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DONALD E. SCHWARTZ
PROFESSOR OF LAW

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CHAIRMAN'S OFFICE
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SEC. & EXCH. COMM.

The Honorable Hamer H. Budge
Chairman
Securities and Exchange Commission
Washington, D.C. 20549

Dear Chairman Budge:

In your address to the American Society of Corporate Secretaries on June 12, 1970, you observed that the proxy rules have been amended frequently and that they are reviewed continuously. In the same speech, you referred to the efforts of Campaign GM to raise various questions of social policy in the forum of the shareholder meeting and the fact that further such efforts can be expected. I am sure it is well recognized that administration of the proxy rules encountered new problems in the General Motors proxy matter, and that restudy of the rules in this context is appropriate. I served as counsel to Campaign GM, and on several public occasions I have indicated that I would suggest to the Commission various rule proposals growing out of that experience. Accordingly, I respectfully submit herewith recommendations for amendments to the proxy rules.

I

Preliminarily, I think it is appropriate to comment on the Corporate Participation Bill (S. 4003) introduced by Senator Muskie on June 23, 1970, which would amend Section 14(a) of the Securities Exchange Act. The purposes Senator Muskie advanced for the bill at the time of its introduction are goals for which the Commission should be striving. Senator Muskie explained that the bill intended to "increase the effectiveness with which corporations serve society" and that his bill would provide "another channel for shareholders to direct their corporations to advance the general welfare." The value of the proxy route is that it provides perhaps the only viable method for shareholders to communicate with each other to challenge management.

But while agreeing with these goals, I think it is preferable to improve the functioning of the proxy process by changes in the rules rather than in the statute. Senator Muskie's bill, in my opinion, does not consider the overall problem of shareholder proposals which are concerned with the social responsibility of

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opinion, does not consider the overall problem of shareholder proposals which are concerned with the social responsibility of corporations, but only that aspect which was most publicized last spring. It is also an ambiguous proposal since it deals with only the second clause of paragraph (c)(2) of Rule 14a-8, and thereby permits exclusion of proposals which are submitted "primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the issuer of its management..." Experience has shown that this clause has been the reason advanced for permitting exclusion of proposals dealing with issues of social policy, evidently because the proponent possessed the objectionable personal motive. The bill does not deal with problems of solicitation which are part of a public interest proxy contest. And, of course, the bill hardens into a fixed solution something which is appropriate for experimentation through rule making. Consequently, I would favor this bill only if it became apparent that there was no prospect for reasonable reform through rule changes.

II

The reform proposals I favor are as follows:

1. Repeal paragraph (c)(2) of Rule 14a-8. This would return to the original interpretation of the Rule, as intended by the Muskie Bill. This interpretation would not allow proposals which are "general" social questions, as distinguished from proposals relating to the conduct of the particular company, to be included in the proxy statement since they would be raised in the wrong forum and excludible under the standards set forth by Baldwin Bane in 1945 in Release 34-3638. However, personal motives, which are most often unascertainable as distinguished from the effect of a proposal, which is objectively determinable, would be rendered irrelevant. The comments of Senator Muskie, and by Judge Tamm in Medical Committee for Human Rights v. Securities and Exchange Commission, decided by the Court of Appeals for the District of Columbia last July, not to mention the Commission's decision in the General Motors proxy matter, indicate that this is the correct interpretation of Rule 14a-8. Repeal of paragraph (c)(2) is preferable to Senator Muskie's bill because it accomplishes the result with less ambiguity. At the same time, the remaining subparagraphs of paragraph (c) would continue to screen those questions which are not the proper concern for shareholder action, or which impair the workings of the corporate machinery.

2. Shareholder proposals are often complicated, particularly those which deal with public interest questions since their economic relationship to the company are not readily apparent. For example, Campaign GM used three pages in its own proxy statement to explain the proposal to create a shareholder's committee; Management used almost three pages to argue against it in its proxy statement. If either side felt 100 words would suffice it is likely they would have used no more. Yet the rules limit the proponents to 100 words in management's proxy statement to support the proposal while not

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restricting management. This is neither adequate, reasonable, nor fair. The limitation was chosen arbitrarily on the basis of then available Commission experimentation (Chairman Purcell so testified at hearings before House Interstate and Foreign Committee in 1943) and Commissioner O'Brien a month after adoption of the shareholder proposal rule described the rule's provisions as only "a step in the direction of placing the shareholder where he would be if it were physically possible to gather all shareholders at the annual meeting." The 100 word limitation compels proponents to seek other means to describe and support their proposals, but often such means will be too expensive. I propose, therefore, that Rule 14a-8(b) be amended to permit a proponent to use both sides of a printed page in support of his proposal. (The text of the proposed amended rule appears in the Appendix to this letter.)

By allowing the proponent adequate space, it is hoped to accomplish a result equivalent to the proponent's use of his own proxy statement. Thus, he would be required to disclose information about his personal interests and background insofar as it relates to the proposal, perhaps revealing his motive for the proposal. While it is maintainted that his motive is not material to the question of whether the shareholders should have an opportunity to consider it, it may be considered significant by another shareholder in deciding how he shall vote.

The proposal would not be available to a shareholder who is engaged in an economic struggle with management. If he is seeking votes for himself or an affiliated person for any other purpose, this route would not be open. Filing requirements and anti-fraud rules are clearly in order.

Admittedly this involves an expense, but one which can easily be justified. The shareholder is communicating with his fellow shareholders on a matter of interest to the group (or else it could be excluded). That involves a benefit to the group. By analogy to the derivative suit, or even to a class suit, such a benefit justifies assessing the group for its costs. It should be remembered that the proxy statement is a company document and not one which belongs to management.

3. Participants in a public interest proxy contest should be able to publicize their efforts without regard to whether they have furnished a proxy statement to everyone, under certain circumstances. This is necessary because there is a public interest, apart from a shareholder interest, in the questions raised, as demonstrated in Campaign GM. What is needed is an interpretation or definition of "solicitation" to exclude from its reach certain kinds of communication which might presently be covered by the holdings of such cases as Studebaker Corporation v. Gittlin, 360 F.2d 692 (2d Cir. 1966) and S.E.C. v. Okin, 132 F.2d 784 (2d Cir. 1943). Without such an interpretation or definition, the rule may work to keep a concerned public from being informed about such proposals unless the proponents could afford to send a proxy statement to each shareholder.

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Such an application of the proxy rules, imposing expensive conditions on the right to communicate, presents a serious constitutional problem.

Moreover, if the expanded supporting statement, referred to above, is used, all shareholders will see approximately the equivalent of a proxy statement, so that a proposal to relax the definition of "solicitation" is less significant, as a shareholder will be adequately informed.

Therefore, an amendment is proposed to Rule 14a-3 (set forth in the Appendix) which would allow both sides to air the issues in public, if they speak in a public manner and not just to shareholders. If shareholders are the exclusive audience, the present rules would apply. Moreover, the present rules would continue to apply to a contest involving control, or an acquisition transaction which has the same affect as a control change. In such a contest, the shareholder interest is so overriding that it emphasizes the existing requirements that a proxy contest should begin with a proxy statement. Further, in such a contest there is usually no economic hardship by insisting that all shareholders receive a proxy statement.

The rule is intended to apply only to a public interest proxy contest, but it does not attempt to identify a public interest proxy contest. It is believed that the key term will be self defining, by adherence to the terms of the rule. The proposal requires that the communication be with respect to a proposal which has been submitted under Rule 14a-8; it does not require that the proposal be included in the management proxy statement, since communication may commence at a time prior to the existence of any such proxy statement, or it may relate to a proposal rejected under the rule and for which a limited solicitation is undertaken. Further, by insisting that the communication be made in a public manner, it is assumed that only proposals affecting the public interest will be worth the expense of such an effort. It affords management the oppprtunity to respond before there is a proxy statement, since otherwise management might be unfairly muzzled. Even if the proponents are engaged in an election contest with management, the rule would apply to them unless they were seeking to elect a majority of directors to be elected at that meeting, which might be less than a majority of the full board if it is a staggered board.

The purpose in choosing to amend Rule 14a-3, rather than amend the definition section of 14a-1, is to make clear that the exemption would not extend to the filing requirements of 14a-6, or the anti-fraud requirements of 14a-9.

4. Rule 14a-8 was born out of the recognition that the proxy statement serves in lieu of a meeting. It is also noteworthy that the proxy statement has "become the pre-eminent medium for upgrading the quality and quantity of corporate disclosure, as observed by former Chairman Cohen. Its disclosure function should now be

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utilized to further the shareholder's knowledge about the public impact and concerns of his corporation, a hope that has long been held for the Rule.

One practice common to shareholder meetings is the question and answer period at which time management deals with a wide range of inquiries. It is most likely that matters of public interest arise at this time. Some questions are intended not just to satisfy the questioner's curiosity, but to obtain or confirm information which might affect future action. What the questioner is seeking is an answer in a public forum. Questions asked at the open forum of a shareholders' meeting do not carry very far. It is suggested that the proxy rules be amended to permit use of the proxy statement to serve as such a forum for asking and obtaining the answers to questions. In this manner, the proxy statement is serving its function as a substitute meeting.

I am mindful of the opportunity to harass management. Therefore, the rule restricts questions to the scope of company activities which they could carry on (not necessarily only those things management contemplates), but protects confidential information by the same formula used in the General Motors shareholder committee proposal, and also excludes personal questions. While it would be ideal in one sense to print the answers in the proxy statement, or the annual report, this could be excessively burdensome. But at least the shareholder should be able to obtain circulation of the information and have it made part of the public file. Therefore, the compromise is to require a post meeting report to be sent to shareholders which would contain the answer or a fair summary, and also requiring an answer to be filed in the same manner as a monthly report on Form 8-K, and subject to anti-fraud rules.

Another significant reason for providing this information, subjecting it to anti-fraud rules, and causing it to be made public, is that it will serve as a check on the rhetorical answers by management that they are functioning as responsible companies. Campaign GM demonstrated a tendency on the part of institutions that professed to desire the same objectives to rely on management assertions that they were doing what was necessary. The institutions indicated that they would monitor the situation, and a means must be found to assist them in this endeavor. Otherwise, it is likely that management could withstand any public interest assertion by continued rhetoric.

Thus, a new paragraph (e) is suggested for Rule 14a-8, which is included in the Appendix. Amendment to paragraph (d) might also be desirable to allow a procedure to objections to questions.

5. Certain procedural reforms will be necessary in view of the Dow Chemical decision. In your address to the American Society of Corporate Secretaries, you stated that "it has generally been the policy of the Commission to make an informal review of the staff's position on a particular proposal when it is requested to do so by

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either the management, the proponent or the staff." The fact of Commission review was given decisive significance in Dow, and obviously some orderly way must be found for making Commission, and hence judicial, review not arbitrary. Efficient means of rapidly processing resolutions, making a record, examining briefs, hearing arguments, and writing an opinion are needed. The opinions and decisions shall then be public documents. The best means of achieving these essential procedural reforms should probably come from within the agency. But there is clearly a need which should not be long neglected.

6. A study group should be formed, using outside consultants, to study other means of making the rules more responsive to the public interest concerns of a corporation. It would probably be helpful to elicit information about social activities, and the social cost of other activities, on a regular basis. For this purpose, the regular reporting obligation should perhaps be utilized. However, this is doubtless a very complex subject, and the information furnished might vary considerably from company to company, or industry to industry. This is not an area in which the S.E.C. has developed any particular competence over the years, and it points to the advisability of consulting industry leaders, and others, who have been concerned with such problems. Methods of allowing the broadening of the decision making base of the corporation should also be studied. For example, renewed consideration might be given to the S.E.C.'s 1942 proposal to allow nominations for directors to be made by shareholders and included in the proxy statement. When Justice Douglas was Chairman of the S.E.C. he believed it appropriate to suggest that there be public, paid directors on the boards of major corporations. The idea might be revived, and thought through. Directors without a functioning staff would be of little value, as can be seen from the experience of investment companies, or worse, the Penn Central Railroad. The Commission should explore whether it is necessary to adopt rules to require dissemination of soliciting material to beneficial owners, or whether existing stock exchange rules are adequate.

III

These proposals represent my own suggestions, and they are not necessarily representative of the views of Campaign GM or of the Project on Corporate Responsibility. However, copies are being sent concurrently to those groups, and to others who have expressed an interest in proxy rule reform.

Your kind attention, and that of the Commission staff to these proposals will be greatly appreciated.

Respectfully yours,

Donald E. Schwartz

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APPENDIX

A

Amend Rule 14a-8(b) to read as follows:

If the management opposes the proposal, it shall also, at the request of the security holder, include either in its proxy statement or accompanying said proxy statement, a statement of the security holder in support of the proposal, which statement shall not exceed both sides of a single printed page of the same size as was used the previous year, or is now being used, whichever is larger. No security holder whose statement exceeds 100 words, nor any person affiliated with such security holder, shall also be entitled to solicit proxies with respect to the same meeting for any other purpose. The statement shall include the name, address, and principal occupation of the security holder, the amount of securities beneficially owned, and any transaction, material to the shareholder, which he or persons affiliated with him, have had with the corporation during the preceding two years. A copy of the statement in preliminary form shall be filed with the Commission and sent to management, at the same time the proposal is furnished. Neither the management nor the issuer shall be responsible for such statement.

B

Amend Rule 14a-3 By adding a new paragraph (d) as follows:

(d) For purposes of the Rule only, the following shall not be deemed to be a "solicitation":

A communication made in a public manner not addressed exclusively to shareholders, with respect to any shareholder proposal which has been submitted under Rule 14a-8, unless the proponents of the proposal, or the person making the communication, are at the same time:

(1) participants in an election contest, as such terms are defined in Rule 14a-11, involving a majority of the directors to be elected; or

(2) persons affiliated with any of the parties to or the opponents of a merger, consolidation, acquisition or similar matter; provided, however, that no proxy or request for proxy may be furnished with such communication.

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C

Add new paragraph (e) to Rule 14a-8

(e) If a security holder submits a question to management within the time set forth in paragraph (a) of this rule relating to any activity or contemplated activity of the corporation; or with respect to the policy regarding any such activity, or contemplated or potential activity; or with respect to the functioning of the board of directors or management; the proxy statement used by management shall set forth the questions, and such questions shall be answered at the meeting. The answers shall also be set forth, or fairly summarized, in a post meeting report which shall be sent to all shareholders within 30 days following the meeting and shall be filed with the Commission. The answers shall also be filed with the Commission in the same manner as a report on Form 8-K and shall be subject to Rule 14a-9; provided, however, management may refuse to answer any question it reasonably determines is privileged for business or competitive reasons, or which relates to personal information (which shall not permit refusal to answer questions about any payments or other compensation from, or dealings with the corporation), and provided further that management may omit any question and answer which substantially duplicates another question submitted at the same meeting.