SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
(202) 755-4846

FOR RELEASE 12:00 NOON, FRIDAY, MARCH 14, 1975

FURTHER THOUGHTS ON "GOING PRIVATE"

AN ADDRESS BY

A. A. SOMMER, JR., COMMISSIONER

SECURITIES AND EXCHANGE COMMISSION

DETROIT INSTITUTE FOR
CONTINUING LEGAL EDUCATION

SECOND ANNUAL SECURITIES SEMINAR

TROY, MICHIGAN

MARCH 14, 1975

FURTHER THOUGHTS ON "GOING PRIVATE"

A. A. SOMMER, JR.*

COMMISSIONER

SECURITIES AND EXCHANGE COMMISSION

A LITTLE OVER FOUR MONTHS AGO I MADE SOME REMARKS AT THE UNIVERSITY OF NOTRE DAME ON A SUBJECT WHICH WAS INCREASINGLY SHOWING UP ON THE FINANCIAL PAGES, NAMELY, THE PRACTICE BY WHICH CORPORATIONS, FREQUENTLY ONES THAT HAD HAD INITIAL PUBLIC OFFERINGS DURING THE HALCYON DAYS OF THE LATE 60'S AND THE EARLY 70'S, DISPENSED WITH THE PRESENCE OF MINORITY SHAREHOLDERS THROUGH VARIOUS TECHNIQUES: SOLICITATIONS OF TENDERS, SQUEEZE OUT MERGERS, REVERSE SPLITS AND THE LIKE. THE PRACTICE WAS ONE THAT HAD BEEN INCREASINGLY CRITICIZED IN THE BUSINESS PRESS AND WHICH HAD BECOME IN THE EYES OF MANY INDICATIVE OF THE OVERREACHING ATTITUDES OF MANY MANAGEMENTS. PRIOR TO THAT SPEECH NUMEROUS MEMBERS OF OUR STAFF HAD SPOKEN TO ME ABOUT THE PRACTICE, HAD EXPRESSED A CONCERN OVER THE IMPACT WHICH A CONTINUATION OF IT MIGHT HAVE UPON PUBLIC CONFIDENCE IN SECURITIES MARKETS, HAD OPINED THAT THE PRACTICE MIGHT BE ILLEGAL UNDER EXISTING LAW, AND HAD SUGGESTED THAT IF IT WERE NOT, THEN THAT SERIOUS ATTENTION SHOULD BE GIVEN TO THE POSSIBILITY OF EITHER RULEMAKING OR ADDITIONAL LEGISLATION TO DEAL WITH THE MATTER. AS I THOUGHT ON THE MATTER IT DID STRIKE ME AS INDEED IRONIC THAT AT THE TIME WHEN THE COMMISSION WAS BEING ASKED

---

* THE SECURITIES AND EXCHANGE COMMISSION, AS A MATTER OF POLICY, DISCLAIMS RESPONSIBILITY FOR ANY PRIVATE PUBLICATION OR SPEECH BY ANY OF ITS MEMBERS OR EMPLOYEES. THE VIEWS EXPRESSED HERE ARE MY OWN AND DO NOT NECESSARILY REFLECT THE VIEWS OF THE COMMISSION OR OF MY FELLOW COMMISSIONERS.

REPEATEDLY WHAT IT PROPOSED TO DO TO BRING THE PUBLIC BACK INTO THE MARKET, LARGE NUMBERS OF AMERICAN COMPANIES WERE FOLLOWING A COURSE THAT COULD NOT BUT FURTHER ERODE THE CONFIDENCE OF AMERICAN INVESTORS IN OUR MARKETS AND IN THE CONDUCT OF OUR CORPORATIONS.

THE CONSEQUENCES OF THAT SPEECH WERE TO ME STARTLING. WHILE I HAD EXPECTED IT MIGHT RECEIVE SOME MODERATE ATTENTION, I WAS QUITE UNPREPARED FOR THE EXTENT OF THE PUBLIC REACTION. I THINK THE WORDS HAD BARELY LEFT MY LIPS WHEN REPRESENTATIVES OF ONE COMPANY IN THE PROCESS OF GOING PRIVATE HAD ARRANGED A MEETING AT THE COMMISSION TO TELL ME THE ERROR OF MY WAYS (THEY DIDN'T PERSUADE ME). DURING THE FOUR MONTHS SINCE MY REMARKS I HAVE RECEIVED PROBABLY 200 LETTERS OR MORE, THE OVERWHELMING NUMBER OF WHICH -- I WOULD ESTIMATE SOMEWHERE BETWEEN 90 AND 95% -- HAVE BEEN WARMLY ENTHUSIASTIC AND SUPPORTIVE. GRANTED, MANY OF THOSE WHO HAVE CONCURRED WITH MY REMARKS ARE REALLY DOING NOTHING MORE THAN EXPRESSING THEIR DISMAY AND DISPLEASURE OVER THE MARKET LOSSES THEY HAVE SUFFERED INVESTING IN COMPANIES WHICH NOW ARE SEEKING TO GO PRIVATE. BUT IN MANY INSTANCES THE SMALL INVESTORS HAVE EXPRESSED DEEP CHAGRIN THAT THEY HAVE NOT BEEN PERMITTED TO RETAIN INVESTMENTS WHICH THEY MADE WITH THE EXPECTATION THAT THEIR CHOICE WOULD PROVE TO HAVE BEEN A WISE ONE ONCE THE MARKET TURNED. FOR THEM THERE WAS NO CONSOLATION IN FANCY ECONOMIC THEORIES THAT IN TRUTH THEIR POSITION WAS BEING BETTERED BECAUSE THEY WERE RECEIVING A PREMIUM ON THE SECURITY OUT OF WHICH THEY WERE SQUEEZED AND THUS COULD HAVE AN OPPORTUNITY TO INVEST EVEN MORE DOLLARS IN A COMPARABLE SECURITY WHICH PRESUMABLY WOULD ALSO BENEFIT FROM AN UPTURN IN THE MARKET. FOR MANY OF THESE PEOPLE THE SECURITY THEY WANTED WAS THE ONE THEY WERE BEING FORCED TO GIVE UP; THEY DID NOT WANT A SUBSTITUTE, THEY DID NOT WANT A SURROGATE, THEY DID NOT WANT CASH. PERHAPS MORE THAN ANYTHING THEY WERE PIQUED AT WHAT THEY THOUGHT TO BE THE INTOLERABLE

ARROGANCE OF MANAGEMENT WHICH COULD, AFTER THEY HAD MADE AN INVESTMENT COMMITMENT, NOW COMPEL THEM TO GIVE IT UP – OR AT LEAST SURRENDER SOME OF THE BENEFITS OF IT, SUCH AS LIQUIDITY AND REGULAR DISCLOSURE. COMMUNICATIONS WERE NOT ONLY FROM THE LESS SOPHISTICATED AND THE SMALLER INVESTORS. IN MANY INSTANCES REPRESENTATIVES OF SECURITIES FIRMS, PROMINENT AND RELATIVELY CONSERVATIVE LAWYERS, AND WELL-KNOWN JOURNALISTS SPOKE WELL OF THE POSITION I HAD STAKE OUT. ONE OF THESE, A WIDELY-READ AND WELL-KNOWN WRITER ON ECONOMIC SUBJECTS, SAID,

> "IT SEEMS TO ME TO BE NOTHING LESS THAN SCANDALOUS, AND A SPECIES OF DOWNRIGHT FRAUD, FOR SMALL CORPORATIONS TO GO PUBLIC AT HIGHER PRICES, AND THEN BUY BACK SUBSTANTIAL QUANTITIES OF THEIR STOCK AT LOWER PRICES -- PARTICULARLY WHEN THE INITIAL OFFERING INCLUDED PORTIONS OF PRIVATE HOLDINGS. INDEED, I THINK THIS OUGHT TO BE COVERED BY A WHOLE NEW SET OF SEC REGULATIONS."

VARIOUS BUSINESS PUBLICATIONS SAW, AS I DID, THAT THE CONTINUATION OF THIS PRACTICE WOULD IMPAIR SERIOUSLY PUBLIC CONFIDENCE IN SECURITIES MARKETS AND AMERICAN CORPORATIONS. BUSINESS WEEK SAID EDITORIALLY,

> "SECURITIES AND EXCHANGE COMMISSIONER A. A. SOMMER, JR., WAS RIGHT ON TARGET LAST WEEK WHEN HE ASSAILED THE CURRENTLY POPULAR GAME OF 'GOING PRIVATE' -- USING A COMPANY'S MONEY TO BUY UP ITS OWN STOCK AT BARGAIN PRICES SO THAT A SMALL MANAGEMENT GROUP WINDS UP OWNING THE BUSINESS. SOMMER RIGHTLY DESCRIBED THIS AS 'A PERVERSION OF THE WHOLE PROCESS OF PUBLIC FINANCING,' PARTICULARLY IN CASES WHERE THE COMPANY WENT PUBLIC ONLY A FEW YEARS AGO AT TOP PRICES."

NOT UNEXPECTEDLY THERE WERE DISSENTERS. IN SOME CASES, THESE WRITERS ELABORATED INTERESTING AND INTRIGUING ECONOMIC ARGUMENTS. MANY EMPHASIZED

THAT UNDER STATE LAWS CORPORATIONS CLEARLY HAD A RIGHT TO ELIMINATE MINORITIES USING LEGAL TECHNIQUES AND MINORITY SHAREHOLDERS MOVED INTO THEIR POSITION WITH A PRESUMED AWARENESS THAT THEY WERE AT THE MERCY OF THE MAJORITY. IN SOME INSTANCES THE ARGUMENTS STRUCK ME AS A BIT LUDICROUS. ONE WRITER, A MEMBER OF A NEW YORK STOCK EXCHANGE FIRM, ACCOMPANIED HIS LETTER WITH A LONG ESSAY OBVIOUSLY DIRECTED TO CLIENTS OUTLINING THE BENEFITS OF "GOING PRIVATE" AND THE MEANS BY WHICH IT MIGHT BE DONE. THROUGHOUT THIS ESSAY HE REFERRED REPEATEDLY TO THE "REAL" OWNERS OF THE BUSINESS AS CONTRASTED WITH THOSE "PSEUDO" OWNERS WHO HAD INVESTED THEIR DOLLARS IN THE STOCK OF THE ENTERPRISES. I WOULD IMAGINE THAT IT WOULD COME AS A DISTINCT SHOCK TO MANY PEOPLE TO REALIZE THAT THE "REAL" OWNERS OF AN ENTERPRISE WERE THOSE IN CONTROL OF IT AND THAT THOSE WHO HAD MERELY INVESTED THEIR HARD-EARNED DOLLARS WERE SOMEWHAT LESS REAL. I WONDER HOW MANY OF THOSE NON-REAL OWNERS THIS SECURITIES DEALER HAD PUT INTO SECURITIES WITHOUT TELLING THEM OF HIS QUAINT NOTIONS CONCERNING THEIR "INFERIOR" STATUS.

PARTIALLY AS A CONSEQUENCE OF MY REMARKS AND THE PUBLIC REACTION TO THEM, AND PARTIALLY AS A CONSEQUENCE OF THE FERMENT WHICH HAD BEEN DEVELOPING IN THE COMMISSION STAFF FOR SOME TIME OVER THIS MATTER, THE COMMISSION ACCELERATED ITS STUDY OF THE PROBLEM AND THE MANNER IN WHICH THE COMMISSION MIGHT DEAL WITH IT. MANY OF US FELT THAT, INDEED, WHILE IT MIGHT APPEAR SUPERFICIALLY TO BE WHOLLY ONE OF STATE LAW, NONETHELESS, OUR MANDATE TO PROTECT THE INTEGRITY AND THE EFFICIENCY OF SECURITIES MARKETS NECESSITATED AT LEAST THAT WE EXAMINE THE PROBLEM, DETERMINE THE DESIRABILITY OF ACTION WITH RESPECT TO IT, STUDY THE LIMITS OF OUR POWER, AND COMBINE POLICY AND POWER IN A MANNER THAT WOULD SERVE THE INTERESTS OF THE INVESTING PUBLIC. INITIALLY, THE STAFF CEASED GIVING COMMENTS WITH RESPECT TO REGISTRATION STATEMENTS OF SECURITIES INVOLVED IN GOING PRIVATE AND REFUSED ACCELERATION. THERE WAS A

GOOD DEAL OF CRITICISM OF THIS, BUT THE STAFF JUSTIFICATION, IN MY ESTIMATION, HAD MERIT: UNTIL THE MATTER WAS CLARIFIED, IT HARDLY SEEMED APPROPRIATE FOR THE COMMISSION TO TAKE AFFIRMATIVE ACTION TO FACILITATE A RESULT THAT PERHAPS WAS NOT ONLY CONTRARY TO PUBLIC POLICY BUT AGAINST ESTABLISHED LAW AS WELL. IT WAS MADE CLEAR TO REGISTRANTS THAT NOTHING BARRED THEM FROM WITHDRAWING THE CUSTOMARY DELAYING AMENDMENT AND ALLOWING THE REGISTRATION STATEMENT TO GO EFFECTIVE 20 DAYS AFTER THE LAST AMENDMENT BY OPERATION OF LAW. OBVIOUSLY TO PRACTITIONERS AND BUSINESSMEN ACCUSTOMED TO THE SEARCHING SCRUTINY AFFORDED BY THE STAFF AND ITS CONSEQUENT LETTER OF COMMENT, THE PROSPECT OF TAKING ACTION AS SERIOUS AS A PUBLIC OFFERING WITHOUT THE BENEFITS OF SUCH PROCEDURE WAS AN AWESOME AND PERHAPS SOMEWHAT FRIGHTENING ONE. ALSO, OF COURSE, THERE WAS THE PROBLEM OF HOLDING AN ISSUER STILL FOR A FULL 20 DAYS; IN MANY INSTANCES, DURING THAT TIME MATERIAL EVENTS OCCURRED WHICH REQUIRED FILING OF ANOTHER AMENDMENT AND A CONSEQUENT FURTHER DELAY IN EFFECTIVENESS. AS I'M SURE MOST OF YOU KNOW BY NOW, ONCE AGAIN THE WHEELS ARE TURNING AND LETTERS OF COMMENT AND GRANTS OF ACCELERATION ARE POURING OUT, AT LEAST IN CASES WHERE THE STAFF DOES NOT HAVE REASON TO THINK AN INVESTIGATION IS MERITED.

AFTER LENGTHY DISCUSSIONS AMONG MEMBERS OF THE STAFF, MEMBERS OF THE COMMISSION, AND BETWEEN THE STAFF AND THE COMMISSION, THE COMMISSION HAS NOW ISSUED TWO PROPOSED RULES AND HAS ORDERED PUBLIC INVESTIGATORY HEARINGS TO REVIEW THE ENTIRE PROBLEM OF GOING PRIVATE, INCLUDING THE EXTENT OF THE COMMISSION'S POWER TO DEAL WITH IT, PARTICULARLY THROUGH MEANS OTHER THAN DISCLOSURE. THESE HEARINGS ARE PRESENTLY SCHEDULED TO BEGIN IN APRIL; PRIOR TO THAT TIME PEOPLE HAVE BEEN ENCOURAGED TO MAKE WRITTEN SUBMISSIONS AND OF COURSE DURING THAT TIME THE STAFF WILL BE DOING CONSIDERABLE WORK INFORMALLY TO PREPARE FOR THESE INQUIRIES. IT IS HOPED AS A CONSEQUENCE OF THESE HEARINGS WE

MAY HAVE A MUCH BETTER NOTION OF THE EXTENT TO WHICH THIS PRACTICE EXISTS, AND ITS EFFECT UPON SHAREHOLDERS, THE BENEFITS WHICH PURPORTEDLY ACCRUE TO MINORITY SHAREHOLDERS AS CONTRASTED WITH THOSE ACCRUING TO CONTROLLING INTERESTS, THE EFFECT OF SUCH CONDUCT UPON MARKETS, THE EXTENT OF THE COMMISSION'S POWER TO DEAL WITH THE MATTER, AND THE POSSIBLE DESIRABILITY OF LEGISLATION TO DEAL FURTHER WITH THE MATTER. IT WAS FELT THAT, GIVEN THE COMPLEXITY OF IT, THE RELATIVE NEWNESS OF THE PRACTICE, AT LEAST AS A COMMON PRACTICE, THE GREAT VARIETY OF PERMUTATIONS THAT OCCUR IN THE COURSE OF COMPANIES GOING PRIVATE, AND THE PATENT DIFFICULTY OF DISTINGUISHING THOSE CIRCUMSTANCES IN WHICH THE ELIMINATION OF MINORITY SHAREHOLDERS IS JUSTIFIED AND THOSE WHERE IT ISN'T, THE BEST MEANS OF REACHING RATIONAL CONCLUSIONS WAS A THOROUGH AND PUBLIC EXAMINATION OF THE SUBJECT.

I WILL NOT ATTEMPT TO STATE ANEW THE OPINIONS I EXPRESSED FOUR MONTHS AGO. I STILL BELIEVE STRONGLY WHAT I SAID THEN, I WOULD RATHER ADDRESS MYSELF TO THE MORE PROFOUND, IF YOU WILL, IMPLICATIONS OF THIS PRACTICE. IT SEEMS TO ME THAT SOME OF THE MOST PERPLEXING AND PERHAPS IMPORTANT ISSUES OF CORPORATION AND SECURITIES LAW ARE POSED BY THIS PROBLEM, THE ISSUES WHICH HAVE BEEN INCREASINGLY THE SUBJECTS OF CONTROVERSY AND LEARNED WRITING AND WHICH IN MY ESTIMATION MUST I THE NEAR FUTURE BE MUCH MORE DIRECTLY AND FORCEFULLY ADDRESSED THAN THEY HAVE BEEN IN THE PAST.

FOR SOME TIME NOW THERE HAS BEEN WIDESPREAD CRITICISM OF THE INADEQUACIES OF STATE CORPORATION LAW. EVER SINCE THE DAYS WHEN NEW JERSEY WAS REGARDED AS THE ULTIMATE REFUGE OF MANAGEMENT, THERE HAS BEEN INCREASING EMPHASIS IN MOST STATES ON THE DESIRABILITY OF CORPORATION LAWS THAT WERE FLEXIBLE, AFFORDED MAXIMUM PROTECTION FOR MANAGERIAL DECISIONS, INSULATED MANAGEMENT AGAINST MANY MINORITY COMPLAINTS. DISTINGUISHED SCHOLARS LIKE PROFESSOR WILLIAM CARY HAVE NOTED THE EXTENT TO WHICH THIS TREND HAS DENIED

MINORITY SHAREHOLDERS OF CORPORATIONS EFFECTIVE PROTECTION IN MANY AREAS, SUCH AS CONFLICTS OF INTEREST. THE IMPLICATIONS OF THESE STATUTES WERE OFTEN EXPANDED BY STATE COURTS WHICH IMPLEMENTED THEIR PROVISIONS BY FURTHER STRENGTHENING THE POSITION OF CONTROLLING INTERESTS. WHILE THERE HAVE BEEN SOME EXCEPTIONS TO THIS TREND, NONETHELESS IT IS FAIR TO SAY THAT THIS ATTITUDE HAS BEEN PREVALENT. ON THE OTHER HAND, INCREASINGLY GREATER DEMANDS HAVE BEEN MADE UPON ALL THOSE INVOLVED IN THE SECURITIES DISTRIBUTION AND TRADING PROCESS -- DIRECTORS, OFFICERS, ATTORNEYS, ACCOUNTANTS AND THE LIKE. THIS PHENOMENON HAS CAUSED COURTS AND A NUMBER OF WRITERS TO SPEAK OF THE ADVENT OF "FEDERAL CORPORATION LAW." OBVIOUSLY THEY ARE NOT REFERRING TO A FORMAL STATUTE, SUCH AS HAS BEEN OFTEN PROPOSED TO GOVERN THE AFFAIRS OF CORPORATIONS, AT LEAST THOSE OF A CERTAIN SIZE. THESE CASES AND WRITERS SPEAK RATHER OF THE PROCESS BY WHICH THE SECURITIES AND EXCHANGE COMMISSION AND THE FEDERAL COURTS HAVE SHAPED RULES GOVERNING THE CONDUCT OF VARIOUS PARTICIPANTS IN THE CORPORATE PROCESS IN AREAS WHICH PREVIOUSLY WERE CONSIDERED THE EXCLUSIVE PRESERVES OF STATE LAW. THE PRINCIPAL INSTRUMENTS BY WHICH THIS HAS BEEN DONE HAVE BEEN RULE 10B-5 AND THE PROXY RULES. THE COURT OF APPEALS FOR THE THIRD CIRCUIT SEVERAL YEARS AGO SUMMARIZED THE PROCESS IN THESE WORDS:

> "THAT ACT [THE SECURITIES EXCHANGE ACT OF 1934] DEALS WITH THE PROTECTION OF INVESTORS, PRIMARILY STOCKHOLDERS. IT CREATES MANY MANAGERIAL DUTIES AND LIABILITIES UNKNOWN TO THE COMMON LAW. IT EXPRESSES FEDERAL INTEREST IN MANAGEMENT-STOCKHOLDER RELATIONSHIPS WHICH THERETOFORE HAD BEEN ALMOST EXCLUSIVELY THE CONCERN OF THE STATES. SECTION 10(B) IMPOSES BROAD FIDUCIARY DUTIES ON MANAGEMENT VIS-A-VIS THE CORPORATION AND ITS INDIVIDUAL STOCKHOLDERS. AS IMPLEMENTED BY RULE 10B-5 AND SECTION 29(B), SECTION 10(B) PROVIDES STOCKHOLDERS WITH A POTENT WEAPON FOR ENFORCEMENT OF MANY FIDUCIARY DUTIES. IT CAN BE SAID FAIRLY THAT THE EXCHANGE ACT, OF WHICH SECTIONS

> 10(B) AND 29(B) ARE PARTS, CONSTITUTES FAR REACHING FEDERAL SUBSTANTIVE CORPORATION LAW."

THERE ARE MANY REASONS FOR THIS EXPANSION OF FEDERAL LAW. FIRST HAS BEEN THE RECOGNIZED INSUFFICIENCY OF STATE LAWS. WHILE THEY HAVE REMAINED RELATIVELY STATIC IN DEALING WITH RELATIONS BETWEEN THE CONTROLLING INTERESTS AND MINORITY SHAREHOLDERS, THE PUBLIC INSISTENCE UPON HIGHER STANDARDS OF CONDUCT ON THE PART OF CORPORATE MANAGEMENT HAS STEADILY ACCELERATED. THUS, AGGRIEVED SHAREHOLDERS, FRUSTRATED IN THEIR EFFORTS TO SECURE REDRESS THROUGH STATE COURTS INTERPRETING STATE STATUTES, HAVE HAD IMAGINATIVE RECOURSE TO THE FEDERAL COURTS. THESE HAVE PROVIDED AN UNUSUALLY FRIENDLY FORUM. LIBERAL RULES OF VENUE AND SERVICE HAVE FACILITATED ACTIONS WITH NATIONWIDE IMPLICATIONS. FURTHER, THE RULES OF DISCOVERY CONTAINED IN THE FEDERAL RULES OF CIVIL PROCEDURE AND THE EASE, PARTICULARLY SINCE THE LATE SIXTIES, WITH WHICH CLASS ACTIONS CAN BE MAINTAINED, HAVE PROVIDED SIGNIFICANT ADVANTAGES TO PLAINTIFFS. SECONDLY, THESE COURTS HAVE BEEN PECULIARLY AMENABLE TO RESOURCEFUL APPLICATIONS OF RULE 10B-5 AND THE PROXY RULES, AS WELL AS OTHER FEDERAL SECURITIES LAW CONCEPTS, AND HAVE READILY ACCEDED TO SUGGESTIONS OF THE COMMISSION AND PLAINTIFFS' COUNSEL URGING EXTENSIONS OF THE SCOPE OF THESE LAWS. MOST OF THE RESTRAINTS UPON THE EXPANSION OF THESE CONCEPTS – RELIANCE, SCIENTER, PRIVITY, THE BIRNBAUM CASE – HAVE BEEN STEADILY WEAKENED THROUGH THE YEARS UNTIL FINALLY IN WHITE V. ABRAMS, THE COURT OF APPEALS FOR THE NINTH CIRCUIT ARTICULATED A FLEXIBLE STANDARD THAT APPEARS TO HAVE PRESCINDED FROM MOST OF THESE CONVENTIONAL CONSIDERATIONS.

THE REPURCHASE OF SHARES, MERGERS, AND REVERSE STOCK SPLITS HAVE ALL BEEN CONVENTIONALLY REGARDED AS MATTERS GOVERNED BY STATE LAW, EXCEPT INSOFAR AS THE FEDERAL LAW HAS INTRUDED TO DEMAND APPROPRIATE DISCLOSURE. NO ONE TODAY QUESTIONS THE PERTINENCE AND PROPRIETY OF THE COMMISSION IN

DEMANDING DISCLOSURE WHEN THESE TRANSACTIONS ARE INVOLVED IN THE "GOING PRIVATE" PROCESS. THE CRITICAL QUESTION IS: CAN THE COMMISSION GO BEYOND DISCLOSURE AND IMPOSE DUTIES UPON CONTROLLING INTERESTS THAT ARE SUBSTANTIVE AND WHICH CLOSELY RESEMBLE REQUIREMENTS WHICH HAVE HISTORICALLY BEEN THE DOMAIN OF STATE LAW? FOR INSTANCE, CAN THE COMMISSION COMMAND THAT FOR A CORPORATION TO "GO PRIVATE" IT MUST SECURE THE CONSENT OF A MAJORITY OF THOSE WHOSE INTEREST MIGHT BE LIQUIDATED BY THE PROPOSED COURSE OF ACTION? CAN THE COMMISSION IMPOSE AS A FEDERAL OBLIGATION THAT THE TRANSACTION BE FAIR TO THE MINORITY AND PRESCRIBE, PERHAPS, THE PROCEDURES BY WHICH SUCH FAIRNESS IS TO BE DETERMINED? THE ANSWERS TO THESE QUESTIONS, FRANKLY, DEPEND UPON HOW BROADLY OR RESTRICTIVELY ONE CHOOSES TO READ SECTIONS 10(B) AND 13(E) OF THE SECURITIES EXCHANGE ACT OF 1934. A BROAD READING, WHICH I FOR ONE ADVOCATE, APPEARS TO PROVIDE A BASE UPON WHICH THE COMMISSION MIGHT BUILD SUCH REQUIREMENTS.

THE FEDERAL COURTS HAVE TOYED WITH SUCH A READING OF THE FEDERAL SECURITIES LAWS. IN SCHOENBAUM V. FIRSTBROOK, THE COURT OF APPEALS FOR THE SECOND CIRCUIT SAID,

> "[I]T IS ALLEGED THAT [THE DEFENDANT] EXERCISED A CONTROLLING INFLUENCE OVER THE ISSUANCE TO IT OF TREASURY STOCK…FOR A WHOLLY INADEQUATE CONSIDERATION. IF IT IS ESTABLISHED THAT THE TRANSACTION TOOK PLACE AS ALLEGED IT CONSTITUTED A VIOLATION OF RULE 10B-5, SUBDIVISION (3) BECAUSE [THE DEFENDANT] ENGAGED IN AN ACT, PRACTICE OR COURSE OF BUSINESS WHICH OPERATES OR WOULD OPERATE AS A FRAUD OR DECEIT UPON ANY PERSON, IN CONNECTION WITH THE PURCHASE OR SALE OF ANY SECURITY."

BUT IN POPKIN V. BISHOP, DECIDED SOME FOUR YEARS LATER, THE COURT APPEARED TO RETREAT FROM THIS ADVANCED POSITION WHEN IT ASSERTED THAT THE

REACH OF RULE 10B-5 DID NOT EXTEND BEYOND ASSURING FULL DISCLOSURE AND, SPECIFICALLY, THAT THE FAIRNESS OF A TRANSACTION WAS NOT SUSCEPTIBLE OF REVIEW BY FEDERAL COURTS UNDER THAT RULE.

A BROAD READING OF RULE 10B-5 IS INTIMATED BY BROMBERG:

> "ALTHOUGH DISCLOSURE IS A MAJOR TOOL OF SECURITIES REGULATION AND SERVES SEVERAL PURPOSES, 10B-5 WAS NOT BORN WITH DISCLOSURE AS ONE OF ITS MAIN OBJECTIVES. IT SEEMED TO BE CONCERNED WITH DEVIOUS SCHEMES, ALTHOUGH IT CONTAINED THE STANDARD BAN ON MISLEADING PARTIAL DISCLOSURE."

ADDITIONAL SUGGESTION THAT SUCH AN EXTENSION OF RULE 10B-5 WOULD NOT BE INAPPROPRIATE IS CONTAINED IN THE SUPREME COURT DECISION IN SUPERINTENDENT OF INSURANCE V. BANKERS LIFE & CASUALTY CO. IN THAT CASE JUSTICE DOUGLAS (A FORMER CHAIRMAN OF THE COMMISSION, I MIGHT ADD) SAID,

> "THE CONGRESS MADE CLEAR THAT 'DISREGARD OF TRUST RELATIONSHIPS BY THOSE WHOM THE LAW SHOULD REGARD AS FIDUCIARIES, ARE ALL A SINGLE SEAMLESS WEB' ALONG WITH MANIPULATION, INVESTOR'S IGNORANCE AND THE LIKE. H.R. REP. NO. 1383 73D CONG., 2D SESS., P. 6. SINCE PRACTICES 'CONSTANTLY VARY AND WHERE PRACTICES LEGITIMATE FOR SOME PURPOSES MAY BE TURNED TO ILLEGITIMATE AND FRAUDULENT MEANS, BROAD, DISCRETIONARY POWERS' IN THE REGULATORY AGENCY HAVE BEEN FOUND PRACTICALLY ESSENTIAL.

THE CASES, FEDERAL AND STATE, ARE FILLED WITH STRONG STATEMENTS ON THE OBLIGATIONS OF CONTROLLING INTERESTS TO MINORITY SHAREHOLDERS AND THE BROAD SCOPE OF THE CONCEPT OF FRAUD IN SECURITIES CONTEXTS. I WOULD SUGGEST THAT THE TOOLS FOR COURTS LOOKING INTO THIS MATTER ARE AT HAND – AND IN ABUNDANCE.

"GOING PRIVATE" PRESENTS SOMEWHAT DIRECTLY AND DRAMATICALLY THE PROBLEMS WHICH ARE AT THE CUTTING EDGE IN THE DEVELOPMENT OF FEDERAL SECURITIES LAW. TO WHAT EXTENT SHOULD THE EXPANSION OF FEDERAL SECURITIES LAW

BE FOSTERED? SHOULD THE EXPANSION OF ITS CONCEPTS BE LIMITED TO AREAS IN WHICH STATE CORPORATION LAW IS NOT OPERATIVE? SHOULD IT BE CONFINED SIMPLY TO DISCLOSURE OR SHOULD THE POWERS ACCORDED THE COMMISSION BE READ TO SANCTION EXTENSION INTO MORE SUBSTANTIVE RULE-MAKING? WHERE STATE LAW PROVIDES INADEQUATE PROTECTION FOR SHAREHOLDERS, PARTICULARLY MINORITY SHAREHOLDERS, SHOULD FEDERAL LAW BE INTERPRETED BROADLY TO SUPPLY SAFEGUARDS LACKING IN STATE LAW?

THESE ARE IMPORTANT AND DIFFICULT POLICY QUESTIONS THAT ARE FOCUSSED SHARPLY BY THIS ISSUE. THE POLICY QUESTION, OF COURSE, IS INEXTRICABLY INTERLACED WITH PROBLEMS OF COMMISSION POWER, AND THE DETERMINATION OF THAT INVOLVES, OF COURSE, STATUTORY INTERPRETATION, THE ATTITUDE OF COURTS EVIDENCED IN THEIR DECISIONS, LEGISLATIVE HISTORY, PLUS SOME CONCERN FOR INTERPRETING THE COMMISSION'S MANDATE IN A MANNER THAT MAKES IT RELEVANT TO THE NEEDS AND CONCERNS OF THE DAY. THE COMMISSION HAS THROUGH ITS HISTORY, IN MY ESTIMATION, DONE AN OUTSTANDING JOB OF KEEPING ITS MANDATE FRESH AND RELEVANT. AS DIFFERENT PROBLEMS IN THE SECURITIES MARKETS HAVE EMERGED, THE COMMISSION HAS FASHIONED THE MEANS OF DEALING WITH THEM EFFECTIVELY. IT HAS CONFRONTED AND DEALT EFFECTIVELY WITH THE PROBLEMS OF THE "HOT ISSUES", THE PAPER JAM IN THE BACKROOMS OF THE SECURITIES INDUSTRY, THE EMERGENCE OF THE BOILER SHOPS, THE NOVELTIES OF THE PYRAMID SCHEMES AND THE COIN DEALS AND LAND DEVELOPMENTS, AND IMAGINATIVE AND MISLEADING ACCOUNTING METHODS. WITH RESPECT TO NONE OF THESE WERE THE TOOLS AND CONCEPTS FOR MEETING THEM CLEARLY DEFINED IN THE STATUTES ADMINISTERED BY THE COMMISSION, AND YET THE COMMISSION, USUALLY WITH AN ULTIMATE JUDICIAL APPROVAL, HAS FOUND THE MEANS OF DEALING WITH PROBLEMS NOT REMOTELY FORESEEN BY THOSE WHO FRAMED THE COMMISSION'S MANDATE.

THE "GOING PRIVATE" PHENOMENON ALSO POSES PROBLEMS THAT GO BEYOND SIMPLY JURISDICTIONAL MATTERS. IT CONFRONTS US ANEW WITH THE NEED OF DEFINING

IN MORE PRECISE FASHION THE OBLIGATIONS OWED BY THE CONTROLLING INTERESTS OF A CORPORATION TO THE MINORITY. THIS HAD BEEN A MATTER OF INCREASING CONCERN TO WRITERS AND COURTS ALIKE AND BOTH HAVE FOUND THE NEED FOR ESTABLISHING HIGHER STANDARDS OF CONDUCT. STEADILY FEDERAL COURTS AND, TO A SOMEWHAT LESSER EXTENT, STATE COURTS HAVE PLACED LIMITATIONS ON THE USE BY CONTROLLING SHAREHOLDERS OF THE POWER THEIR SHARES AND POSITIONS AFFORD THEM. IN 1974 THE FIFTH CIRCUIT COURT OF APPEALS READ INTO THE MECHANICAL PROCEDURES OF THE GEORGE CORPORATIONS LAW THE ADDITIONAL REQUIREMENT THAT A SHORT FORM MERGER BE ACCOMPANIED BY AN APPROPRIATE BUSINESS REPORT IN JONES V. H.F. AHMANSON & CO., THE CALIFORNIA SUPREME COURT DETERMINED THAT MAJORITY SHAREHOLDERS COULD NOT EXERCISE THEIR POWER IN A MANNER THAT AFFORDED THEMSELVES THE BENEFITS OF A PUBLIC MARKET AND A LISTING ON THE NEW YORK STOCK EXCHANGE WHILE DENYING THE SAME BENEFITS TO THE MINORITY. THE BALTIMORE CITY COURT OF APPEALS, OF ALL COURTS, IN A DECISION CHARACTERIZED BY ASTUTE INSIGHTS, DETERMINED THAT A CORPORATION WHICH, WHEN IT WENT PUBLIC, DISCLOSED IN ITS PROSPECTUS THAT IT WAS APPLYING FOR LISTING ON THE NEW YORK STOCK EXCHANGE AND WHICH WAS SUBSEQUENTLY LISTED, COULD NOT, AT THE BEHEST OF THOSE IN CONTROL, TAKE ACTION WHICH WOULD DEPRIVE THE CORPORATION OF THAT LISTING.

I WOULD SUGGEST THAT THE "GOING PRIVATE" PRACTICE AFFORDS A NEW OPPORTUNITY TO ASSESS THE NATURE OF THIS RELATIONSHIP AND DEFINE IN A NEW CONTEXT THE DUTY OWED BY THE CONTROLLING INTERESTS IN A CORPORATION TO THE PUBLIC OR MINORITY SHAREHOLDERS. AS I EARLIER SUGGESTED, IT IS THE OCCASION FOR A DELICATE ASSESSMENT OF THE BENEFITS WHICH ACCRUE TO THE MAJORITY, THE DETRIMENTS SUFFERED BY THE MINORITY, THE SIGNIFICANCE OF THE PURPORTED CORPORATE PURPOSE. THUS FAR IN WEIGHING THESE FACTORS THE COURTS HAVE NOT, IN MY ESTIMATION, REACHED CONCLUSIONS THAT ARE SUFFICIENTLY REFLECTIVE OF THESE FACTORS.

THE PROBLEM POSED BY "GOING PRIVATE" IS A DIFFICULT ONE WITH MANY FACETS. NO ONE WOULD WISH THAT THE STRUCTURES OF CORPORATIONS BE FOREVER CAST IN STONE WITH NO OPPORTUNITY FOR REORGANIZATION WHEN BUSINESS NEEDS REASONABLY DEMAND OR JUSTIFY IT. IN MANY INSTANCES THE ELIMINATION OF MINORITY SHAREHOLDERS IS SENSIBLE AND JUSTIFIED. BUT ALAS, THAT IS NOT ALWAYS THE CASE AND OFTEN THE PURPOSE OF THE REORGANIZATION HAS LITTLE PURPOSE OTHER THAN THE ELIMINATION OF A TROUBLESOME MINORITY THAT NOT MANY YEARS AGO WAS WELCOMED INTO THE CORPORATE FOLD WHEN THEY WERE WILLING TO PAY HIGH PRICE EARNINGS MULTIPLES FOR THE PRIVILEGE OF BECOMING SHAREHOLDERS. IF THEY ARE NUISANCES AND EXPENSIVE AND IRRITATING NOW, THEN THEY SHOULD HAVE BEEN THEN, ONLY THEN THEIR PRESENCE WAS THE MEANS OF EXPANDING THE CORPORATE COFFERS OR ENRICHING THE CONTROLLING SHAREHOLDERS.

IT IS DIFFICULT TO WRITE PRECISE RULES THAT WILL CLEARLY DISTINGUISH THE TRANSACTIONS WHICH SHOULD NOT BE CONSIDERED VIOLATIVE OF THE MANDATE THE COMMISSION IS UNDER FROM THOSE WHICH DO VIOLATE THAT MANDATE AND WHICH UNDERMINE THE CONFIDENCE OF THE PUBLIC IN SECURITIES MARKETS AND CORPORATE INTEGRITY. THE COMMISSION AND ITS STAFF STRUGGLED FOR THE LAST SEVERAL MONTHS WITH THE MEANS OF MAKING THIS DISTINCTION. VARIOUS FORMULAE WERE PROPOSED AND REJECTED. HENCE IT WAS FINALLY CONCLUDED THAT THE ONLY PROPER MEANS OF RESOLVING THIS TROUBLING DILEMMA WAS TO AFFORD THE PROBLEM THE ATTENTION IT DESERVES AND HAVE PUBLIC HEARINGS TO GIVE EVERYONE AN OPPORTUNITY TO EXPRESS HIMSELF OR HERSELF ON NOT ONLY THE MANIFESTATIONS OF THE "GOING PRIVATE" PROBLEM, BUT THE DIFFICULT ROOT PROBLEMS WHICH UNDERLIE IT. THIS COURSE DID NOT SATISFY ALL CRITICS OF GOING PRIVATE; FOR INSTANCE, BUSINESS WEEK SCORNED THIS APPROACH AND URGED THE COMMISSION TO "QUIT SUCKING ITS THUMB."!

AS LAWYERS, OF COURSE, WE TEND TO DEFINE PROBLEMS IN TERMS OF RIGHTS AND DUTIES AND WE ARE CALLED UPON BY OUR CLIENTS, NOT TO COUNSEL THEM WITH RESPECT

TO MORALITY, BUT RATHER WITH REGARD TO THEIR LEGAL OBLIGATIONS AND THEIR LEGAL RIGHTS. I WOULD URGE, HOWEVER, THAT NARROW LEGAL CONSIDERATIONS DO NOT EXHAUST EITHER THE RESPONSIBILITIES OF BUSINESSMEN OR THE INTERESTS OF ATTORNEYS AND I WOULD SUGGEST THAT MANY OF THE PROBLEMS WHICH BESET AMERICAN SOCIETY ARE NOT GOING TO BE RESOLVED IN THOSE TERMS. MANY PEOPLE IN THIS COUNTRY ARE SEVERELY DISILLUSIONED WITH OUR SECURITIES MARKETS AT THE SAME TIME NATIONAL LEADERS, INCLUDING THE CHAIRMAN OF THE NEW YORK STOCK EXCHANGE, ARE SUGGESTING THAT THE NEED FOR PUBLIC PARTICIPATION TO MEET THE ACCELERATING CAPITAL NEEDS OF AMERICAN INDUSTRY HAS NEVER BEEN GREATER. PEOPLE ARE BEING CALLED UPON INCREASINGLY TO INVEST THEIR MONEY IN AMERICAN CORPORATIONS AT A TIME WHEN THEIR CONFIDENCE IN THE INTEGRITY AND MORALITY OF CORPORATE LEADERSHIP HAS BEEN SERIOUSLY WOUNDED BY DISCLOSURES OF ILLEGAL POLITICAL ACTIVITY ON THE PART OF CORPORATE EXECUTIVES. IN THESE TIMES I WOULD SUGGEST THAT THE CRITERION FOR CORPORATE CONDUCT CANNOT BE CONFINED SIMPLY TO WHAT IS LEGAL OR WHAT CAN BE GOTTEN AWAY WITH; RATHER, THE GAZE OF THE BUSINESSMAN AND THE LAWYER MUST RAISE UP AND REACH OUT AND A MOST RELEVANT CONSIDERATION IN PLANNING CORPORATE CONDUCT SHOULD BE THE MANNER IN WHICH PUBLIC CONFIDENCE IN SECURITIES MARKETS AND OUR CORPORATE COMMUNITY ARE AFFECTED. PROFESSOR CARY HAS STATED THE PROBLEM WITH CHARACTERISTIC DIRECTNESS AND SIMPLICITY:

> "THE INTEGRITY OF MANAGEMENT IS INCREASINGLY IMPORTANT IN A COUNTRY WHICH UNTIL RECENTLY HAS BOASTED OF WIDENING MASS CAPITALISM. ONE CANNOT OVEREMPHASIZE THE IMPORTANCE OF CONFIDENCE, AND A HIGH STANDARD OF CONDUCT BY DIRECTORS, AS AN ESSENTIAL INGREDIENT TO PRIVATE INVESTMENT IN PUBLIC ISSUE COMPANIES."

I BELIEVE THAT IN MANY INSTANCES THE EFFORTS BY ENTREPRENEURS TO GO PRIVATE MAY HAVE TRANSGRESSED STATE AND FEDERAL SECURITIES LAW; IN SOME OTHER INSTANCES, IF THIS CONDUCT IS NOT NOW AGAINST THE LAW, THEN I WOULD SUGGEST THAT EITHER THROUGH RULEMAKING OR LEGISLATIVE ACTION ADDITIONAL RESTRAINTS SHOULD BE PLACED UPON THE ABILITY OF CONTROLLING INTERESTS TO SQUEEZE OUT MINORITY SHAREHOLDERS ON ANY TERMS OTHER THAN THE MOST DEMONSTRABLY FAIR. BUT EVEN WITH RESPECT TO THOSE TRANSACTIONS WHICH MAY WELL BE DEFENSIBLE UNDER PRESENT LAW OR ANY SCHEME OF CONTEMPLATED LAW, I WOULD SUGGEST THAT BUSINESSMEN SHOULD BE ALERT TO THE MANNER IN WHICH THEIR ACTIONS WILL IMPACT PUBLIC CONFIDENCE.

IT IS OFTEN SAID THAT WE ARE UNDERGOING A CRISIS OF CONFIDENCE -- CONFIDENCE IN ALL OF OUR INSTITUTIONS, IN ALL OF OUR LEADERSHIP. I WOULD SUGGEST THAT THE PROCESS OF "GOING PRIVATE" DOES NOTHING TO RESOLVE THIS CRISIS.