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# AROUND AND BEYOND THE SEC—THE DISENFRANCHISED STOCKHOLDER

DAVID C. BAYNE, S. J.\*

In an analysis of the SEC proxy regulations two notable deficiencies recommend themselves for correction by amendment: I. Evasion of Regulation by Non-Solicitation, and II. The Double Standard of Applicability.

## BACKGROUND

The story of proxy regulation, and the use of the proxy itself,<sup>1</sup> is the story of an evolution from the early days—when the shareholders' meeting performed a full, free, and democratic function, and substantially every shareholder attended—to the present, when few shareholders even consider attending<sup>2</sup> and, once present, frequently have considerable difficulty in obtaining a hearing.<sup>3</sup>

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1. A proxy to vote shares of stock is an authority given by a shareholder who has the right to vote, to another to exercise this right. *Manson v. Curtis*, 223 N.Y. 313, 119 N.E. 559 (1918). The same definition could be applied to any authority to perform any act in execution of a right held by a shareholder. In some instances there is enclosed with the notice of the shareholders' meeting a proxy form which is merely to be signed and returned in the self-addressed and stamped envelope, giving the desired authority to the management. The procedure may be mechanical and perfunctory.

2. Much of this is due to a complexity of factors incident to the growth of the corporate system. There are some indications, however, that management is not displeased with the status quo. For example, although the directors meet in New York City, F. W. Woolworth continues to hold its meetings in Watertown, N.Y., in the face of continued protests from small shareholders. Anaconda Copper meets in Butte, Montana. Southern Pacific has moved its meeting from Spring Station, Kentucky, to Wilmington, Delaware, even farther from its ownership. Continental Can has recently acceded to shareholder requests and moved from isolated Millbrook, New York, to New York City. Kaiser-Frazer meets in Reno, Nevada, which is far from its ownership concentration in the east. The management of U.S. Steel opposes shareholder requests to move from Hoboken to New York City. Shareholder complaint has also recently been levelled at New York Central, Valspar, Bethlehem Steel and Standard Oil of New Jersey, because of the locus of corporate meetings. This point is discussed at some length in Gilbert, *Management and the Public Stockholder*, 28 HARV. BUS. REV. NO. 4, 73, 74 (July 1950). See also, Gilbert, TENTH ANNUAL REPORT OF STOCKHOLDER ACTIVITIES AT CORPORATION MEETINGS 1-4 (1949).

3. The status of the stockholder at the present-day corporation meeting can be estimated from the following statement, accurate and representative in spite of its light tone:

"I'd never attended a stockholders' meeting, so I expected to be welcomed cordially and to be treated like one of the owners. You can see how naive I was. The meeting was a disgrace. . . . I got up to ask a question, but before I had a chance to say anything, one of the officers sitting in the back of the room made a motion to adjourn. It was seconded and passed in no time. I was still standing there when the chairman said, 'And now a delightful collation awaits you in the adjoining room,' and everybody

Since an absentee vote was not contemplated by the common law, the common law had little to say about the proxy; voting by a shareholder had to be *viva voce et praesens*.<sup>4</sup> This left the matter up to the states, and the states usually returned the deference by leaving the matter up to the common law; thus the proxy was virtually unregulated in 1933.<sup>5</sup>

However, the need for a change from the unprincipled days before and during the twenties was patent. It was widely felt that the proxy machinery could no longer remain exclusively in the hands of insiders, nor be simply a device for perpetuation of control,<sup>6</sup> for management indemnification,<sup>7</sup> for blanket ratification and approval of any and all management acts,<sup>8</sup> and for approval of envisaged future transactions,<sup>9</sup> officer pension plans,<sup>10</sup> stock options<sup>11</sup> or management employment contracts.<sup>12</sup> Nor did the other elements of corporate evolution, in addition to the passing of the shareholder participation in the shareholders' meeting, aid the return to corporate democracy. The nation-wide dispersion of shares, the stronger hold of management, the smaller and smaller interests of the individual shareholder—all aided management in retaining control and made the job of devising effective and feasible

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went for the free lunch. There I was, a part owner—I had ten shares—and I had been treated like a tramp by these people, who were my employees. I was horrified."

Lewis D. Gilbert, quoted in John Bainbridge, *Profiles—The Talking Stockholder*, 24 THE NEW YORKER, No. 42, 40 (December 11, 1948). The narration is of Mr. Gilbert's attendance in 1933 at a meeting of the Consolidated Gas Company.

4. See Commonwealth *ex rel.* Verree v. Bringhurst, 103 Pa. 134 (1883); Manson v. Curtis, 223 N.Y. 313, 119 N.E. 559 (1918); 5 FLETCHER, C.Y.C. CORP. 167. See also Axe, *Corporate Proxies*, 41 MICH. L. REV. 38 (1942); Note, 53 HARV. L. REV. 1165 (1940).

5. The statutory provisions of the states confine themselves mainly to provisions dealing with the expiration date of the proxy, revocability, length of term and similar matters. There is practically no regulation similar to the present SEC proxy provisions. The state statutes generally leave the matter to the corporate charter and by-laws. See *Regulation of Proxy Solicitations*, 33 ILL. L. REV. 914 (1939); *Hearing Before the Committee on Interstate and Foreign Commerce on H. R. 4314*, 73rd Cong., 1st Sess. 90 *et seq. et passim* (1933).

6. See sample proxies in REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B, at 77 *et seq.*

7. See *Notice of Annual Stockholders' Meeting, Aluminum Company of America*, REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B.

8. See *Proxy for Annual Meeting of March 21st, 1944, The Associated Laundries of America, Inc.*, REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B.

9. See *Notice of Annual Meeting of Stockholders, Atlas Plywood Corporation*, REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B.

10. See *Annual Meeting of Stockholders, Draper Corporation*, REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B.

11. See *Notice of Annual Meeting of Stockholders, Clinchfield Coal Company*, REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B.

12. See *Notice of Special Meeting, American Potash & Chemical Corporation*, REPORT OF THE SEC (1946), *op. cit. infra* note 19, Appendix D, Exhibit B. See *passim* also for illustrations of omissions, use of fine print for concealment and general failure to disclose.

proxy regulation difficult.<sup>13</sup> But, it seemed agreed that lack of disclosure and subtle deceptions should give way to an intelligent vote, coupled with and based on an understanding of disclosed facts.

Under the Securities Exchange Act of 1934 the SEC was given the task of devising a set of regulations and rules (which later applied under the PUHCA and the ICA) that would adequately compensate for the deficiencies of state statutes and the common law and provide a substitute for the evanescent meeting.<sup>14</sup> The Act makes it

unlawful for any person . . . to solicit . . . any proxy or 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.<sup>15</sup>

This provision is, moreover, very intimately related to the overall disclosure

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13. Nor did the proponents of the securities legislation find themselves without strong opposition. See references at notes 5 and 14. For an interesting exposition of the arguments of the opposition see also *Hearings Before House Committee on Interstate and Foreign Commerce*, H. R. REP. Nos. 1493, 1821, 2019, 78th Cong., 1st Sess. 149-159 (1943), and especially the objections of Lewis H. Brown, president of Johns-Manville Corp., Charles S. Garland, partner of Alex. Brown & Sons, Baltimore, Edward Hopkinson, Jr., senior partner of Drexel & Co., and chairman of the executive committee of Baldwin Locomotive Works, Emil Schram, president, New York Stock Exchange, Robert W. White, vice-president, Union Carbide and Carbon Co. In sum their objections were: the shareholders have not demanded any changes; revision would induce delisting of securities; the paper work would impede war work; the revisions were outside SEC authority; and the minimum disclosure would become the maximum. See also *Suggestions for Revisions of S.E.A. of 1934 by the Committee on Security Regulation of Commerce and Industry Association of New York, Inc.* 6 (1947). In connection with the opposition of the American Bar Association see Bayne, S.J., *The Tucker Fiasco*, 81 AMERICA 153, 155, 156 (April 30, 1949); see also the further comment and reprint of this article in *The SEC, the American Bar Association, and the Tucker Fiasco*, Extension of Remarks of Hon. Walter A. Lynch of New York in the House of Representatives, May 18, 1949, 95 CONG. REC. No. 88, A3220 (May 18, 1949).

14. For a sketch of the history see 10 SEC ANN. REP. 51 *et seq.* (1944); H.R. REP. No. 1383, 73rd Cong., 2d Sess. 13, 14 (1934); SEN. REP. No. 792, 73rd Cong., 2d Sess. 12 (1934); *Hearings on S. 2408, op. cit. infra* note 19, at 9 *et seq.* For the history of the proxy in general, see Axe, *Corporate Proxies, op. cit. supra* note 4.

15. Section 14 (a), 48 STAT. 881 (1934), 15 U.S.C. § 78a *et seq.* (1946).

"It was the intent of Congress to require fair opportunity for the operation of corporate suffrage. The control of great corporations by a very few persons was the abuse at which Congress struck in enacting Section 14 (a)." SEC v. Transamerica Corporation 163 F.2d 511, 518 (3d Cir. 1947).

The same fundamental purpose of a return of control to the shareholder was at the base of the provisions in the Holding Company Act. Public Utility Holding Company Act of 1935, 49 STAT. 838 (1935), 15 U.S.C. § 79 *et seq.* (1946). The Senate Committee said relative to the proxy provisions in that act: "Subsection (e) covers the solicitation of proxies in connection with all holding companies and subsidiary company securities so that such solicitation will not afford the basis for subtle control adverse to the interests of investors who have a right to be kept fairly and properly informed by representatives of their own choosing as against selfish self-constituted, self-perpetuating cliques." SEN. REP. No. 621, 73rd Cong., 1st Sess. 35 (1935).

purposes of the securities acts.<sup>16</sup> The Commission, “. . . to protect investors by requiring the disclosure of certain information to them and by affording them an opportunity for active participation in the affairs of their company,”<sup>17</sup> promulgated comprehensive regulations providing for a most substantial variety of information to be given when a proxy is sought.

Hence the proxy was to bear a heavy burden in the projected restoration of corporate democracy.<sup>18</sup> But the proxy, even in a legitimate form, can be valuable to the shareholder only if he uses it intelligently. In turn, this can occur only if the shareholder is informed of what has transpired in the corporation during the recent period, what is to be discussed, voted on, and approved. This disclosure the Act compels.<sup>19</sup> (A complete resume of the SEC proxy regulations appears as an appendix to this article.)

### I. EVASION OF REGULATION BY NON-SOLICITATION

One of the two major deficiencies in the SEC proxy provisions permits complete non-disclosure to shareholders, and hence a denial of corporate

16. Thus, concerning the Securities Exchange Act of 1934 the Senate Committee Report said:

“In order that the stockholder may have adequate knowledge as to the manner in which his interests are being served, it is essential that he be enlightened not only as to the financial condition of the corporation, but also as to the major questions of policy, which are decided at stockholders’ meetings. Too often proxies are solicited without explanation to the stockholder of the real nature of the matters for which authority to cast his vote is sought.” SEN. REP. No. 1455, 73rd Cong., 2d Sess. 74 (1934).

17. 13 SEC ANN. REP. 41 (1947).

18. Thus Louis Loss, Associate General Counsel of the SEC reported:

“The proxy instrument is an essential device in the modern corporation with its thousands and sometimes hundreds of thousands of scattered stockholders. It is a device which can be used for good or ill. If stockholders are informed of the affairs of their corporations and given an opportunity to cast their proxy votes intelligently, the proxy device may well turn out to have been the salvation of our present-day corporate system. On the other hand, if the proxy instrument is no more than a blank check, the whole device simply makes for self-perpetuation of management and leaves the door open, as the Commission said in its 1946 report, ‘for executive irresponsibility and outright fraud.’” *Some aspects of the Securities and Exchange Commission’s Legislative Program*, an address given before the New York Young Republican Club, New York City, April 1st, 1949, at 5.

19. Attempts to amend the 1934 Act came in 1941 and 1942. The summary of the SEC’s stand on the amendment proposals was embodied in *Report of the Securities and Exchange Commission on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934*, House Committee Print, Committee on Interstate and Foreign Commerce, 77th Cong., 1st Sess. (1941). Efforts at amendment were renewed in 1946 in *A Report of the Securities and Exchange Commission on a Proposal to Safeguard Investors in Unregistered Securities*, House Doc. No. 672, 29th Cong., 2d Sess. (1946). The SEC announced in *Securities Exchange Act Release No. 4399* (January 9, 1950) the transmittal to Congress of a supplemental report bringing up to date the report originally submitted in 1946. This report was also entitled *A Proposal to Safeguard Investors in Unregistered Securities*, Securities and Exchange Commission, Washington, D.C. (1950). These latest efforts of the SEC are embodied in the so-called Frear Bill. See *Hearings on S. 2408 before a Subcommittee of the Committee on Banking and Currency, United States Senate*, 81st Cong., 2d Sess. (February 7-10, 1950).

democracy by the simple expedient of failing, either partially or completely, to solicit proxies. This is not legally reprehensible because Regulation X-14 and Schedule 14A regulating the proxy and the proxy statement come into operation *only if and when the management determines to solicit*. This loophole results in major *possibilities* of abuse.<sup>20</sup>

Practices of non-solicitation generally follow one of three types. (And in the main, the particular *effects* resulting from each of the types are reliable indicia of the *motives* of management in avoiding the solicitation.)

I. *Total Non-solicitation Without Control*. A management without possession of a controlling block of stock or without a readily accessible block in a small group of shareholders may fail to solicit altogether if it is free from the necessity of having the shareholders approve or authorize any management proposal or activity.

An illustration of this type is The Glidden Company. Glidden has both its common stock and convertible preferred stock registered on the New York Stock Exchange and hence is subject to the SEC proxy regulations.

The company has consolidated assets of \$77,000,000.<sup>21</sup> It had average net sales of \$180,000,000 in the years 1947, 1948, and 1949 and an average net profit of \$10,000,000 annually for the same period.<sup>22</sup> The Company has 17,000 shareholders and no one owner holds as much as 10%.<sup>23</sup> As of January 31, 1950 all directors and officers as a group owned 3.4% of the common stock and less than 1% of the preferred stock.<sup>24</sup> The ten major officers, who are all directors as well, receive aggregate salaries of \$606,762 annually.<sup>25</sup>

The following letter in answer to an inquiry concerning solicitation for the 1949 annual meeting expresses Glidden's reasons for non-solicitation:

Our Executive Committee has decided, after carefully considering the matter, that the management should not solicit proxies for

20. The problem was discussed in *SEC Report on Proposals for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934, op. cit. supra* note 19, at 35. The possibilities of meeting the problem under the present status of proxy regulations is discussed in Friedman, *SEC Regulation of Corporate Proxies*, 63 HARV. L. REV. 796, 819 (1950). The general conclusion is that the Commission is at present without power to meet this problem adequately.

21. Thirty-Second Annual Report, Fiscal Year Ended October 31, 1949, The Glidden Company.

22. See Prospectus, The Glidden Company, Blythe & Co. 7 (March 15, 1950).

23. The Glidden Company, SEC 1934 Act Registration File No. 1-531. Public Document Room, Securities and Exchange Commission, Washington, D.C. There are 1,784,000 shares of common stock outstanding. The prospectus cited note 22 *supra* announces an offering of 178,535 shares of common stock. There are outstanding 199,540 shares of convertible preferred stock.

24. Prospectus, *op. cit. supra* note 22, at 15.

25. *Ibid.* Adrian D. Joyce, Chairman of the Board, receives \$96,500 and the president, his son, receives \$75,000. For a picture of the strictly business background of Glidden and the extent of its enterprise, see *House That Joyce Built*, 38 FORTUNE, No. 5, 95 (May 1949).

the Annual Meeting to be held on February 10, 1949 and incur the expense involved in preparing and printing a proxy statement, postage, etc., *since the Directors do not have any particular matter which they wish to submit to the stockholders. . . .*  
(Signed)<sup>26</sup>

In an eleven-year survey made of the Glidden Company's proxy-soliciting practices it was found that proxies were solicited by management only once for an annual meeting.<sup>27</sup> Thus, although the shareholders may have received some information, only once for these eleven annual meetings has the company been compelled to make the complete disclosures required by SEC proxy regulations.

The concrete results of such a policy are summarized in another letter from Glidden to an inquiring shareholder:

3. Although some shares were represented by proxies which were sent in unsolicited and some stockholders were present in person, *a quorum was not present and no business could be transacted.*

4. Under the Company's Regulations, *the directors and officers must hold over until their successors are elected and qualified and since a quorum was not present at the meeting, it was necessary for the directors to hold over.*

(Signed)<sup>28</sup>

In these circumstances, non-solicitation, not touched on by the present SEC proxy provisions, will usually result in failure of a quorum, with the consequence that the annual meeting will perforce adjourn *sine die*.<sup>29</sup> Pursuant to the by-laws the directors must hold over until their successors are chosen; yet an election of successors cannot occur without a meeting and the possibility of transacting business.<sup>30</sup>

But more significant are the *possible* results of non-solicitation: 1) Complete non-disclosure to the shareholder of the basic information concerning the meeting and the affairs of the corporation. 2) Effectual denial of the

26. (Emphasis added). Copy on file, Business Section, Library, West Baden College.

27. The Glidden Company, SEC Proxy File No. 11-109. The period covered in the survey was 1940-1950 inclusive. In addition to the solicitation for the annual meeting of 1947, The Glidden Company held two Special Meetings during the period studied for which proxies were solicited. In October, 1945 a meeting was held to split the common stock; in October 1947 the meeting was to approve a retirement plan for employees and officers, with no other business contemplated.

28. (Emphasis added). Copy on file, Business Section, Library, West Baden College.

29. Thus, The Glidden Company announced to a questioning shareholder: "The Annual Meeting of the Common Stockholders of The Glidden Company, held in Cleveland, Ohio, on Thursday, February 9, 1950, in the absence of a quorum was adjourned *sine die*." From a letter of The Glidden Company, February 27, 1950. Copy on file, Business Section, Library, West Baden College.

30. The policy of General Paint Corporation changed with the annual meeting of 1950. Prior to that time non-solicitation resulted in the absence of a quorum and adjournment of the annual meetings. Records of the Los Angeles Stock Exchange; Notice of Annual Meeting of Stockholders, General Paint Corporation, February 14, 1950.

opportunity to vote and participate in the conduct of the firm. 3) The dispersed shareholders, although perhaps representing as high as 99% of the stock, are thereby precluded from easy organization, from otherwise accessible control, from effectual opposition to management policies. 4) The elimination of the opportunity for shareholder initiation of plans or proposals through the proxy machinery. 5) Restricting vocal opposition.

II. *Total Non-solicitation With Control.* Management may fail to solicit where 1) management holds control, either itself or in close affiliation, although its holding may be a bare 51% of the voting shares; and 2) the management is faced with the actual need of holding a meeting. For example, action at a meeting duly called and held may be necessary to eliminate a provision of the corporate charter. Non-solicitation, of course, does not block a quorum or the consequent transaction of business.

This type of non-solicitation is seen in the maneuvering of Coty, Inc. Coty has net assets of over \$6,000,000<sup>31</sup> and over 5,000 shareholders.<sup>32</sup> In August 1950 the directors of Coty held 51% of the 1,488,906 voting shares.<sup>33</sup>

The juxtaposition of non-solicitation and solicitation at two recent meetings of Coty—special and annual, held on the same day—presents an apt illustration of the practice of non-solicitation by a management having control and a quorum in hand.

Since 1922, the Certificate of Incorporation of Coty has provided for cumulative voting in the election of the directors, thereby permitting the minority shareholders a pro rata representation on the board. The management of Coty determined to remove this cumulative voting provision because, said the president of Coty, "a group which might be acting 'for selfish motives' had been acquiring stock to obtain representation on the board of directors."<sup>34</sup> The elimination of a charter provision required the action of the holders of a majority of the outstanding shares of stock. The further business facing the meeting included the election of the directors, and submission for shareholder approval of two proposals advanced by shareholders. These four items could all have been considered at one meeting. The annual meeting was scheduled for October 23, 1950.<sup>35</sup>

The management sent out a "Notice of Special and Annual Meetings of Stockholders"; both were to be held on October 23. At 10:00 A.M. the

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31. MOODY'S INDUSTRIAL MANUAL (1950).

32. *Ibid.*

33. Notice of Special and Annual Meetings of Stockholders, Coty, Inc., 4, 5 (September 26, 1950). Of these 765,213 shares held by the directors, 47.28% or 708,745 are held by Yvonne Cotnareanu. The Chairman of the Board, Grover A. Whalen, owns 4,000 shares.

The directors of Coty receive annual salaries ranging from \$40,000 to \$50,000.

34. Wall Street Journal, October 24, 1950; the Sunday Star, Wilmington, October 29, 1950.

35. Notice, *op. cit.* *supra* note 33.



Special Meeting was to consider only the amendment to the Certificate of Incorporation. The annual meeting was to follow immediately at 11:00 A.M. for the election of directors and consideration of the two shareholder proposals. In the notice the company stated: "For your convenience a proxy for the Annual Meeting is enclosed. No solicitation of proxies for the Special Meeting will be made."<sup>36</sup>

At the Special Meeting the cumulative voting provision was eliminated by the vote of 773,988 management shares; 60 votes were cast in opposition by a minority shareholder.<sup>37</sup> The president of Coty did not reveal the identity of the group seeking representation on the board, but did point out pertinently that if proxies had been solicited for the Special Meeting, "we would have had to disclose completely the information."<sup>38</sup> The minority shareholder's attempts from the floor to have the Special Meeting adjourned until proxies could be solicited were blocked.<sup>39</sup>

In addition to non-disclosure and the complete denial of a minority vote, this type of situation can lead to other harmful results: 1) Securing to management the full benefits of actually holding a meeting and transacting business. 2) Avoidance of the odium, often experienced under Type I *supra*, accompanying an open and continued refusal to hold the annual meeting. 3) Removal of the opportunity for shareholder initiation of plans and proposals. 4) Elimination of two kinds of opposition—a. Where the charter requires approval of some proposal by two-thirds or more of the voting shares present at a meeting, the holders of 51% can work a substantial incursion into minority rights by not soliciting proxies which may oppose majority action. Non-solicitation will usually result in the shares held by management being about the only shares present at the meeting. b. Non-solicitation of proxies, and the frequently indefinite notices of what will transpire at the meetings, tend to eliminate any vocal objections and discussion at the meeting. Although this opposition is doomed of necessity to be ineffectual, it carries with it a number of factors offensive to management—the poor public relations, the nuisance value, and the possible ill-effects on the market value of the shares that attend suspicion of chicanery. These are all avoided by holding the meeting and conducting business without dissension.

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36. *Id.* at 2.

37. *Women's Wear Daily*, October 24, 1950; the *Sunday Star*, Wilmington, October 29, 1950.

38. *Ibid.*

39. *Wall Street Journal*, October 24, 1950; *Women's Wear Daily*, October 24, 1950; the *Sunday Star*, Wilmington, October 29, 1950. The proceedings at the meetings prompted a shareholder to comment:

"... that Coty's failure to solicit proxies indicated a definite need for new legislation at Washington to require proxy solicitation under the rules of the Securities and Exchange Commission." From *On Rodney Square* by Henry L. Sholly, in the *Wilmington Star*, October 29, 1950.

III. *Partial Non-solicitation Without Control.* This may occur where 1) a meeting must or is desired to be held in order to secure authorization for a plan or proposal, 2) management does not have a quorum in hand, 3) there are large blocks of voting shares in the hands of a few accessible and controllable shareholders which will guarantee control of the meeting.

International Shoe Co. is one of the larger companies following this type of solicitation. (Net assets exceed \$100,000,000<sup>40</sup> and the firm has over 11,000 shareholders.<sup>41</sup>) The company expresses its policy in the following letter:

We informed you in our letter of February 10, 1948 that this company considered it 'desirable and feasible to solicit proxies from larger shareholders.' That was done this year in connection with the meeting to be held on February 28, 1949. There are approximately 425 from whom the proxies were solicited.

(Signed)<sup>42</sup>

Thus the protection of the SEC proxy provisions was afforded to less than 4% of the shareholders of International Shoe in 1949.<sup>43</sup>

This policy of partial solicitation can bring non-disclosure, denial of the vote to the bulk of the shareholders and hence the minimization of effective minority opposition. At the same time the management can have the benefit of a legally conducted meeting and avoid the stigma which attaches to not holding meetings.

40. MOODY'S INDUSTRIAL MANUAL (1950).

41. International Shoe Company, SEC 1934 Act Registration No. 1-91.

42. Copy on file, Business Section, Library, West Baden College. "Our letter of February 10, 1948," referred to in the letter above, stated:

Because of the time and expense involved, the company has not made it a practice to solicit proxies from all of its 11,000 stockholders, but it has considered it desirable and feasible to solicit proxies from larger stockholders.

I should point out that the fact that you did not receive a proxy form along with the 'Notice of the Annual Stockholders' Meeting' did not preclude your voting your stock in person or by any proxy whom you might wish to designate."

Letter, International Shoe Company, St. Louis, Missouri, dated February 10, 1948; copy on file, Business Section, Library, West Baden College.

43. International Shoe Company, SEC Proxy File No. 11-112. One shareholder in International Shoe Company attempted to circumvent the management policy and received the following:

I am instructed by Messrs. Frank C. Rand, Byron A. Gray, Andrew W. Johnson and Oliver F. Peters, who are named in the proxy you have sent us, to inform you that they decline to act as your proxy at the annual stockholders' meeting of the International Shoe Co. on Feb. 28th, subject to the conditions indicated in the proxy.

It is suggested that you select your own proxy and place upon him such conditions, limitations, and directions, as you choose.

Your proxy is returned herewith.

(signed)"

Letter, International Shoe Company, St. Louis, Missouri, dated February 17, 1949; copy on file, Business Section, Library, West Baden College.

## THE EXTENT OF THE PRACTICE

The exact number of companies which follow Glidden, Coty, and International Shoe through the loophole in the disclosure provisions of the Securities Exchange Act is not known. No authoritative up-to-date survey of the extent of the practice has been made, either as to complete failure to solicit, or partial solicitation.

A survey made ten years ago indicated a general increase in the practice of non-solicitation. At that time, corporations listed on the New York Stock Exchange which failed to solicit proxies increased from 1.8% in 1938 to more than 11% in the years 1939, 1940, and 1941. Non-solicitation in firms listed on the New York Curb Exchange rose from 6.5% in 1938 to 27% in 1939, to 29% in 1940, and to 31% in 1941.<sup>44</sup> The report of the SEC for 1949 indicated that about one-third of the listed corporations failed to solicit proxies.<sup>45</sup>

A survey made by the writer shows a number of large firms which currently pursue a policy of non-solicitation. The following firms, as indicated by the records of the New York Stock Exchange, the New York Curb Exchange and the SEC, have avoided solicitation for the years 1940-1949 inclusive:<sup>46</sup>

<i>Corporation</i>	<i>Total Assets</i>
(1) Crown Central Petroleum Corporation	\$19,400,000
(2) Esquire, Inc.	8,000,000
(3) The A. C. Gilbert Company <sup>47</sup>	5,900,000

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44. *Hearings before Committee on Interstate and Foreign Commerce on Proposed Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934*, 77 Cong., 1st Sess. 1144 (1941).

45. 15 SEC ANN. REP. 34, 48 (1949).

46. Other material data is available on the firms selected:

<i>Corporation</i>	<i>SEC 1934 Act Registration File No.</i>	<i>SEC Proxy File No.</i>
(1) Crown Central Petroleum Corp.	1-1059	11-883
(2) Esquire, Inc.	1-2983	11-1771
(3) The A. C. Gilbert Co.	1-254	11-1808
(4) The Glidden Co.	1-531	11-109
(5) R. G. LeTourneau, Inc.	1-2496	(A)
(6) The Silex Co.	1-2946	11-1692
(7) Spear and Co.	1-775	11-468
(8) Johnson and Johnson	1-3215	(A)
(9) Venezuelan Petroleum Company	1-1155	11-293
(10) A. S. Beck Shoe Corporation	1-3267	(A)
(11) Wilson Brothers	1-3329	(A)

(A) These firms were not assigned SEC proxy numbers since no proxies have ever been solicited under SEC regulations.

47. During the year 1946 the A. C. Gilbert Co. solicited proxies for a special meeting of stockholders. This was the only time during the 1940-1950 period inclusive that the firm solicited proxies from its shareholders.

(4) The Glidden Company <sup>48</sup>	76,700,000
(5) R. G. LeTourneau, Inc.	21,200,000
(6) The Silex Company	2,900,000
(7) Spear and Company	14,300,000
(8) Johnson and Johnson <sup>49</sup>	80,200,000
(9) Venezuelan Petroleum Company	63,100,000
(The following firms have never solicited proxies under SEC regulations)	
(10) A. S. Beck Shoe Corporation (1946-1950 incl.)	13,600,000
(11) Wilson Brothers (1947-1950 incl.)	5,700,000

These random selections indicate that a noteworthy section of the so-called regulated firms are not regularly soliciting proxies. And to these samplings many other firms occupying substantial positions in the national economy could be added.<sup>50</sup>

48. See *supra* note 27. The Glidden Company solicited at one annual meeting during this period and at two special meetings.

49. The survey in regard to Johnson and Johnson applies only to the last ten years. Johnson and Johnson has approximately 1580 shareholders. Letter, dated October 23, 1950, on file, Business Section, Library, West Baden College.

Johnson and Johnson has evidenced a determined policy of non-solicitation. The agenda of business, available at the Special Meeting of Stockholders of Johnson and Johnson, September 7, 1949, carried at the bottom of the first page the following parenthetical remarks:

"(Note: You will recall that Mr. John Gilbert is apparently planning to attend. If he follows his usual tactics, he will object to the fact that proxies have not been solicited. You will probably want to reply that in accordance with the statement you made at the previous meeting we have presented our views on this and other matters to the SEC which is in process of revising its requirements. Pending some modification of their views along the lines of our suggestions, we are not prepared to solicit proxies. If, as he started to do at the last meeting, he moves an adjournment in order that proxies may be solicited, we will have to put the motion to a vote and vote it down.)" Copy on file, Business Section, Library, West Baden College.

50. For example, the following firms have not solicited proxies for their last annual meeting at least:

Corporation	SEC 1934 Act		Gross Assets	Date of Annual Meeting
	Registration File No.	SEC Proxy File No.		
George A. Fuller Company	1-458	11-1666	\$12,064,991	4-11-50
G. Krueger Brewing Company	1-1331	11-688	9,083,817	5-24-50
The Outlet Company	1-1209	11-40	8,841,764	4-19-50
Fedders-Quigan Corporation	1-2150	11-399	10,279,042	4- 3-50
Casco Products Corporation	1-2639	11-1377	3,924,733	6- 6-50
Penn Electric Switch Company	1-2779	(A)	3,346,446	3-28-50
Shellmar Products Corporation	1-3326	11-2198	15,351,241	4-10-50

(A) This firm was not assigned a SEC proxy number since no proxies have ever been solicited under SEC regulations.

Copies of all notices of 1950 annual meetings of these firms are on file, Business Section, Library, West Baden College. Asset figures are all from MOODY'S INDUSTRIAL MANUAL (1950). National Steel has not solicited proxies for any meeting, annual or special, in the years ending September 30, 1938, 1939, 1940, 1941, 1942, 1946, 1947, 1948, 1949, according to the records on file in the New York Stock Exchange. The firm had \$129,042,022 in assets as of December 31, 1949. MOODY'S INDUSTRIAL MANUAL (1950).

## RECOMMENDATIONS FOR AMENDMENT

The problem of evasion of regulation by non-solicitation has not received the national attention which it would seem to warrant. The currently proposed amendment to the Securities Exchange Act, the Frear Bill, does not remedy the situation; and hence one may assume that even if the amendment carries, one-third of the larger corporations will continue a practice of non-solicitation. The investor protection and corporate democracy provided for by the SEC proxy provisions will be accorded only at the sufferance of management.

At most the policy is a modern, corporate form of benevolent despotism. It is not corporate democracy at its best; it cannot be said in any wise that the possibility of abuse offered management is a corporate desideratum. Considering the *possibilities* of abuse *in vacuo* and as outlined in the Glidden, Coty and International Shoe illustrations, there seems little question that a solution for the problem is needed. Various suggestions have been offered but no one of them has carried a plan far enough to work an effective restoration of corporate democracy. For it would appear that it is primarily through adequate information and a vote that the shareholders may first detect and later correct management abuse should it perchance arise.

A recent commentator touched on the question and concluded that "a careful study of the problem might suggest that effective corporate democracy can be achieved only through a disinterested, active participation in corporate affairs by some private or public agency charged with representing the viewpoints and protecting the interests of the various non-management groups."<sup>51</sup> Such thoughts are reminiscent of the O'Mahoney-Borah Bill<sup>52</sup> of some years ago which would have provided for the appointment by a federal agency of a "certified corporation representative" who would be named proxy for the absent shareholders and who would represent them at the meeting. There would seem to be no major objection to a natural emergence of private groups<sup>53</sup> dedicated to the furtherance of the cause of the small independent shareholder, but cogent objections to entrusting what have been traditionally the corporate owners' functions and duties to a governmental agency, where strict necessity does not so postulate, suggest opposition to a certified corporate representative.

In 1941 the SEC considered the problem of non-solicitation and listed some suggestions for remedying it. At that time the Commission said:

51. Friedman, *SEC Regulation of Corporate Proxies*, 63 HARV. L. REV. 796, 821 (1950).

52. S.3072, H.R. 9589, 75 Cong., 3d Sess. (1938).

53. E.g., the Federation of Women Shareholders under the leadership of Wilma Soss. Recall the American Investors Union for the purposes of studying corporate reports and prospective securities issues for the help and education of the unformed and untrained. It had its counterpart in England in the Shareholders' Protective Association.

Through its administration of the proxy regulations the Commission has become increasingly aware that some issuers have avoided adequate disclosure to their stockholders by the simple device of not soliciting proxies. This is especially vicious because, in many cases, the failure to solicit proxies prevents the presence of a quorum and thus results in self-perpetuation of management. As a consequence, stockholders are deprived of an opportunity to pass upon the activities of management and to remove bad management from office.<sup>54</sup>

The amendment proposed by the SEC<sup>55</sup> at that time was the insertion of a requirement in the Securities Exchange Act "that issuers submit to their security holders prior to meetings the information required by the proxy rules."<sup>56</sup> It was felt that the effect of this suggestion would be "to re-enfranchise security holders who have been denied the opportunity of casting their ballots because of the reluctance of some managements to make adequate disclosure under the proxy regulations."<sup>57</sup>

A close inspection of the recommendation indicates that the Commission was not suggesting a mandatory annual proxy but only that the disclosure materials be given the shareholders. This would mean that the shareholder would receive the information but would not receive the proxy forms requisite to the actual mechanics of voting. The shareholder would be *informed*, but would not be an informed *voter*.

Whether the Commission at that time fully intended this dichotomy is debatable. The SEC would understandably be reluctant to ask for an annual mandatory proxy in so many words, and yet there seems no other feasible solution to the problem. Once the requirement of the proxy materials has been made, the added requisite of the proxy itself is a very slight addition; yet the information without the mechanics of the vote is bootless. These considerations lead quite logically, it is submitted, to the recommendation of the annual mandatory proxy. An annual meeting, the information needed to form an intelligent judgment and the actual opportunity to vote—all seem reasonable demands on the part of the shareholder as just rights incident to his ownership in the corporation. Under the present-day system of dispersed holdings, distant meeting-places, and the use of the mailed-in proxy, the most feasible guarantee of corporate democracy is the annual mandatory proxy and proxy statement.

## II. THE DOUBLE STANDARD OF APPLICABILITY

The second major defect in the present Act is the anomalous double standard of applicability. Two great groups of U. S. corporations are

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54. REPORT OF THE SEC, *op. cit. supra* note 19, at 35.

55. *Ibid.*

56. *Ibid.*

57. *Ibid.*

separated only by the arbitrary norm of (1) registration of securities on a national securities exchange, (2) operation of a public utility holding company or (3) investment company. Investors with securities in these classifications are guaranteed the protections of the SEC proxy provisions; all others are not, though the "other companies [may be] of comparable importance, and public interest."<sup>58</sup>

The fact that a large segment of the U. S. corporations are not subject to SEC regulations does not, of course, establish actual abuse or oppression of shareholders; at the same time there exists marked *possibilities* of abuse outside the restraining pale of the SEC. An illustration is that of the Ward LaFrance Truck Corporation.<sup>59</sup>

In 1941, the Ward La France Truck Corporation, of Elmira, New York, operated a successful business in fire apparatus and motor trucks with net profits for the year ending December 31 of \$77,000 after taxes. With the advent of the war and the demand for trucks and heavy mechanical equipment, the company's net profits increased to \$384,000 after taxes for the eleven month period ended November 30, 1942. This represented an increase in earnings per share on securities outstanding of over 500%—from \$2.73 in 1941 to \$15.75 in 1942.<sup>60</sup>

As of September, 1942, Ward La France had outstanding 10,500 shares of its Class A stock, with one vote per unit, and 17,202 shares of Class B stock, with one and one-half vote per unit. With the exception of 7,171 shares of the Class A in the hands of the public, A. Ward La France and Joseph Grossman, president and treasurer respectively of the company, owned all of the outstanding stock and hence held 80% of the voting power of the corporation.<sup>61</sup>

58. REPORT OF THE SEC (1946), *op. cit. supra* note 19, at v.

59. The report of this investigation was contained in *Securities Exchange Act Release No. 3445* (June 12, 1943). The Securities and Exchange Commission instituted an investigation into the Ward La France transaction pursuant to Section 21 (a) of the Securities Exchange Act of 1934. (It should be observed that the investigation was not initiated under the proxy regulations of the Commission.)

60. The following table indicates the rapid and substantial increase in profits:

	Year ended Dec. 31, 1941	8 months ended Aug. 31, 1942	11 months ended Nov. 30, 1942
Net income before Federal Income and Excess Profit taxes:	\$159,845.27	\$1,300,729.52	\$1,764,448.89
Net Income after:	77,590.46		384,976.28
Earnings per share on securities then outstanding:	2.73		15.75

*Securities Exchange Act Release, op. cit. supra* note 59, at 2.

61. *Securities Exchange Act Release, op. cit. supra* note 59, at 2 *et passim*. La France and Grossman owned 74% of the outstanding shares.

Contemplating the continued war profits,<sup>62</sup> La France and Grossman entered into private negotiations with S. A. Odlum of Salta Corporation culminating in the execution of an agreement whereby:

1) La France and Grossman would receive \$900,000 for the bulk of their stock. This represented \$45.86 per share.<sup>63</sup>

2) The Board of Directors of Ward La France would adopt a plan of liquidation, effecting a transfer of all the corporate assets to Salta as a going concern.<sup>64</sup> Liquidation would result in the payment of the book value of \$28.03 per share to the minority public shareholders.

3) Salta would retain La France and Grossman for seven years at an annual salary of \$60,000 each until cessation of the war, and thereafter at \$20,000.<sup>65</sup>

Salta had received the balance sheets and earnings statements of Ward La France which revealed the appreciable increases in the months of 1942.<sup>66</sup> Moreover during the period prior to and during the negotiations, La France, Grossman and Salta, as well as the corporation itself, availed themselves of insider trading profits.<sup>67</sup>

Since the plan of liquidation envisaged by the agreement necessitated shareholder approval, a stockholders' meeting was called for November 23, 1942, to pass on the plan, which La France and Grossman had already caused the directors to approve.<sup>68</sup>

An announcement of the shareholders' meeting was mailed to each shareholder. The proxy soliciting letter was brief, concise, and altogether uninformative:

To the Stockholders:

At a meeting held today the Board of Directors of your corporation declared it advisable to dissolve the corporation and approved a Plan of Liquidation. . . . This plan provides for the payment to each stockholder . . . of his *proportionate share of the net assets* of the corporation in cash upon surrender of the certificates for shares of stock which he owns. . . .

In the event that you cannot attend the meeting, please sign and return the enclosed proxy in the enclosed envelope.

(Signed)<sup>69</sup>

62. In addition to the factor of continuing war profits was the attractive savings in excess profits taxes. Salta had a large tax base and hence could avoid heavier taxes to which Ward La France would be subject.

63. *Securities Exchange Act Release, op. cit. supra* note 59, at 3.

64. *Ibid.*

65. *Ibid.*

66. *Id.* at 2.

67. *Id.* at 4 *et passim*. Due to the extent of the La France and Grossman holdings any purchases effected for Ward La France resulted in their benefit and were tantamount to purchases made directly by themselves.

68. *Id.* at 4, 5.

69. (Emphasis added). *Id.* at 14.



Beyond this letter the shareholders received nothing that would inform them of the conditions surrounding the dissolution. 1) At no time did the shareholders learn of the increase of profits from \$77,000 in 1941 to \$384,000 in the first eleven months of 1942.<sup>70</sup> 2) The private sale to Salta of the La France-Grossman stock was not revealed. 3) The differential between the \$45.86 per share for the La France-Grossman interest and the \$28.03 per share paid the public shareholders was kept secret.<sup>71</sup> 4) The agreement to rehire La France and Grossman at salaries of \$60,000 per annum was likewise suppressed.

The result of the proxy solicitations was complete approval at the shareholders' meeting of the plan of liquidation. There were no dissenting votes.<sup>72</sup> The proxy announcement had succeeded in disclosing nothing, had gained blanket power and had effected in full the plans of La France, Grossman and Salta.

A correlative consideration of the disclosure requirements of Regulation X-14 and the conduct of the Ward La France solicitation shows the sharp contrasts between regulated and unregulated firms. In the light of this illustration two questions arise: How many firms are unregulated? How many follow disclosure practices akin to Ward La France's?

#### THE 'UNREGULATED SEGMENT'

Knowledge of how great a segment of the investing public shares in the protection of the proxy rules is essential to a determination of what remedies should be written into the Securities Exchange Act. Two Commission

70. *Securities Exchange Act Release*, *op. cit. supra* note 59, at 2.

71. *Id.* at 5.

72. *Ibid.* The financial editor of the Chicago Herald-American recently noted shareholder concern over abuse in a similar proxy solicitation:

"On May 10, stockholders of the Camden Forge Company will be asked to approve an amendment to the concern's certificate of incorporation, changing the tenure of office of directors from one to three years with only one-third of the board to be elected each year.

Unlike the Montgomery Ward & Co. charter, which permits such change by majority action of directors, it is necessary for two-thirds of the Camden Forge stockholders to approve before this backward step can be taken.

It is unthinkable that stockholders will ratify the proposal. One business man in sending his proxy against the plan, described it as 'an undemocratic corporate subterfuge to perpetuate management in office.'

In this particular instance, the management, with arrogant disregard of fair treatment of stockholders, makes no provision on the proxy for a negative vote.

Under normal circumstances the Securities and Exchange Commission would prevent such a one-sided presentation, but inasmuch as Camden Forge stock is not listed on a registered securities exchange the SEC lacks jurisdiction over its proxy solicitation.

Undemocratic corporate managements, intent upon concentrating more and more power in their hands, serve to weaken the American system of private enterprise." Robert P. Vanderpoel, Chicago Herald-American, Financial Section, May 3, 1949.

surveys, published in 1946 and 1950, lay the base for considering the number and size of unregulated corporations.

In its 1950 report the SEC indicates that a study of the corporations having assets of at least \$3,000,000 and 300 security holders yields 1741 corporations not subject to Regulation X-14.<sup>73</sup> Set off against this figure are 2194 corporations listed under the Securities Exchange Act of 1934.<sup>74</sup> Bearing in mind that not *all* large U. S. corporations are included in the SEC figure of 1741 (since a number have less than 300 shareholders and others are exempt), it is consequently a sound inference that roughly one-half of the larger U. S. corporations are unregulated by SEC proxy rules.<sup>75</sup> The Commission's 1946 report indicated substantially the same state of regulation, as the 1950 report, with some increase towards a higher percentage of non-regulation in 1950.<sup>76</sup>

The value of the securities issued by the larger corporations only, covered in the 1950 report, is estimated at \$19,000,000,000; they are traded at the rate of \$1.5 billion annually.<sup>77</sup> From this it can be seen that these firms,

73. *A Proposal to Safeguard Investors, op. cit. supra* note 19, at 17, 18. The breakdown of this figure of 1741 can be achieved by reference to the table compiled by the SEC in this same report, at 18.

74. *Hearings on S.2408, op. cit. supra* note 19, at 18.

75. There is further support for this conclusion in the number of corporations that are technically subject to Regulation X-14 but due to a loophole in the provisions of the 1934 Act do *not* provide their shareholders with the benefits of the proxy provisions. These corporations may be estimated to be one-third of those corporations actually registering their securities on a national exchange. For figures, see 13 SEC ANN. REP. 33, 42 (1947); 15 SEC ANN. REP. 34, 48 (1949).

76. The estimates made by the Commission in the 1946 report indicated about 3,090 corporations with \$3,000,000 in assets and 300 or more security holders, excluding banks. Thus the following summary excludes, as did the 1950 report, the smaller firms which seldom register their stocks on a national exchange, and are neither public utility holding companies or investment companies.

I. Reporting to Securities and Exchange Commission under :	
(a) Securities Exchange Act of 1934 .....	1,455
(b) Other acts (and not under 1934 Act)	
(1) Public Utility Holding Company Act of 1935 .....	38
(2) Investment Company Act .....	98
	—
	136
	—
	1,591
	—
II. Reporting publicly to other Federal agencies, but not to the Securities and Exchange Commission: .....	102
III. Reporting only to State commissions: .....	397
IV. Companies not making public reports to Federal or State agencies (estimated)	1,000
V. Total (estimated) .....	3,090
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A REPORT OF THE SEC (1946), *op. cit. supra* note 19, at 25.

77. *A Proposal to Safeguard Investors op. cit. supra* note 19, at 18, 19.

unregulated by the proxy provisions, form a most substantial segment of our economy.<sup>78</sup>

The SEC also reported on the amount of assets of certain large corporations, none subject to the proxy rules, which have voting securities admitted to unlisted trading privileges on the New York Curb Exchange. In this 1950 report, the following corporations had the largest amount of assets:<sup>79</sup>

<i>Company</i>	<i>Assets</i>	<i>Number of Stockholders</i>
Humble Oil & Refining Co.	\$861,400,000	11,617
Creole Petroleum Corp.	618,900,000	4,600
Aluminum Company of America	503,600,000	4,923 (pfd.)
Great Atlantic & Pacific Tea Company	322,800,000	Not disclosed <sup>80</sup>
Weyerhaeuser Timber Company	210,100,000	Not disclosed <sup>81</sup>
Singer Manufacturing Company	202,900,000	3,800

Many other companies that occupy a prominent position in U. S. business find themselves beyond the reach of the SEC proxy provisions. These include: *American Book Company, Carnation Company, Chesebrough Mfg. Co., Claude Neon Inc., Crown Cork International Corp., Durham Hosiery Mills, New Jersey Zinc Co., Goodman Mfg. Co., Gorham Mfg. Co., Great Northern Paper, Glen Alden Coal Co., Horn and Hardart, Lit Brothers, Pepperell Mfg. Co., Pitney-Bowes, Prentice-Hall, Segal Lock, Sherwin-Williams, John B. Stetson, Technicolor, Inc., Thew (Lorain) Shovel Co.,<sup>82</sup> Remington Arms, Crowell-Collier Publishing Co., American Optical, and American Potash and Chemical Corporations.<sup>83</sup> The remaining 1500 unregulated corporations remain uncategorized and as a group unknown.*

78. Speaking about the need for removal of the double standard of applicability, Harry A. McDonald, Chairman of the SEC said:

"Approximately 1,100 companies not now required to file any reports with the Commission and about 650 additional companies which file some but not all of the reports required by sections 12, 13, 14, and 16 of the Securities Exchange Act would be affected by the proposed amendment. Although, in terms of numbers, these corporations constitute a relatively small segment of our economy, they represent a considerable portion of the larger aggregations of capital and they have a very significant effect on the national welfare." *A Proposal to Safeguard Investors, op. cit. supra* note 19, at v.

79. *Id.* at 19. In the report the SEC covered only 96 corporations, all of which were domestic industrial corporations not subject to the proxy regulations and whose voting securities had been admitted to unlisted trading privileges on the Curb Exchange. These companies were chosen regardless of number of security holders, volume of trading or size of company. *Id.* at 10.

80. In the 1946 report, note 19 *supra*, the number of stockholders of the Great Atlantic and Pacific Tea Company was 14,217.

81. In the 1946 report, note 19 *supra*, the number of stockholders of Weyerhaeuser Timber Company was 803.

82. All of these firms and many more are listed in Appendix C in *A Proposal to Safeguard Investors, op. cit. supra* note 19, at 67, 68, 69.

83. The last four firms were listed by Louis Loss, Associate General Counsel, SEC, in an address, *Some Aspects of the Securities and Exchange Commission's Legislative*

The 1946 report created a similar impression as to the number<sup>84</sup> and size of the unregulated corporations.<sup>85</sup>

#### THE EXTENT OF ABUSE IN UNREGULATED FIRMS

Since opportunity for abuse is one thing and actual abuse another, the SEC took a representative sampling of the 1741 corporations and investigated in detail their proxy-soliciting practices. The study was made in 1949 and included an examination of all proxy-soliciting materials sent out in 1948 and 1949 by 96 corporations which are admitted to unlisted trading privileges on the New York Curb Exchange.<sup>86</sup> A total of 202 meetings<sup>87</sup> were held by these firms.<sup>88</sup>

The following words of the 1950 report epitomize the results of the survey:

In only ten of all the 144 meetings where action was taken upon matters other than the election of directors were the stockholders accorded a right to vote with respect to the *specific* item to be considered at the meeting. In the other 104 instances *the stockholders*

*Program*, delivered at New York City before the New York Young Republican Club, April 28, 1949, at page 7.

84. A REPORT OF THE SEC (1946) *op. cit. supra* note 19, at 77. The 1946 survey made by the staff of the Commission examined 76 corporations whose voting securities had been admitted to unlisted trading privileges on the Curb Exchange and whose assets exceeded \$3,000,000 and were traded in a volume over 5,000 shares in the year 1944.

85. See, A REPORT OF THE SEC (1946), *op. cit. supra* note 19, at 22.

86. Of the 76 corporations included in the 1946 study, 61 were also in the 1950 report.

87. Of these, 191 were annual meetings and 11 special meetings. *A Proposal to Safeguard Investors, op. cit. supra* note 19, at 10.

88. The following breakdown indicates the subjects which were under discussion at the meetings for which the proxies were solicited:

	<i>Number of Meetings</i>
Election of directors	191
Approval of auditors	30
Approval of all acts of management	54
Bonus and profit-sharing plans, including stock options	4
Pension and insurance plans	12
Management employment contracts	2
Compensation of directors	2
By-law and charter amendments providing for indemnification of officers and directors	5
Supervisory contract with an affiliate	1
Modification of an underwriting contract	1
Purchase and sale of property	4
Merger agreement	1
Authorization for new or additional securities	13
Modification or exchange of securities	4
Authorization for purchase of outstanding securities	1
Retirement of treasury shares	5
Approval of charitable contributions	5
Miscellaneous by-law and charter amendments	25

*Id.* at 11.

were compelled either to vest absolute discretion in the proxy holder or be disenfranchised.<sup>89</sup>

A summary analysis of this report shows the extent to which the standards of disclosure established by the SEC are not satisfied by the unregulated corporations:

1) *Election of Directors.* In 84% of the instances when proxies were requested for the election of directors, the shareholder was not informed of the names of the men who were nominated for the board.<sup>90</sup>

2) *Remuneration of Management.* In 185 out of the 191 times (or 97%) when proxies were sought for the election of directors the remuneration of management was not disclosed, either individually or in the aggregate. Moreover, in 95% of the instances the security holdings of officers and directors were not revealed.<sup>91</sup>

3) *Selection of Independent Auditors.* In practically all of the instances where shareholders were asked to approve auditors for the coming year, the name of the auditing firm remained undisclosed.<sup>92</sup>

4) *Blanket Ratification of Management Acts.* On 54 occasions the shareholders were asked to execute proxies for the blanket approval and ratification of all acts of management since the last annual meeting. These requests were made in the face of non-disclosure of the nature of the acts, when it was clear from other sources that material and important transactions had been effected in the interim.<sup>93</sup>

5) *Pension Plans.* In approximately 80% of the cases where shareholders were asked for proxies in approval of pension plans the amounts payable to directors and officers were not disclosed, nor was the cost to the company divulged.<sup>94</sup>

6) *Issuance of New Securities.* In approximately 50% of the cases where the shareholder was asked to approve the issuance of new securities or the modification of the rights of existing securities, there was no financial statement accompanying the proxy.<sup>95</sup>

A comparison of the findings in the comparable survey made by the Commission in 1946<sup>96</sup> indicates such slight improvements as to invalidate

89. *Id.* at 11, 12. Emphasis added.

90. *Id.* at 12.

91. *Ibid.*

92. *Id.*, at 12, 13. In some cases it was apparent that the company intended to change auditors, a fact which made the names of the auditors particularly relevant.

93. *Id.* at 13.

94. *Id.* at 14.

95. *Id.* at 15. There is an unusual device commented on in the Senate hearings:

In one case that came to our attention the form of the proxy appeared on the back of the dividend check, so that if you endorsed your check you gave a proxy. That lawyer, of course, well earned his fee.

From the testimony of Louis Loss, *Hearings on S. 2408, op. cit. supra* note 19, at 24.

96. In the 1946 study the Commission examined the proxy-soliciting materials sent to the stockholders of 76 corporations, none subject to the SEC proxy provisions. The materials examined were sent for 152 meetings—142 annual meetings and 10 special meetings. The following is a summary of the survey:

any conjecture that managerial despotism is becoming more benevolent.<sup>97</sup> Hence it may be concluded that the double standard of applicability has actually resulted in a double standard of conduct.

#### RECOMMENDATIONS

There seems to be little question as to the need for broadening the coverage of the 1934 Act. It is difficult to adduce reasons for denying the protective benefits of the SEC proxy provisions to one great segment of U.S. investors while guaranteeing them to another. This is the more true when there is little logic in the criteria of separation. Historically the congressional aim was uniform investor protection.<sup>98</sup> The caution attending a venture into a new field prompted the proponents of the original bill to confine themselves to the safer and more generally known area of listed securities.<sup>99</sup> But the arguments, originally advanced and generally accepted,<sup>100</sup> which impelled Congress to enact the existing provisions, likewise support extending the Act's benefits to all corporations of similar size, importance, and number of shareholders.

*The Frear Bill.* Recommendations for a wider application of the SEC proxy regulations are contained in the Frear Bill<sup>101</sup> which was introduced and considered last year in the Senate by the Banking and Currency Subcommittee.<sup>102</sup> The Bill contemplates the addition of a new subsection to Section 12 of the Securities Exchange Act requiring companies *engaged in interstate*

(1) In only 16 of the 142 annual meetings were the nominees for directorates named in the materials.

(2) Only four companies offered an opportunity for a "Yes" or "No" vote on the individual items of business to be transacted at the meeting.

(3) The remuneration of management, either individually or in the aggregate, was not stated in any of the proxy-soliciting materials.

(4) In only one case was there disclosure of the personal interest of officers and directors, or of their associates, in any of the matters to be acted upon.

(5) In roughly half of the proxies there was to be blanket approval and ratification of all acts and proceedings of management since the last annual meeting without specification of the acts.

A REPORT OF THE SEC (1946), *op. cit. supra* note 19, at 75, 76.

97. Speaking for the SEC, Louis Loss, Associate General Counsel, stated:

"We found some improvement over 1946, but most of the companies, most of the presently unregulated companies, continued to request their stockholders to give their proxies, exercise their corporate franchise, without any adequate information." *Hearings on S. 2408, op. cit. supra* note 19, at 23.

98. Thus in its original form Section 15 of the Securities Exchange Act made provision for such Commission rules as are "necessary or appropriate in the public interest and to insure the investors protection comparable to that provided . . . in the case of national securities exchanges." 48 STAT. 895 (1933-1934). See discussion of this point in *Hearings on S. 2408, op. cit. supra* note 19, at 15, 16.

99. *Hearings on S. 2408, op. cit. supra* note 19, at 15, 16. The sanction was directed against the dealers trading in the securities and not against the corporations. Hence no such sanction was exercisable as to unlisted securities.

100. *Id.* at 11.

101. See note 19 *supra* for brief details of previous attempts at similar legislation.

102. The testimony is in *Hearings on S. 2408, op. cit. supra* note 19.

commerce<sup>103</sup> to register with the SEC all securities not already listed on an exchange. Registration would have the same consequence as listing.<sup>104</sup> However, only those companies with assets of \$3,000,000 or more and 300 or more security holders would be subject to the legislation.<sup>105</sup> Due to the backlog of more pressing legislation no action was taken on the bill. It is expected that it will be reintroduced in 1951.<sup>106</sup>

The Frear Bill offers an excellent plan for plugging a major loophole in federal securities regulation. It would provide the shareholder in unlisted securities a voice in management which he now seldom has. It would require substantial disclosure; but it would not cure the evils depicted in Part I of this article.

The principal objections to the Bill,<sup>107</sup> beyond the traditional opposition to any federal supervision,<sup>108</sup> might be listed as threefold:<sup>109</sup> 1) the expense of compliance, 2) the arbitrary nature of the norm of application, 3) the harm to the over-the-counter market.

103. (Emphasis added). The new subsection (g) reads: "(1) Every issuer which is engaged in interstate commerce or in business affecting interstate commerce, or the securities of which are regularly traded by use of the mails or any means of instrumentality of interstate commerce . . ." S. 2408, 81st Cong., 1st Sess. (1949).

104. Subsection (g) (1) imposes on the issuer the proxy provisions of Section 14 of the Securities Exchange Act "with the same force and effect as if all the securities of any such issuer were registered pursuant to subsection (b)." S. 2406, 81st Cong., 1st Sess. (1949). The Frear Bill, of course, in effecting uniformity of application of the Securities Exchange Act would thereby affect also the registration, periodic reporting and insider trading provisions of that Act as well.

105. These figures were originally suggested by the New York Stock Exchange and the New York Curb Exchange. Louis Loss, Associate General Counsel of the SEC, said: ". . . The New York Exchanges—not the Commission but the two New York exchanges—suggested three quarters of what is now the Frear Bill." *Hearings on S. 2408, op. cit. supra* note 19, at 17.

106. The sponsor of the bill, Senator Frear, on September 27, 1950 communicated to the writer that he intends reintroducing the bill early in 1951.

107. Opposition to the Frear Bill has come mainly from management, with two major spokesmen for management, the National Association of Manufacturers and the Chamber of Commerce, being the most vocal.

The financial community has in general supported the bill. Senator Frear lists the following supporters: Investment Bankers Association, National Association of Securities Dealers, New York Stock Exchange, New York Curb Exchange, and others. *Hearings on S. 2408, op. cit. supra* note 19; 96 CONG. REC. No. 186, 15366 (September 19, 1950). Presidential approval was made public on the first day of the subcommittee hearings. Needless to say, "independent public shareholders are fully in sympathy with the objectives of the bill . . ." Gilbert, *Management and the Public Shareholder*, 28 HARV. BUS. REV., No. 4, 79, 80 (July, 1950).

108. Good summaries of this class of opposition can be found in the testimony and statements of the following: Cyrus S. Eaton, Senator James Murray, the National Association of Manufacturers and the Chamber of Commerce of the United States. *Hearings on S. 2408, op. cit. supra* note 19, at 150, 157, 199, 216.

109. Lesser objections to the bill have taken the form of speculation as to the effect of the legislation on equity security offerings, institutional buying, and the general reactions of issuers, investors and the market to the changed requirements. In the main the result would most likely be increased buying by the small investor with consequent increases in equity offerings. This would eliminate the fear of a rush of institutional

The cost of compliance should not be burdensome for the greater majority of the corporations affected, since the average U.S. firm with assets of \$3,000,000 or more already maintains the necessary accounts and records.<sup>110</sup>

Objections to the norm of applicability are such as would be levelled at any norm. The figures selected have been discussed for a decade,<sup>111</sup> and represent a practicable working criterion subject to change with the experience of the years.<sup>112</sup>

The fact that both the Curb and Stock Exchanges favor the bill<sup>113</sup> bears out the conclusion that the amendment will not create an unjust advantage against the over-the-counter market. Any readjustments which might occur would substantiate the arguments that legislation towards uniformity will put the two markets on a basis of healthy competition of merits rather than of legal pressures and happenstances. The basis for listing should be the price and nature of the security, the extent of speculative interest, the amount of trading volume, and other straight competitive factors.<sup>114</sup>

One may question the details of the method proposed for achieving corporate democracy and management responsibility. But before shareholders finally abandon all their rights and duties to management or irrevocably abdicate their ownership functions to government, serious thought to these recommendations is warranted. An indication of the failure of the American way and a sure invitation to totalitarianism is the continued violation of fiduciary duty by corporate management. Reform here is a part of that whole which will insure the perpetuation of our free enterprise system.

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investors. Such a prognostication is supported by the fact that added confidence would be engendered in the small investor by the full disclosure pursuant to the regulations of the Act. See, *The Frear Bill: Extension of Investor Protection to Unlisted Securities*, 45 ILL. L. REV. 263 (1950).

110. "The question posed by the proposed legislation is not whether such records should be maintained, but whether they should be made available to the public stockholders—the owners of the enterprise." *A Proposal to Safeguard Investors, op. cit. supra* note 19, at 19, 5. For the few corporations lacking such records the bill would perform the excellent collateral function of raising the accounting standards to an acceptable level. In any consideration of the expense of compliance the central factor must remain that the proxy provisions of the Commission guarantee the shareholder a democratic right that is his due and for which he himself and none other is paying.

111. *Hearings on S. 2408, op. cit. supra* note 19, at 12, 96 *et seq.*, 140.

112. The exemption authority of the Commission and the added discretion in defining the phrases surrounding the figures "\$3,000,000" and "300" afford the opportunity of mitigating the onerousness of the arbitrary norm. Subsection (g) (7), S. 2408, 81st Cong., 1st Sess. (1949).

113. *Hearings on S. 2408, op. cit. supra* note 19, at 69, 104.

114. Frear, *Protection of Investors in Large Corporations*, 96 CONG. REC. No. 186, 15365, 15367 (September 19, 1950).



## APPENDIX I

## COLLATERAL RECOMMENDATIONS

There are two lesser amendments that logically group themselves around the question of uniformity of application. (1) The exemption presently accorded banks<sup>115</sup> might well be removed. The shareholders in U.S. banks do receive much indirect protection not accorded other shareholders, but there seems valid argument for including them in the specific protections of the proxy provisions. (2) Since Regulation X-14 does not prescribe the content of information in the annual report and the financial statements but rather leaves it to the "opinion of the management"<sup>116</sup> to determine their adequacy, reasonable amendment would seem to demand a form and content similar to or, as has been suggested,<sup>117</sup> identical with Form 10-K—the report made annually for the purpose of keeping up to date the information filed initially on registration under the Securities Exchange Act.

Other changes in the Act bear consideration. The expense of solicitation when not for and on behalf of management presently must be borne by the shareholder submitting the proposals. Subject to defined maximum costs, provision might well be made for the corporation to offset the expense of bona fide shareholder proposals.

A point which has been mentioned previously in connection with the general disclosure provisions of the SEC is the need of shareholders for a more understandable correlation of the information dispensed with the problems of the small investor. The proxy statement should be explained in non-technical, understandable terms. There should be analysis, and explanation, even to the point of explaining the value of the investment;<sup>118</sup> but such an advance would appear to be a matter for the Commission in the formulation of its rules rather than the subject of an amendment.

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115. See Subsection (g) (2) (E), S. 2408, 81st Cong., 1st Sess. (1949).

116. The annual report must contain "such financial statements for the last fiscal year as will, in the opinion of the management, adequately reflect the financial position and operations of the issuer. Such annual report, including financial statements, may be in any form deemed suitable by the management." Rule X-14A-3 (b). For the prescriptions and conditions surrounding this annual report see Appendix II.

117. Emerson and Latham, *SEC Proxy Regulation: Steps Toward More Effective Stockholder Participation*, 59 YALE L. J. 633, 675 (1950).

118. See an excellent presentation of the case for such explanation and simplification in Rukeyser and Haney, *To Simplify or not to Simplify*, POINT OF VIEW 12 (May, 1948).

## APPENDIX II

## SEC PROXY REGULATIONS

In all there are nine proxy rules in Regulation X-14<sup>119</sup> followed by Schedule 14A which gives the "Information Required in Proxy Statement."<sup>120</sup>

Rule X-14A-3 requires that no solicitation shall be made ". . . unless each person solicited is concurrently furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A." In a management solicitation relating to an annual meeting at which directors are to be elected, each proxy statement must be accompanied by an Annual Report. This report shall contain "such financial statements for the last fiscal year as will, in the opinion of the management, adequately reflect the financial position and operations of the issuer. Such annual report, including financial statements, may be in any form deemed suitable by the management."

Rule X-14A-4 says the proxy "shall indicate in bold face type whether or not the proxy is solicited on behalf of the management." It must identify clearly and impartially each matter intended to be acted upon, whether proposed by management or by shareholders. There must be means in the form of proxy whereby the shareholder can specify by ballot his particular choice in any matter up for decision at the meeting. If there is to be an election of officers or directors—" (d) No proxy shall confer authority (1) to vote for the election of any person to any office for which a bona fide nominee is not named in the proxy statement . . . "

Rule X-14A-5 presents a set of precise directions for handling Schedule 14A. The Schedule requires information about the interest of management, of nominees for election to directorate, and of their associates; the general security structure as to voting and the holders of such securities must be listed. Information on any plan—election, bonus, pension—is required in

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119. This Regulation could be said to be the culmination of three years of experience with proxy control. The Commission on September 24, 1935, promulgated its first rules, designated the LA rules. These required general information; there was no detailed requirement as to items to be included. But on August 1, 1938, the Commission issued Regulation X-14. The requirements now became specific as to what information must be given. Through the years this Regulation X-14 has been amended constantly. The Annual Reports of the Commission trace these amendments. For a study see Bernstein and Fischer, *The Regulation of the Solicitation of Proxies: Some Reflections on Corporate Democracy*, 7 U. OF CHI. L. REV. 226 (1940).

A very detailed and technical commentary on the proxy rules may be found in Emerson and Latham, *SEC Proxy Regulation: Steps Toward More Effective Stockholder Participation*, 59 YALE L. J. 633 (1950).

120. The rules and schedule here given embody the most recently proposed amendments. Announced on July 6, 1948, in *Securities Exchange Act Release No. 4114* (July 6, 1948). For the comments of an attorney of the Commission touching on many of the problems surrounding the proxy rules, see Friedman, *SEC Regulation of Corporate Proxies*, 63 HARV. L. REV. 796 (1950).

great detail. No action can be taken without full disclosure. Likewise, the information required on remuneration and other transactions with the directors, nominees, officers and others is extensive.

Rule X-14A-6 requires the proxy materials to be filed with the SEC ". . . at least ten days prior to the date definitive copies of such materials are first sent or given to security holders . . ."

X-14A-7 provides that the management must provide a list of shareholders or mail solicitation materials for any shareholder who so demands.

X-14A-8 states "(a) If any security holder . . . shall submit to the management . . . a proposal *which is a proper subject for action* . . .<sup>121</sup> the management shall set forth the proposal in its proxy statement and shall identify the proposal in its form of proxy and provide means by which security holders can make the specification. . . ." An outstanding illustration of the possible value of this rule has been created by Mr. James Fuller of Hartford. Fuller's ownership in seven large firms does not exceed fifteen shares in any instance, yet he has been able by virtue of Rule X-14A-8 to have American Tobacco, Consolidated Edison, Curtis Publishing, Woolworth, Allied Stores, Gimbel's and Associated Drygoods submit twenty-five proposals to the shareholders.<sup>122</sup>

X-14A-9 tersely forbids statements which are "false or misleading with respect to any material fact . . ."

This is the whole of the administrative control of the proxy.

121. The *Transamerica Corporation* case well illustrates the application of Regulation X-14, and Rule X-14A-8 specifically. A shareholder owning seventeen shares in Transamerica submitted three proposals which he intended to present at the next meeting and which were, therefore, to be included in the proxy solicitation material sent out by Transamerica. Notice of the proposals was not included in the proxy statement as required by X-14A-8. The result: the SEC sought and obtained an injunction to prevent Transamerica from soliciting proxies.

The shareholder's requests were: (1) independent auditors—to be chosen by the stockholders at the annual meeting; (2) elimination of the by-law requirement that notice of any alteration of the by-laws be given in the notice of the meeting; (3) a post-meeting report for the shareholders. The corporation maintained that the proposals were not "proper subjects," within Rule X-14A-8. But the court thought otherwise:

"True it may cost Transamerica \$20,000 annually, but accurate information as to what transpires respecting the corporation is an absolute necessity if stockholders are to act for their joint interest. *If stockholders cannot act together, they cannot act effectively.*" (Emphasis added). *SEC v. Transamerica Corp.*, 163 F.2d 511, 517 (3rd Cir. 1947), cert. denied, 332 U.S. 847 (1948). See Note, *Permissible Scope of the Stockholder Proposals under SEC Proxy Rules*, 57 *YALE L.J.* 874 (1948). See also *Doyle v. Milton*, 73 F. Supp. 281 (S.D.N.Y. 1947).

122. For the full details see *Hearings Before House Committee, op. cit. supra* note 13, at 224-230.

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