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MORE ABOUT THE SECURITIES AND EXCHANGE COMMISSION'S PROXY RULES

Address of

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It gives me particular pleasure to meet the American Society of Corporate Secretaries in New Hampshire. New Hampshire was one of the thirteen colonies to form the United States in the days when the lamp of freedom was first lighted in America. She has some distinguished sons in Washington today. I think of Styles Bridges and Norris Cotton, her two Senators. I think, too, of the great service given to this free country and to the free world by New Hampshire's former Governor, Sherman Adams, the Assistant to the President. So it is good to be with you here.

The attention of the American people has been directed in the past few months to the subject of the stock market by the study undertaken by the Committee on Banking and Currency of the United States Senate. Any study of the stock market necessarily includes the subject of Federal regulation of securities.

I'm sure most of you followed the news accounts of the daily parade of witnesses at the hearings before the Senate Banking Committee which lasted for several weeks, from March 3 to 23. Those who testified were drawn from among officials of stock exchanges and over-the-counter market, brokerage houses, investment companies, labor organizations, banks, business and industrial establishments, the press, universities and Government. They gave a great deal of interesting testimony about how the securities markets operate, their relationship to the Government and the public, and their relationship to the national economy.

Also, 5,500 individuals -- brokers, dealers, investment advisers, financial writers and others in the financial world and 113 economists -- received questionnaries from the Senate Banking Committee, and supplied answers, on the subject of recent and not so recent rises in the market prices of stocks. Over 1,300 replies to these questionnaires were received and analyzed by the Committee's professional staff. Thus, an enormous amount of expert opinion was gathered into the hands of the Committee. This is presently under study by the Committee and by the Committee's staff.

Further hearings on one phase of the study -- proxy contests for control of listed corporations -- have been scheduled to commence this very day and to continue during early June. More hearings may be held after that if the Committee so decides.

What ultimately will result from the study no one not connected with the Senate Banking Committee, least of all I, could possibly say.

In addition to the testimony of the witnesses taken at the hearing (which comprises a document of over 1,000 pages), there has also been released by the Senate Banking Committee a very interesting staff report entitled "Factors Affecting the Stock Market". Information for this report was supplied to a major extent by the Securities and Exchange

Commission, the Federal Reserve System and the New York and American Stock Exchanges. Also, last week there was released by the Committee a Committee print of its Report on the Stock Market Study, together with individual views and minority views of members of the Committee.

Neither the 1,300 answers to the Committee's questionnaires nor the testimony of the various witnesses were particularly directed to the question of the Federal regulation of the solicitation of proxies of security holders of listed companies. However, the subject was sufficiently in the public mind because of the struggles for control of certain large and well-known corporations in the past two years that it did receive the passing attention of some witnesses and of the Committee. The report of the Committee contains the following passage:

> "Proxy Regulation - Section 14 of the Securities Exchange Act, which deals with the solicitation of proxies, simply provides that it shall be unlawful to do anything -
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> > 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.
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> "This blanket authorization to the Commission is the subject of rather comprehensive rules regarding the solicitation of proxies.
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> "Senator Capehart has introduced a bill (S. 879) which would require certain additional disclosures from persons seeking to control issues listed on a national securities exchange. This question, together with the whole subject of modern methods of corporate control, and effective corporate democracy through the exercise of the right to vote share in importance. A subcommittee under the chairmanship of Senator Lehman will shortly hold public hearings on these subjects."

That which I have just quoted was part of the Committee report, but in the minority report of four Republican Committee members, Senators Capehart, Bricker, Bennett and Beall, there appear the following passages:

> "Significantly, this report contains no recommendations for remedial legislation to cure the purported evils found in the stock market. In only one instance is there reference to a definitive legislative proposal and that concerns a bill introduced before the hearings were held. Instead it is proposed that there be further general investigations on at least 10 different subjects....."

I have examined the Committee report carefully, and find the following subjects of which the Committee seems to desire further investigation. Each of these is of considerable importance, and so I will list them for you, briefly:

(1) The growth of institutional investment,
(2) The difference in credit regulations with respect to listed and unlisted securities,
(3) The sale of low priced stocks, including the exemption from registration of issues of $300,000 or less,
(4) The segregation of functions of brokers and dealers,
(5) The operations of specialists on the exchanges,
(6) The operations of floor traders on the exchanges,
(7) The extent to which the Exchange Act has effectively outlawed manipulative activities,
(8) The adequacy of the Investment Advisers Act,
(9) The adequacy of the insider trading provision (Section 16) of the Exchange Act,
(10) Proxy regulations, and
(11) The impact of defense contracts on stock price behavior.

These are the subjects of possible further investigation by the Committee. Some have been studied exhaustively in the past, such as segregation of brokers and dealers' functions and the operations of specialists and floor traders on the exchanges. But others, such as the growth of institutional investment and its impact on the market, and the sale of penny stocks, particularly in the context of the "uranium boom", are more or less virgin territory.

We cannot help but be aware at the Commission that the public -- albeit an unsuspecting, willing, trusting, gullible public -- may be taken advantage of by some fraudulent and illegal promotions of Canadian and domestic uranium stocks. The truly unfortunate part of these fraudulent and illegal offerings is that they often take place by telephone or mail and are consummated before the Commission's enforcement staff can get at them. Further, people who have been "taken" are often unwilling to admit this to a law enforcement agency. People are reluctant to tell the Commission about being defrauded. This impedes our investigative work. When the illegal or fraudulent offering comes by mail or phone from Canada, there is the additional inherent difficulty of attempting to enforce our anti-fraud law against people -- many of them Americans -- who are actually in another country.

The more that can be learned about such subjects as these by an impartial and objective study by a Congressional committee with the high standing of the Senate Banking Committee, the better.

Not without importance is a concluding sentence in the minority report of the four Republican Senators I just named:

> "However, we do concur in recommending further study by the Committee on over-the-counter markets, speculation in 'penny stocks', and foreign sales of securities to United States citizens, with the objective of developing specific legislation if needed."

At about the time the Committee report was released, Senator Fulbright introduced a bill (S. 2054) to bring certain unlisted companies having $5 million or more of assets and 500 or more security holders under the reporting, proxy and insider trading provisions of the Exchange Act.

In view of the references to proxies in the report, in view of the fact that the one definitive legislative proposal referred to in the paragraph from the minority report was the bill (S. 879) introduced by Senator Capehart, and in view of the bill (S. 2054) introduced by Senator Fulbright, I think it is a fair inference that the subject of Federal regulation of the solicitation of proxies in listed companies has received a great deal of thought by the distinguished Senators on the Banking Committee of both political parties.

Now what is the significance of all this to corporate secretaries? What does it mean that one of the great committees of the Congress, a committee which twenty years ago participated in bringing forth the securities legislation which has been of such a great influence on the American capital markets, is taking an interest in proxy solicitations in listed companies. Does it mean that Federal regulation of the solicitation of proxies in listed companies has failed? Does it mean that there is about to be some new legislation to improve the techniques of Federal regulation of proxy soliciting? Or does it mean that the Securities and Exchange Commission may revise and improve its existing regulatory techniques which are based upon the statutory provision of Section 14 of the Exchange Act which has been in effect these past twenty years? I ask these questions not because I can answer them definitely or certainly at this time. I can suggest a few approaches. Perhaps some answers will be furnished by corporate secretaries. Perhaps some answers will emerge from the Senate Banking Committee study. Certainly some answers will come from the Securities and Exchange Commission as time goes on. Or, perhaps answers will come from all three.

I'm going to divide up my discussion of the problem into three phases -- first legal, second economic and third regulatory.

Alfred E. Smith, who was a great believer in constitutional government, used to say "let's look at the record".

One of the basic philosophies of the Commissioners of the Securities and Exchange Commission as it is presently constituted is that the source of our authority stems from the Congress. In each problem we face we say to ourselves first "let's look at the law".

The law, as it pertains to proxy solicitations in listed companies, is a very broad mandate, a very broad grant of power by the Congress to the Commission. Section 14 (a) of the Exchange Act provides as follows:

> "It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted 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."

Notice a couple of points about that statute. In the first line it says "It shall be unlawful for any person....." It doesn't say it shall be unlawful for the management, or for directors, or for controlling persons. It says it shall be unlawful for "any person" to solicit proxies in contravention of the Commission's rules.

Notice that it says "in contravention of such rules and regulations as the Commission may prescribe". There is no indication of any restriction, any limitation on the rules and regulations the Congress intended the Commission to prescribe. Nor is there an indication of the type of regulation the Congress intended the Commission should devise and promulgate. But, notice that whatever rule or regulation the Commission should prescribe under this broad Congressional mandate was to be a regulation which the Commission should "prescribe as necessary or appropriate in the public interest or for the protection of investors". This last, I think, is of major importance. Throughout all of the statutes the Securities and Exchange Commission administers there flows the thread, expressed in section after section and clause after clause, that the regulation contemplated by the Congress should be that which in the determination of the Commission is necessary or appropriate in the public interest or for the protection of investors.

The only light shed on the conditions the Congressional committees had in mind as needing correction, when the Exchange Act was adopted, is to be found in the committee reports. They mentioned solicitation of proxies by management concealing secret options and interests in underwriting arrangements. They mentioned insiders retaining control without adequate disclosure of their interests and without adequate information about management policies. They mentioned managements using

proxies to take from stock holders valuable property rights for their own selfish advantage. But these reports are merely part of the legislative history, and under familiar principles are hardly to be relied on heavily in construing statutory language which on its face is clear. The breadth of the grant of authority can hardly be questioned, considering the wording of the Exchange Act.

Let me contrast for a moment this broad grant of rule-making power with a different legislative approach, the legislative approach which was used by the Congress when it wrote the Securities Act.

Both the Securities Act and the Exchange Act are thought of as "disclosure" statutes. By that is meant that in addition to providing civil and criminal sanctions against misrepresentation and fraud, they were designed so as to assure to the public and to investors disclosure of certain pertinent financial and business information by companies coming into the public market with new issues of securities, in the case of the Securities Act, and by companies whose shares were listed on national securities exchanges, in the case of the Exchange Act.

But in the Securities Act the information which the Congress deemed should be disclosed was clearly set forth in the statute.

Section 7 of the Securities Act provides that a registration statement must contain the information and be accompanied by the documents specified in Schedule A to the Act, when relating to a security issued, generally speaking, by a corporation, or the information and documents specified in Schedule B, when relating to a security issued by a foreign government. And then in Schedules A and B to the Securities Act the Congress specified in considerable detail the types of information, both business and financial, which in furtherance of the basic legislative purpose of full disclosure, it deemed should be made available to the public and the investor. Then, having specified what disclosure should be required, the Congress wisely, in my opinion, added flexibility to the administration of the statute by giving the Commission power to increase or in certain instances vary or diminish the particular items of information required to be given. Similar legislative treatment is accorded the prospectus for new issues of securities, additional Commission discretion being granted by the 1954 amendments adopted by the 83rd Congress.

Thus, the Commission, in administering the Securities Act, has available in considerable detail an outline of that which the Congress intended should be the basis of its registration forms, prospectus requirements and rules.

Contrast this legislative treatment with Section 14 of the Exchange Act where no such statutory guide lines are available for the Commission to follow.

Historically then, in the intervening twenty years since the Exchange Act was enacted, the Commission has felt its way along. There have been five major revisions since the first rudimentary proxy rules were adopted in 1935. Each of these revisions, based on the analogy of Schedules A and B of the Securities Act, was designed to elicit and bring into focus the types of information which the Commission felt should be furnished to security holders by persons, be they management or others, seeking security holders' proxies.

Generally speaking, the type of information required under the proxy rules as they exist today provides the security holder with a broad basis of financial information about the company and specific information about the persons seeking to be elected directors, their business experience, their remuneration and contractual relations with the company, if any, their bonuses, stock options and other emoluments of office. The information prescribed for such disclosure is calculated to enable the average "prudent" investor to act intelligently upon each separate matter for which his vote or consent is sought. The annual financial report must precede or accompany management's proxy soliciting material.

I think within a very broad grant of power the Commission, through years of experience, has devised proxy soliciting regulations which work well in the vast majority of cases to which they apply and which have provided an enormous base for the thing called "corporate democracy".

Now, what is my justification for saying that the proxy rules have provided a base for corporate democracy? Again, let's look at the record, this time the economic record. The staff report of the Senate Banking Committee includes the estimate that (eliminating intercorporate holdings) the total market value of outstanding stock in all American business corporations at the end of 1954 was about $268 billion. The number of corporations whose securities are registered under the Exchange Act and listed on national securities exchanges has been about 2,100 in the past two or three years.

I am not aware that there have been any serious administrative difficulties -- difficulties of the kind that could not be worked out by the registered companies with the staff, or occasionally, by the registered companies with the Commission -- except in the case of the companies, a comparative few, in which proxy contests for control were carried on, and another handful in which shareholder proposals under the "shareholder proposal" rule (Rule X-14A-8) were involved.

In terms of the impact of the proxy rules on the economy of the country, this is a pretty good indication that the proxy rules are working well. The value of listed common stock of corporations in which proxy contests have occurred was $414 million in 1954 and $650 million this 1955 proxy season. For comparative purposes the value of all common stocks

listed on national securities exchanges was $169 billion at the end of 1954 and $175 billion during the 1955 proxy season. Thus the value of listed stock of companies involved in proxy contests in 1954 was 1/4 of 1% and in 1955 1/3 of 1% of the value of all listed stock.

In 1954 twenty-one listed companies were involved in proxy contests for control of management. In the first three months of 1955 six companies were so involved. Since that time three other contests have commenced or are about to. While some of these concerned some of the larger companies, most of them related to companies of smaller size. Many of them, however, involved the use of public relations counsel. Public relations counsel are adept at utilizing many media of communication to condition public opinion and the opinion of security holders. Despite the fact that the number of the proxy solicitations involved in proxy contests is minor in relation to the number of uncontested proxy solicitations, the proxy campaigns have raised unique problems under the Commission's rules and new questions as to the proper role or function the Commission should follow. Our staff is studying the contests of the past two years with a view to recommending revisions of the rules.

In view of the relatively limited number of companies which have been involved, the direct economic impact of proxy contests on the national economy is comparatively small. Furthermore, let us think for a moment just what a proxy contest is. A proxy contest is a struggle for control of a corporate enterprise. The struggle takes place in the forum of a shareholders meeting. The shareholders have the right to vote and this means that it is the shareholders, the owners of the business, who exercise their judgment as to which contesting group, be it management or outsider, shall direct the policies and fortunes of their company for the ensuing year.

No one can measure the indirect economic effect of a few hard fought contests for control of some of the well known companies. The Commission, of course, cannot and does not pass on the merits of contestants and their causes. Can anyone say, however, that the publication of charges and counter-charges by opposing sides on subjects pertaining to corporate management, financial policies and management practices and the publication of owners' reactions to the debates at the shareholders' meetings may not have an indirect economic impact upon the economy by producing a greater awareness of public interest in corporate affairs and corporate stewardship? Is it not reasonable to expect that the encouragement and studied stimulation of widespread ownership of corporate equities which has been a mark of recent years would produce eventually closer scrutiny of the achievements and policies of professional management? Let me emphasize that this is an example of the basic principles of democratic representative government applied to corporate organizations. The two groups compete for the shareholders' favor. After all, competition is in the American tradition, and this includes competition among men for control of corporate enterprises.

So much for the law, so much for the economics -- now what are the regulatory problems?

The basic theory of the Commission's rules, which were designed primarily for the typical uncontested proxy solicitation, is that if the important facts are fairly, accurately and clearly presented to the shareholder he will be able to vote intelligently. The selection of management is of vital interest to shareholders because, in the last analysis, the ability, background and experience of management is a cornerstone for investors' judgments as to the value of the company's securities. To aid investors in reaching an informed judgment, the proxy rules provide that investors be furnished information in the form of a "proxy statement" which identifies the nominees, describes their relationships with, and interests in, the issuer, their business experience, their compensation, and their past and prospective transactions with the company. Beyond this the rules simply require that there be no misleading statements of fact and no omission of material facts necessary to make the facts stated not misleading in the circumstances. The rules also require that misleading statements in or omissions from statements previously made be corrected in subsequent soliciting material. Although the Commission has power to seek an injunction in the courts for the correction of misleading statements or to prevent the use of proxies obtained by improper soliciting material or methods, in practice this drastic remedy is rarely used. The administrative processing by the staff, and the availability to each party of the processes of the courts, are usually sufficient to compel correction or other appropriate action without recourse to the courts.

I spoke to your Chicago chapter on February 9 of this year and outlined in considerable detail the problems involved in administering the proxy rules in the context of hard fought proxy contests for control. This discussion has been widely circulated and I will not waste your time by repeating it. That discussion was based on the contests in the 1954 proxy soliciting season. Since February 9, the 1955 proxy soliciting material has pretty well run its course although, as I just mentioned, there are three proxy contests still in active condition. The experience of the 1955 season was no different in kind from 1954. It was different only in degree. I thought last year that we'd seen every kind of proxy contest problem in the New York Central case and the New Haven case taken together. Add Montgomery Ward and those three were the big proxy contests of the last two years. The rest were mostly in smaller companies.

In our staff's administration of the proxy rules in the context of proxy contests a few basic concepts should be recognized. First, the rules apply equally to the management in control seeking to retain and perpetuate control on the one hand, and to the outsider seeking to gain control on the other. Remember a few minutes ago I read the words of Section 14 that apply to "any person". Our staff has been subjected to very strong pressures and efforts at persuasion in conferences, discussions

and conversations over the telephone and in correspondence from representatives of management and of outsiders in these contested proxy contests. Usually each side complains that the staff is giving some undue advantage to the other side. In my opinion this is not so. The staff always tries to administer the rules impartially. The Commission itself has been subjected to public criticism by people complaining that one side or the other is getting better treatment from the staff. I believe that this criticism is not justified by the facts. Indeed, when pressed for facts justifying allegations of treatment favoring one side or the other such critics, so far as I know, have never come up with any. Refuge is taken in the critic's own individual opinion. But there is a fundamental reason why such criticism in the nature of things is unlikely to be founded in facts. This is because the staff and the Commission discuss a person's preliminary proxy soliciting material only with that person. Management material is discussed only with and commented on only to representatives of management. Outsiders' material only with their representatives. So only if management or the outsiders themselves release our comments on proxy soliciting material can the other side or the public know what we said. This occurs very rarely. Usually when we have criticized material the person who submitted it prefers to keep the criticism private and not spread it abroad in the land.

Another thing that should be remembered is that unless all proxy soliciting material is filed with and processed by the Commission, the proxy rule requiring the filing of a formal proxy statement and its processing by the staff could be evaded and avoided. This means that we require to be filed with us advertising material, transcripts of press conferences, if any transcripts exist, and things of that kind which are intended for distribution or communication to security holders. But it should be clearly understood that we do not require to be filed with us, indeed we could not and should not under familiar constitutional guarantees, require to be filed material printed or broadcast as news by newspapers or radio or television. The only material which we require to be filed with and processed by our staff is material distributed or sought to be put out to security holders by persons soliciting their proxies.

Finally, it should be clearly understood that our processing does not attempt to interfere with or invade the rights of contestants in a proxy contest to set forth their case clearly, concisely, accurately and persuasively. What our processing does attempt to do is to see to it that material distributed to stockholders by persons soliciting proxies does not contain misrepresentations of fact, half-truths, or omissions of facts needed to make the stated facts accurate. Also, and this is most important because of the bitter personal animosities that have developed in many proxy contests, proxy soliciting material processed by our Commission must not contain unsupported attacks on personal integrity or libelous or slanderous material. We, as an agency of the United States Government, will not have anything to do with that sort of material. We advise

contestants in proxy contests seeking to use such material that they do so at their own risk and not with any administrative sanction of the Federal government.

So it is left to you representatives of listed companies to form your own opinions as to whether you think our administration of Section 14 of the Exchange Act is generally a benefit to your security holders. It is left to the Congress, acting at the moment through the Banking and Currency Committee of the Senate, to hear your views and ours as to how this broad grant of power to our Commission, in the public interest and for the protection of investors, is working. Any evaluation of how the rules are working must, of course, be made in the light of the statutory objectives of fair disclosure to security holders of basic facts about the companies in which the public's savings are invested.