

THE REVISED PROXY RULES OF THE SECURITIES AND EXCHANGE COMMISSION

An Address

by

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In discussing the revised proxy rules 1/ of the Securities and Exchange Commission and the role of the Commission in proxy contests, two fundamental concepts should be kept in mind. First, the Commission, as an independent regulatory agency of the United States Government, acts in the capacity of an objective, impartial umpire in examining the proxy material of participants. The Commission must be, and always is, scrupulously neutral; it neither takes sides nor plays favorites in proxy contests. Second, the rules of the Commission governing proxy solicitations have been developed within the framework of the comprehensive statutory pattern of the Federal securities acts. The principal objective of these statutes is to preserve, with respect to new issues of securities sold to the public in interstate commerce and issues of securities listed and traded on national securities exchanges, free, open and honest securities markets by requiring full disclosure of all material facts and by preventing the dissemination of false and misleading statements concerning companies and their securities.

The statutory authority of the Commission to regulate the solicitation of proxies rests on Section 14 of the Securities Exchange Act of 1934 2/. Subsection (a) provides that it shall be unlawful for any person to solicit or permit the use of his name to solicit any proxy, consent or authorization in respect of any security registered on any national securities exchange 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. This broad grant of administrative power is limited only by the standards encompassed in the words "public interest" and "protection of investors." These standards have been judicially recognized as reasonable, adequate and sufficiently definite guides for administrative action. 3/

At the time of the enactment of the Exchange Act, the proxy had become a device for continuing management in corporate office and for ratifying its policies. The control of corporations by insiders had been perpetuated through the solicitation of proxies by management,

1/ Securities Exchange Act Release No. 5276.

2/ 15 U.S.C. Section 78n.

3/ American Sumatra Tobacco Corp. v. S.E.C., 110 F. 2d 117, 121 (C.A.D.C., 1940); Wright v. S.E.C., 112 F. 2d 89, 94-95 (C.A. 2, 1940)

which simply requested that stockholders execute and return proxies without disclosing the purposes for which the proxies were to be used.^{4/}

The legislative history of the Exchange Act indicates, however, that the Congress was concerned with the abuse of proxies by seekers of corporate power as well as by entrenched management. The Congressional reports state 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."^{2/}

The proxy rules that are now in effect were designed primarily for the conventional solicitation of proxies by management where solicitations in opposition to management did not occur. In recent years, many bitterly-fought proxy contests between management and opposing groups for control of large and important corporations have strained the administration of these rules. In 1954 there were 21 contested elections, and in 1955 there were 17. As novel situations, which were not specifically covered by the proxy rules, developed during these contests, it became necessary for the Commission to improvise and interpolate administratively, so that reasonable adherence to the standards of fair conduct and accurate disclosure contemplated by the statute could be achieved.

For the past two years the Commission has been intensely studying the operation of its proxy rules in contested proxy solicitations. A comprehensive revision of the rules, clarifying their applicability to proxy contests, has recently been completed. In order that the legal theory underlying the rules may be understood, the legal relationships between security holders, corporate directors and proxies will be briefly described before discussing the salient provisions of the revised proxy rules.

The right of corporate vote usually attaches to, and is an incident of, the ownership of a share of stock. It is a property right of the security holders.^{6/} At common law stockholders were not permitted to authorize another person to vote their shares, but the trend toward professional management of corporations and public ownership of corporate securities has made voting by proxy essential for the conduct of business at meetings of shareholders. The statutory law of the various states has conferred upon stockholders the right to vote by proxy in accordance with the provisions of the corporate charter and by-laws.^{7/}

^{4/} Senate Committee Report No. 792, 73d Cong., 2d Sess., page 12.

^{5/} Senate Committee Report No. 1455, 73d Cong., 2d Sess., page 77.

^{6/} Fletcher Cyc. Corp. (Perm. Ed.) Section 2025.

^{7/} Ibid, Section 2050.

The term "proxy" has a twofold meaning. It refers to the authorization given by the owner of a share of stock to another person to represent the security owner in a stockholders' meeting and to vote the shares pursuant to instructions. The term is also used to refer to the person who holds the written authorization. The legal relationship between a proxy and a security holder is that of an agent to his principal. Its formation, however, is inverted, since it is the agent who initiates the authorization through solicitation of stockholders for appointment as trustee of the voting rights of stockholders. The fiduciary relationship is created when the person seeking the support of stockholders offers himself as an agent to manage their property rights.^{8/} The legal concepts applicable to fiduciaries are also generally considered to govern the conduct of directors in the management of corporate affairs.^{9/}

The proxy rules affirmatively direct that certain basic information concerning the action to be taken at a corporate meeting must be furnished to stockholders in the form of a proxy statement. Solicitation of proxies is prohibited unless the proxy statement and all other written proxy soliciting material, except press handouts, speeches and scripts, have been filed with the Commission in advance of distribution. The documents are processed to determine whether they appear to comply with the disclosure standards of the rules. The Commission does not purport to pass upon the merits, or underwrite the accuracy or adequacy of, or give approval to, the statements made. The responsibility for the truth, accuracy and fairness of every piece of proxy material filed with the Commission rests with persons soliciting the proxies.

If the Commission concludes that any soliciting material is objectionable in some particulars, it indicates to the proxy solicitor that revisions, additions or deletions should be made. The Commission is empowered to institute proceedings in the Federal District Courts seeking to enjoin the solicitation, or compel the resolicitation, of proxies, or restrain the voting of proxies, where it has reason to believe that misleading statements are being used to obtain the support of security holders. No statutory authority exists for the Commission, by its own administrative action, to compel the correction of false or misleading proxy material or to prevent solicitations in disregard of its rules. However, the possibility that the Commission may enlist the assistance of the Federal courts to prevent the use of material that the Commission believes to be incomplete, misleading or incorrect is a powerful deterrent to any wilful violations of the rules. In the absence of a heated contest for corporate control, persons filing proxy material with the Commission have usually cooperated in making appropriate revisions in accordance with its suggestions prior to commencing any solicitations.

8/ Ibid, Sections 2050, 2060.

9/ Ibid, Section 838.

The proxy statement provides the security holders with a broad base of financial information about the company, as well as specific information about the persons seeking to be elected directors, such as their business experience, remuneration, contractual relations with the company, options, bonuses, and other emoluments of office. 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 issuer. It must also summarize the background of each participant and his interests, by securities holdings or contract, in the issuer. The proxy statement must be furnished to security holders before or concurrently with the delivery of the proxy. The rules provide that the form of proxy shall afford the person solicited with the opportunity to specify by ballot a choice between approval or disapproval of each matter or group of related matters to be acted upon.

The vast majority of proxy filings each year involve solicitations by management for various types of corporate action where no counter-solicitation occurs. Proxy contests have involved only a small fraction of the total market value of all stocks listed on national securities exchanges - $\frac{1}{4}$ of 1% in 1954, and $\frac{3}{8}$ of 1% in 1955. Where, however, opposing factions hurl charges and counter-charges in an effort to obtain stockholders' support, regulation by an impartial Government agency, which scrutinizes proxy material for accuracy and fairness, becomes increasingly important to protect the property rights of security holders. The revised proxy rules define more precisely than do the present rules the procedures to be followed and the types of disclosure required in contests for the election or removal of corporate directors.

In proxy contests no solicitation of proxies may be commended unless an informational statement concerning each participant is first filed with the Commission and each national securities exchange with which any security of the company is listed. The term "participant" includes, in addition to the issuer and its directors, and nominees for directors, persons and groups primarily engaged in, and responsible for, the conduct of the proxy solicitation. Those taking the initiative to organize a stockholders' committee or contributing more than \$500 to the committee, or lending money or furnishing credit for the purpose of financing or otherwise influencing the contest, are included in the definition of participant.

Each participant is required to disclose in this document his occupational background and personal history, the amount of securities of the company that he owns, the transactions in which the securities were acquired, the circumstances under which he became a participant, and any arrangement or understanding respecting future employment or other transactions with the company. A summary of this information concerning participants must be included in the respective proxy statements

of the contesting groups. This type of disclosure is vitally important for the protection of investors in contests for corporate control. Where persons seek to be appointed fiduciaries of the property interests of security holders, conflicts of interests should be identified and exposed. In the past, participants in proxy contests have sometimes attempted to conceal their background, financial interests in the company and activities in the solicitation for proxies.

Corporate shares are often held in street names ^{10/} and their ownership is constantly changing. Participants in a proxy contest may no longer rely on reaching the beneficial owners solely through direct solicitation of stockholders of record. The widespread use of paid advertisements, prepared press releases, press interviews, and radio and television broadcasts, has, therefore, become a common and necessary technique in inducing security holders to give, revoke or withhold proxies. Whether statements are written and prepared in advance or are spontaneous utterances they, nevertheless, may constitute part of a continuous plan to influence stockholders. Soliciting activities of this nature must be, and, of course, are, subject to the Commission's standards of fair disclosure and, specifically, to the rule prohibiting false and misleading statements.

It is administratively impractical for the Commission to scrutinize in advance of publication all statements made to the general public by participants in an election contest. For example, it is, of course, impossible to regulate spontaneous oral statements that may be made to the press. The rules do 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, and, as an administrative convenience to the public, such documents may be filed with, and will be reviewed by, the Commission in advance of use.

All advertisements used as soliciting material in a proxy contest must 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, paid for its republication.

The annual report of a company is not usually considered to be proxy soliciting material and does not have to be filed with the Commission. However, any portion of the annual report that discusses the solicitation

^{10/} Stock which is registered in the name of a nominee such as a brokerage firm.

of an opposition group is subject to the proxy rules and must be filed with the Commission prior to distribution to stockholders.

In the heat of bitter struggles for corporate control, participants are inclined to make ambitious predictions of the operating and financial results that will occur if they win the election. Prognostications regarding specific future security values, earnings and dividends are usually not supported by factual data and may be misleading. Vicious attacks impugning character, integrity and personal reputation are frequently aimed at adversaries. This type of argumentation in proxy soliciting material tends to confuse security holders and to destroy the corporate franchise, and its use would violate the rule proscribing false and misleading statements.

Public stockholders, no less than public investors, are entitled to protection from false, misleading and irrevelant statements. The objective of the Commission, in adopting its revised proxy rules, is to provide more effective guides for the conduct of proxy solicitations, especially in contests for the election of corporate directors, to assure fair and honest treatment to owners of securities, both by management and by outsiders seeking to acquire corporate control.

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