of directors usually works in a harmonious give-and-take relationship and is not in any sense under physical compulsion or actual control of any single person or faction. This is a technical and complicated area, and the Commission cannot grant a no-action letter if it feels that there is an element of indirect common control.

It has recently been charged that the Commission has changed its policy with respect to the issuance of no-action letters and that the Commission will no longer grant no-action letters unless it is a clear situation. I want to assure you that the Commission

still, and will continue, to issue these letters, but it will not issue them where there is a conflict as to the facts or where it is practically impossible to determine whether or not control does or does not exist. This will be especially true where the individual, whose relationship to the issuer is in question, is in such a position that he can get the issuer to file a registration statement. It is our basic belief that the public is entitled to be protected and to be given all the facts which would go into a registration statement. Under this philosophy, it seems clear that the Commission will not grant no-action letters unless it is convinced that either the securities were acquired with a bona fide investment intent and this investment intent has been changed by circumstances beyond the control of the individual, or where it can be shown that there is no control, either direct or indirect, on the part of the individual seeking a no-action letter. If this position were not followed by the Commission, I believe that we would not be doing the job that has been entrusted to us by Congress.

In order to alleviate what might be a harsh result in this area by having a controlling person "locked in" with respect to his securities, unless a registration statement has been filed, the Commission adopted Rule 154. In large measure, this rule came into being as a result of the Commission's determination in the Ira Haupt case, where the broker was determined to have participated in a distribution by a controlling person. Under this rule, persons in a control position may effectuate small distributions of their securities if the total of all securities of the same class sold, by or on behalf of the same person within the preceeding period of six months, does not exceed one per cent of the outstanding securities in the case of an over-the-counter company. In the case of securities sold on a national securities exchange, these shares must not exceed the lesser of one per cent of the outstanding shares or the total volume of the maximum of one week's trading out of the last four weeks on that exchange. The effect of this rule is to permit minor distributions by persons in control relationships without requiring the effectiveness of a registration statement. At the present time, I can say to you that the Commission is looking into the operations of Rule 154 in order to determine the extent of its use. We sincerely hope that its provisions and purposes have not been abused because we believe that it has been effective and helpful in keeping with Congress' basic intent as expressed in the Act.

The Commission recently sent out for comments a proposed modification of Rule 16b-3 relating to exemptions from the insider trading restrictions. In fact, there were two such proposals distributed, the latter one being a minor modification of the first.

The effect of these proposals is to tighten the exemptions available with respect to stock options. Section 16(b) of the Securities Exchange Act of 1934 was enacted for the purpose of preventing the unfair use of information in short-term trading by persons owning beneficially more than ten per cent of any class of equity security which is registered on a national securities exchange and by directors and officers of the issuer of such security. It provides that benefits realized by such persons from the purchase and sale, or the sale and purchase, of any equity security of the company, within a period of less than six months, shall enure to and be recoverable on behalf of the company. This section exempts from its operation any transaction or transactions which the Commission, by rules and regulations, may exempt as not comprehended within its purpose.

Prior to September 1952, Rule 16b-3 provided an exemption from Section 16(b) for shares of stock acquired pursuant to bonus, profit sharing, retirement, thrift or similar plans meeting specified conditions. The rule was broadened in 1952, to cover acquisitions of non-transferable options and stock acquired under such options pursuant to a stock option plan meeting similar conditions. The exemption provided by the rule for stock acquired pursuant to options has been the subject of litigation. While the decisions of the courts have not been uniform, doubt has been expressed as to the validity of the rule insofar as it relates to the acquisition of shares through the exercise of so-called "restricted" stock options. I should point out that, in spite of the decisions in Greene vs. Dietz and Perlman vs. Timberlake, the Commission is not convinced that it lacks the power to create the exemption as it is presently stated. However, in view of the attitude of the court in these two cases, as a matter of policy the Commission proposes to restrict the scope of its present rule. Under the proposals, the rule will be amended to delete the exemption for the acquisition of securities upon the exercise of non-transferable options and to provide that the selection of persons participating in bonus, profit sharing, retirement, thrift, savings, option or similar plans will be made by the board of directors, a majority of whom are disinterested or by a disinterested committee.

The Commission has had some doubts as to the desirability of the exemption as now expressed in Rule 16b-3 for some time. In view of the court's pronouncements in the Dietz and Perlman cases, sufficient doubt as to the legality and propriety of this exemption has been cast, so that the Commission now proposes to restrict the exemption in the manner just stated. It might interest you to know that the corporate bar generally agrees that as a result of these recent cases there is a genuine question as to the propriety of retaining the rule as it is now written. It was with these thoughts in mind that the Commission proposed the modifications as they are

embodied in our releases. You, as corporate secretaries, should be extra alert in these areas to make sure that any stock option plan being considered by your corporation is in accord with the proposal that is ultimately adopted by the Commission.

One of the more important things that you as corporate secretaries are concerned about are the periodic and annual reports that must be filed with the Commission. The Commission has recently announced certain modifications in its Form 9-K. The modifications were of minor nature and should prove no undue hardship to the industry.

Some time ago, the Commission sent out for comment proposed modifications of its Form 8-K. A number of comments were received, many of which were not very favorable to the proposed changes. The bulk of the criticism expressed in the comments dealt with the proposal for a notification to the Commission of any agreements made with respect to the acquisition of or disposition of assets. I trust that you realize that the purpose of this proposed modification was the fact that rumors of mergers and acquisitions have become one of the major causes for market fluctuations. Many of these rumors have no justification or basis in fact. Although I have heard comments that this proposed change was the result of some kind of agreement between the Commission and the Department of Justice, so that we might inform them in advance of such proposed changes, I want to assure you that this was not the case. It was merely felt that some official notification to the Commission of these proposals would be a means of disseminating to the public information which might be intelligently digested, rather than having the market fluctuate unnecessarily because of some unfounded rumors.

It seems clear that some changes will be necessary in this Form 8-K. I trust that you realize that the draftmanship of our forms has become increasingly difficult because of various enforcement problems which arise. Although the form was designed for the use of men desiring to comply with SEC requirements, there have been occasions when compliance has been avoided. A recent illustration of this was in the Guterma case. You might remember that some of the counts in the indictment were dismissed by the judge. Specifically, the problem involved related to instruction 3 in item 2 of Form 8-K. Mr. Guterma's attorney argued that an 8-K was not required unless the entire series of transactions were confined within the space of one month. In my opinion, the obvious purpose of item 2 was to make sure that an 8-K is filed when a series of related transactions, regarded in the aggregate, reached the fifteen per cent mark. However, the judge seemed to adopt Mr. Guterma's argument, or at least felt that the instruction was not precise enough to warrant a criminal

action. Certainly, the items and instructions in this form will have to be changed to meet any future doubts that might be cast. It is not the purpose of the Commission to make its forms so technical that they will be an impossible burden for the corporations. However, in view of our past experiences, they will have to be made precise and technical enough so that the transactions and items which were intended to be covered will be known to all. I truly hope that the result of this overhaul will be something which will be palatable to both the corporate secretaries and their house counsel. If this is not the case, I am sure that we will hear of it when the final form is submitted for comments.

Form S-8, adopted in 1953, is specified for registration under the Securities Act of 1933, by an issuer subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, of equity securities which are offered pursuant to certain stock purchase plans for the benefit of employees of the issuer or its subsidiaries. Prior to its adoption, representations had been made to the Commission by a number of companies that it was unreasonable and unnecessarily expensive to be required to keep an S-1 prospectus current on an annual basis throughout the life of an employee stock purchase plan. It was further urged that the Form S-1 information served no very useful purpose since the members of the plan were employees and had some familiarity with the company, and that the amount of the employer contribution was such that the employee acquired shares at a substantial bargain and, therefore, considerations affecting an investment decision under ordinary circumstances were absent, or at least not as significant to the purchaser.

This form as adopted was not specifically authorized for use in registering stock to be offered pursuant to stock options. However, the case of the suitability of the form for various types of stock option plans was presented and, in some cases, the Commission authorized acceptance of Form S-8, although it is believed that in most of these cases the number of optionees approached or somewhat exceeded the upward limits of the Commission's concept of a private offering from time to time, and the acceptance of registration on Form S-8 appeared to be a solution in particular cases of the more fundamental question of whether registration was required at all. More recently, we have had an increasing number of stock option plans involving offerings to employees generally, and it was in connection with this problem that the Commission directed the staff to reconsider Form S-8 and to make recommendations to the Commission as to whether, or to what extent, the form should be revised to permit its use in connection with stock option plans. The staff is now working on this problem. In the meantime, the Commission has determined to raise no

objection to the use of Form S-8 in connection with the usual stock option plan pending the completion of the staff's study and recommendations to the Commission and the reaching of a decision by the Commission in the matter.

The proxy season is now in its final stages, and it seems appropriate at this time to take stock of some of the developments of the past season. This season was not as hectic as it might have been. One of the more publicized fights was the one involving Managed Funds in which the Channing Company emerged victorious. During the proxy season, the Commission was again called upon to determine which stockholders proposals were required to be included in management's proxy material. Some were inserted; others were omitted. The proposal which received the most attention by the press was the one introduced by Mrs. Wilma Soss for insertion in the proxy material of U. S. Steel. This proposal was that stockholders be given the right to have a secret ballot in the election of directors. Counsel for the company rendered its opinion that this proposal would be improper under the laws of the State of New Jersey, and the company refused to include the proposal on the basis of this legal opinion. However, in the opinion of the Commission, the proposal was so worded that the company was requested to take whatever action necessary consonant with the law to insure a secret ballot. Therefore, the Commission could not, and did not, rely on the legal opinion rendered to the company, and it decided that this proposal would not be violative of New Jersey law. Since it was believed that this was an appropriate proposal for stockholders action, U. S Steel was required to insert it in its proxy material.

It has been suggested that the Commission's action in this case may have opened a Pandora's box for all types of stockholders' proposals. If this turns out to be the case, I would sincerely regret it. However, I believe that the Commission, in interpreting our proxy rules, should require management to include stockholders' proposals in its proxy material if the proposal is a proper one to be acted upon by the stockholders, and is not clearly contrary to the laws of the state of incorporation. We have been careful in the past in scrutinizing various proposals that have been made, and I want to assure you that we will continue to be so in the future.

I am certain that all of you have heard about the length of time that it now takes to process a registration statement. I am sure that none of you rely upon receiving a first letter of comment within 14 days or clearance within 24 days. These were

the averages during 1958. As of March 31st of this year, the average time between the filing of a registration statement and its effectiveness was 40 days with first letters of comment coming after 28 days. I wish I could tell you that things were improving, but they are not. Registration statements have been coming in at a faster rate than ever before in the history of the Commission. During March of this year, 260 registration statements were filed, as compared to 171 being filed in the comparable month of last year. By the end of March, there were 412 registration statements pending, as against 220 in 1959.

The only excuse that I can give for the length of time that it now takes to process a registration statement is our lack of manpower. Under our budget limitations, we have simply not been able to hire the persons necessary to keep up with the workload in this particular area. In fact, I would be safe in saying that we do not have sufficient personnel to effectively handle the workload in any of our areas.

Our budget request to Congress for the fiscal year 1961 was for $8,900,000. This sum would have enabled us to hire an additional 92 persons during the fiscal year. The House has recently passed an appropriation bill which gives to the Commission $8,525,000, or a reduction of $375,000. This appropriation would enable us to employ an additional 46 persons during the fiscal year. This sum is simply inadequate for us to perform our functions under the Acts. Our request for 92 persons was the minimum that we felt would be necessary for the fiscal year. Unless these funds are restored by the Senate, the Commission will be inadequately staffed, and will be unable to effectively perform its functions. I can assure you that we intend to ask the Senate to restore the cut and truly hope that we will eventually be given the money sufficient to support the full 92 additional positions.

There is one more matter which I should like to discuss for a moment before I close. That is the current proposals that are before the various committees in Congress with respect to conflicts of interest legislation. The Commission has always taken a very strong position as to these matters, and we believe that our own Cannons of Ethics have set a fine example. I truly believe that any statute which would unduly hamper the access of the industry to members of the Commission would prove to be unwise with respect to the functions of our Commission, since the primary functions of our Commission are in the disclosure areas. It is imperative that the Commission be in a position to receive the views of the regulated

industries with respect to various matters. Of course, I do not believe that in the quasi-judicial field ex parte communications should be permitted. However, I feel that in an effort to alleviate this particular problem, legislation might be passed which would be broad enough to hamper the Commission's rapport and relationships with the members and segments of the industries subject to our jurisdiction. The Commission has officially expressed this position to the committees studying the various legislative proposals, and I trust and hope that if any legislation is to be forthcoming it will in no way hamper or restrict the fine relationships that have developed and which have proved to be so effective in the past.

I realize that I have not been able to discuss all of the current problems that are pending before the Commission and, in fact, I have only outlined the basic problems which I feel would be of most interest to you. I truly believe that by presenting to you the Commission's feelings and beliefs with respect to these issues, and in return receiving your opinions, we will have a most effective and efficient operation under our Acts. It is only by such a cooperation that both the industry and the public can best be served.