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THE PROXY RULES AND THE PROXY FIGHT

RICHARD W. DUESENBERG*

I

THE PROBLEM AND WHY THE REGULATIONS

The procedure and conduct of shareholder's meetings and the election of directors of a corporation are determined by rules established by the common law, by statutes enacted to govern the operation of corporations, and by the certificate of incorporation and by-laws of the corporation itself. Common law rules grew into a somewhat strict set of formalities, largely because of the continued attempt to analogize the function of the business corporation to the earlier established rules respecting municipal and membership corporations. To relax the rigidity of some of the common law rules, statutes have been enacted in every jurisdiction, either directly changing some of the earlier laws, or permitting corporations through their certificates of incorporation or their by-laws effectually to provide for some technique or formality of self-government not familiar to the older common law.¹

An object of much historic favor and judicial protection was the common law rule requiring that stockholders be physically present at corporate meetings to be able to exercise their voting rights. That the corporation needed the individual judgment of the shareholders was usually given as the reason for the rule.² This no longer controls, and the weight of authority sustains the validity of a by-law providing for voting by proxy, and this irrespective of the presence of a statute or express charter provision authorizing it.³ Today the only states in the union not expressly permitting the use of proxies are Texas and Iowa. However, the proxy prevails there also, being recognized as custom or allowed if authorized by the charter or by-laws of the corporation.⁴

The compelling reason for the change of the common law rule of non-validity of the corporate proxy was undoubtedly one of necessity. It simply would not be possible to gather the thousands, even hundreds of thousands of stockholders of many contemporary corporations into a single meeting hall. The characteristic twentieth-century corporation is an institution not contemplated by the common

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1. DODD & BAKER, *CASES AND MATERIALS ON CORPORATIONS* 203-211 (1951).

2. *Taylor v. Griswold*, 14 N. J. L. 222 (Sup. Ct. 1834); *Perry v. Tuskalooza Co.*, 93 Ala. 304, 91 So. 217 (1891).

3. BALLANTINE, *CORPORATIONS* 406 (1946).

4. For an excellent article on the subject, see Axe, *Corporate Proxies*, 41 MICH. L. REV. 38 (1942).

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law. Its gigantic size is constructed on the billions of dollars poured into it by the multitude of stockholders living in cities, towns, and villages scattered from coast to coast.⁵

The vast increase in share ownership and the geographic dispersion of the owners were contributing factors to the separation of ownership and control in corporate affairs. The stockholder-electorate not only lost personal interest in the management of the corporation of which they were part owners, but often were made mere tools for the perpetuation of the management.⁶

Absence of the stockholder from the annual shareholders' meeting presented a very practical problem respecting the exercise of corporate democracy. In response, the device of proxies came into greater and greater use. The system works substantially in this manner. A committee of proxies is appointed by the management; to be sure, its members are favorable to management, for no one is going to appoint a board capable of turning him out of office. The stockholders are then solicited, provided with a proxy form and instructed to sign and return it as soon as possible. When signed by the shareholder, this form authorizes the proxy to vote the shareholder's share. Such a formalized structure for the exercise of corporate franchise allows the proxy voter to be employed to rubber stamp the selections already made by those in control; the manipulation of a machinery of one's own creation and unpoliced by a neutral observer was a matter rather easily accomplished.⁷

Prior to the enactment of the Securities and Exchange Act of 1934,⁸ the abuses in solicitation of proxies were many. The strict rules of agency law,⁹ which require practice of good faith and the utmost adherence to conduct in the best interest of the principal, were not successfully applied to the relationship between proxy and shareholder. One can speculate on the reasons for this, but obvious among them is the peculiar nature of this relationship. The personal familiarity of the principal with his agent is in no way present; in fact, the only point of contact is often the letter which brought the proxy card, asking for the vote of the addressed stockholder. Unlike the characteristic principal-agent relationship, in which the principal chooses his agent, the proxy is an appointee of management, of the directors of the corporation, and it is they, working through the proxy

5. American Telephone and Telegraph reported a shareholder strength of about 1.1 million in 1952. General Motors at the same time was 455,000. See KIMMEL, *SHARE OWNERSHIP IN THE UNITED STATES* (1952), for a statistical analysis of the subject.

6. BERLE & MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 80-84 (1932).

7. *Id.* at 80-89.

8. 48 STAT. 881 (1934), 15 U. S. C. §78 (1952).

9. The proxy relation is viewed as one of agency. *Duffy v. Loft, Inc.*, 17 Del. Ch. 140, 151 Atl. 223 (1930).

committee, who solicit the authority of the stockholder principal. Thus, while in theory the proxy is an agent for the shareholder, in practice he is an individual under the domination of the board of directors. One study of corporate affairs put it this way: "Legally, the proxy is an agent for the shareholder and necessarily under a duty of fidelity to him. Factually, he is a dummy for the management, and is expected to do as he is told."¹⁰

This does not mean to imply that the fiduciary requirements of the agency relationship were flaunted and ignored. Indeed, the courts did disapprove of the breach of the good faith relationship.¹¹ *Rice and Hutchins, Inc. v. Triplex Shoe Co.*,¹² was a proceeding for the determination of the election of directors. The petitioner had given a proxy to the directors to vote its stock. In exercising the proxy, the directors voted upon a certain resolution the petitioner had no notice that this matter would be brought up at the meeting. The directors were themselves the very parties to benefit from the resolution, for it attempted to ratify earlier improper issuances of stock to the directors. In its opinion, the court was clear in pronouncing its response to the fiduciary character of the shareholder-proxy relationship. It wrote:

A person acting as a proxy for another is but the latter's agent and owes to the latter the duty of acting in strict accord with those requirements of a fiduciary relationship which inhere in the conception of agency. If directors who are agents of stockholders are invested with a fiduciary character which inhibits them from passing judgments where their own peculiar interests are involved . . . I am unable to see why on principle the same sort of inhibition is not imposed on those who act as proxies for a stockholder.¹³

The regulation of proxy solicitation is better understood in the light of the extensive report of the S. E. C. published in eight parts between 1936 and 1938, the research for which was done under the chairmanship of William O. Douglas.¹⁴ The problem noted then was that only rarely did opposition forces succeed in turning out management, a consequence of the inability to stir the lethargic stockholder and the difficulty of meeting the defensive tactics of the "ins." Available to the management was the proxy machinery and the list of stockholders, over which, the report said, they exercised a virtual monopoly because they delayed and hindered access to it, even though under law opposition groups were entitled to access to the list. The result would be a suit to compel production of the list,

10. BERLE & MEANS, *op. cit. supra* note 6, at 245.

11. See *Blair v. Smith Co.*, 18 Del. Ch. 150, 156 Atl. 207 (1931).

12. 16 Del. Ch. 298, 147 Atl. 317 (1929).

13. *Id.* at 309, 147 Atl. at 322.

14. S. E. C. REPORT ON THE STUDY OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTION OF PROTECTIVE AND REORGANIZATION COMMITTEES, 8 Parts (1936-1938).

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but, as the report pointed out, often the victory was won before the suit was completed.¹⁵ This is not to say, of course, that opposition to management never successfully presented itself. The most notable case of success was the seizure of control of the Standard Oil Company of Indiana by John D. Rockefeller in 1929.¹⁶ But it is generally asserted that the standing of Rockefeller in the financial community was more than an incidental factor in his success. The point to be made is that to upset management was a task only the most formidable could achieve.¹⁷

The status to which the exercise of franchise in corporate democracy had descended by the beginning of the third decade of this century prompted the government to endeavor to revive shareholder interest and participation, or at least to protect the security holders from the excessive abuses to which the proxy device was susceptible. The Securities and Exchange Commission was set up and authorized to regulate proxy solicitation. Section 14(a) of the Securities and Exchange Act of 1934¹⁸ conferred this power in these words:

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of any national securities exchange or otherwise, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.¹⁹

Section 14(a) is the basic provision. But the heart of the control which the Commission exercises over proxy practices is found in the regulations which 14(a) authorizes the S. E. C. to prescribe. It is repeatedly emphasized that the language of Section 14(a) is purposefully general.²⁰ It does not describe the type of regulation which the federal legislature intended for the Commission to prescribe,

15. *Id.* part 7, (1938).

16. BERLE & MEANS, *op. cit. supra* note 6, 81-84.

17. An attempt to dislodge management may be waged with the hope of only partial success. As the S.E.C. Report, *supra* note 14, summarized: "But even if an independent outside group does not succeed in obtaining control, it may be able to win a variety of victories and to make various profits. It may conceivably succeed in dislodging a dishonest, inefficient management and its banker from control. It may win representation on the dominant protective committees and reap the profits incident thereto in the form of fees, inside information for trading purposes, and business and professional associations. It may win representation on the board of directors of the reorganized company; obtain improved recognition in a plan of reorganization for certain classes of securities; or receive a cash payment as 'settlement' of claims or for services actually or ostensibly rendered." Part I, at 672.

18. 48 STAT. 895 (1934), 15 U. S. C. §78n (a) 1952).

19. Section 12(e) of the Holding Company Act is similar. Public Utility Holding Co. Ad., 49 STAT. 838 (1935), 15 U. S. C. §79 (1952).

20. Armstrong, *The Role of the Securities and Exchange Commission in Proxy Contests of Listed Companies*, 11 BUSINESS LAWYER 110 (1953).

other than that they should be such as are necessary or appropriate in the public interest or for the protection of investors. The first regulations were not adopted until September 24, 1935,²¹ well over a year after the effective date of the Exchange Act. The most recent rules became effective on January 30, 1956.²²

The recent adoptions are the result of consideration given by the Commission to the last several years' trend toward an increase in non-management proxy filings and the increase in proxy contests. Until recently, it was accepted doctrine that management could be unseated only in the most unusual circumstances. One observer has commented that the number of successful overthrows in the last few years requires a "change in the conventional characterization of the shareholder in our substantial corporations as a supine, opinionless creature who can be neglected or manipulated at will by management."²³ The changes and additions repeat the policy of the S. E. C. in requiring disclosure of the matters to which the proxies are directed, and propose to tighten up on the anti-fraud, misrepresentation provisions of previous roles.

The federal government recognized that the growth of the corporation, the dispersion of its shareholders, and the solicitation practices of management had gone a long way toward making ownership plus control a combination of the past. State statutes and the judicial decisions thereunder failed to restore effective stockholder participation in the conduct of corporate affairs. "The state courts rarely got beyond the formal problems of who may act as proxy holder, the execution of proxies, the duty of inspectors of election, the capacity to appoint a proxy holder, the scope of the proxy holder's authority, the binding effect of the proxy holder's unauthorized acts, and the revocation and termination of proxies."²⁴ Section 14 of the Securities and Exchange Act empowered the Commission to prescribe rules for the regulation of proxy uses, which have reflected the effort to restore an effective voice to the franchise of the stockholder. The rules and regulations pertain to all²⁵ corporations having securities listed on national securities exchanges, plus to corporations subject to regulation under the Public Utility Holding Act.²⁶

21. See Exchange Act Release No. 378 (Class A), Sept. 24, 1935.

22. Securities Exchange Act Release No. 5276, Jan. 17, 1956.

23. Williams, *Thinking Ahead*, 33 HARV. BUS. REV. 21 (1955).

24. EMERSON & LATCHAM, SHAREHOLDER DEMOCRACY, A BROADER OUTLOOK FOR CORPORATIONS 7 (1954).

25. Seven enumerated exceptions are provided for in Rule X-14A-2. They include 1. all non-management solicitations of less than 10 persons, 2. solicitations by one of securities carried in his name or of which he is beneficial owner, 3. securities covered by the Utility Holding Company Act, 4. cases under chapter 10 of the Bankruptcy Act or, 5, under the Securities Act 6. all foreign securities, and 7. the so-called "tombstone proxy," which is nothing more than a newspaper advertisement urging the stockholder to vote and informing him where a proxy may be obtained.

26. 49 STAT. 838 (1935), 15 U. S. C. §79 (1952).

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II

THE PROXY STATEMENT

It should be noted that the initial rules released by the Commission²⁷ were quite skeletal, particularly in comparison to the body of rules that has been constructed since 1935. The present regulations, aimed at procuring intelligent stockholder participation, are constructed around one basic idea; namely, to get proper disclosure of adequate information. To attain this goal, the rules make it unlawful to solicit proxies which are subject to the control of the Commission without first, or concurrently, furnishing the individual solicited a proxy statement.²⁸ Furthermore, it is prescribed in great detail what information is to go into the proxy statement.²⁹ Specifically, the stockholder is to be informed, among other things, whether or not he may revoke his proxy.³⁰ The purpose of this is to prohibit the old practice of couching the proxy in such terms that the shareholder, characteristically lethargic concerning these matters, would consider it irrevocable and therefore regard the act of signing and returning it final and conclusive, whereas in fact the ordinary proxy is not irrevocable.³¹ In compliance with this requirement, most proxy statements, perhaps as a psychological technique, state not only that the enclosed requested proxy is revocable, but contain a bold-face type statement that if the stockholder has signed a proxy of the opposition group, it may be revoked by dating, signing and mailing the requested proxy.³²

Schedule 14A requires also that those making the solicitation identify themselves, especially stating whether they are acting on behalf of management or otherwise, and in the latter case explaining the "otherwise." The identity of the participants in a proxy fight is of the utmost importance for the intelligent exercise of the voting right which each stockholder has. Just as it is crucial to the successful functioning of a democratic state that it be based on an intelligent electorate, so is it necessary that the shareholders of a corporation be properly informed, if they are to receive benefits from the investment they have made in their corporation. This disclosure of the identity of proxy contestants contributes, for instance, to the protection of investors from promiscuous solicitation of their proxies by irresponsible outsiders whose sole purpose it may be to benefit themselves by wresting control of the corporation from the hands of an efficient incumbent.

27. *Supra*, note 21.

28. Rule X-14A-3(a).

29. Schedule 14A.

30. *Id.*, Item 1.

31. See S. E. C., *op. cit. supra*, note 14, at 129, 130.

32. See, *e.g.*, Proxy Statement of Directors and Stockholders Group in Opposition to the Present Management of the New York, New Haven and Hartford Railroad Co., p. 6, dtd. 17 March, 1954.

Under the title "General," information pertinent to the source of funds for carrying on the solicitation, together with information concerning any contract with another or the use of specially obtained employees to carry on the solicitation, is generally given.³³ This is in compliance with Item 3 of Schedule 14A. If an interested party has agreed to contribute to the expenses of the solicitation, this would certainly be included in the statement.³⁴

Several changes are now made in Item 3 of Schedule A. These are intended to supplement the provisions of the proposed Rule X-14A-11, which refers to proxy solicitation in contemplation of a fight for management control. Read together, they make it clear that the Commission wishes the security holders to be given the details of identity and interests of those seeking to gain management control. With respect to the August, 1955, proposals,³⁵ it is suggested that the language of the rules was a bit over zealous in trying to get this information disclosed, for as the proposed Rule X-14A-12 read, it applied not only to solicitations with respect to the election of directors, but "to any other matter which is to be acted upon by the security holders in opposition to the management . . . or to some other person or group of persons."³⁶ The proposal was thus capable of embracing any proxy solicitation in which there was a condition of opposition, be it the important matter of the election of directors or a relatively insignificant proposition tendered under the stockholder proposal rule.³⁷ As adopted, the new rules indicate a retreat by the Commission in the face of heavy opposition, and limit the greater disclosure qualifications to contests over directors.

If a solicitation qualifies under Rule X-14A-11, then it becomes necessary to state the methods employed and to be employed in the solicitation of the proxies.³⁸ If employees, either of the issuer or specially contracted, are engaged, the details of the arrangement must be spelled out.³⁹ It will also be necessary to furnish information concerning the source of funds to carry on the solicitation, with an estimate of the total expense contemplated, including fees for counsel, public relations consultants, advisers, solicitors, advertising, printing, litigations, and all other costs incidental to the solicitation.⁴⁰ In order not to mislead the stockholders concerning the reimbursement of these expenses should the solicitation succeed, the intention of the parties conducting the solicitation as to whether they will

33. *Ibid.*

34. *Ibid.*

35. See Securities Exchange Act Release No. 5212, August 23, 1955.

36. Rule X-14A-12(a).

37. See Rule X-14A-8.

38. Schedule A, Item 3(b)(1). This rule was promulgated on April 11, 1956, effective as of January 30, 1956. SEC Release 5276, Jan. 17, 1956.

39. Schedule A, Item 3(b)(1) and 3(b)(2).

40. Schedule A, Item 3(b)(3), 3(b)(4), and 3(b)(5).

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request the issuer to pay the cost, or whether payment will be submitted to a vote of the security holders, must be stated.⁴¹

In addition to further disclosures concerning the interests giving financial support to a proxy solicitation, the Commission requires information concerning certain persons involved in the matters to be acted upon. In general, their interests must be described. In the case where action is to be taken with respect to the election of directors, the statement must include (1) the name of each person who is a nominee for office, (2) his principal occupation, (3) whether he has previously been a director and (4) the amount of securities of the issuer of which he is beneficial owner.⁴² This is an important point, and it will often be found specifically referred to in the text of the statement. The non-management group, headed by New York broker Patrick B. McGinnis, in the successful fight to gain control of the New York, New Haven and Hartford Railroad in 1954, issued a proxy statement which clearly stated the holdings of the proposed slate of directors, and commented upon them in relation to the holdings of the incumbents in the following fashion: "(T)o put it plainly, those directors of the Corporation who are far and away the largest holders of your company's securities, do not appear on the management slate, while the directors who do appear on it own little or no securities." This, the statement asserted, was an "inequitable situation," which the group wanted to correct.⁴³

The material included in the proxy statement must, under the present rules, be submitted to the Commission ten days prior to the mailing of the soliciting material.⁴⁴ The former rule⁴⁵ required only that the material be filed with the Commission simultaneously with the transmittal of the solicitation. This often imposed upon the Commission the task of investigating quickly to determine if

41. Schedule A, Item 3(b)(5).

42. Schedule 14A, Item 6.

43. Proxy statement, *supra* note 32, at 2. The proxy statements of the contesting groups in the exciting 1954 marathon for control of the New York Central Ry. Co. showed that the opposition's nominees owned 17.4% of the Railroad's stock, the directors owning 1,089,880 of the 6,447,410 outstanding shares of common stock, and 30,000 additional shares being owned by companies controlled by one of the nominees. Of these, a large portion was the controversial 800,000 shares bought in preparation for the fight by nominees Sid W. Richardson and Clinton W. Murchison, both Texas oil men. Proxy Statement for the Proposed Alleghany-Young-Kirby Ownership Board of Directors of the New York Central Co., April 8, 1954. New York Times, April 9, 1954. The management's statement revealed that the incumbent directors of the Railroad owned 106,622 shares, or 1.6% of the stock. (See New York Times, June 10, 1955, p. 29, col. 1, for a report of the heated exchange between Robert Young and Senator Lehman before the Senate Banking and Currency Committee investigating stock market activities. On questioning by Senator Lehman, it was disclosed that all 800,000 shares had been purchased without putting up a penny cash. This Young called the cleverest trick in his financial history.)

44. Rule X-14A-6.

45. Rule X-14A-4.

omissions or misleading statements were present, in order to get them corrected before correction would be ineffectual. And then, also, it occasionally embarrassed the corporation by compelling it to follow up the solicitation with correcting material. The practice became common of utilizing the consultation services of the Commission to insure preparation of a proper statement.⁴⁶ The present requirement of ten days advance filing has obviated both difficulties in this respect.

There are twenty-one items in Schedule 14A. The most important are those referred to above. The remaining items are directed at specific situations, such as a proxy solicitation which may be in reference to installment of a plan for profit sharing,⁴⁷ plans for retirement or of pensions,⁴⁸ mergers, consolidations, and the acquiring of securities of another issuer,⁴⁹ the transfer or acquisition of property,⁵⁰ and other various matters. Item 7 is important from the point of view of requiring, when the matter to be acted upon is the election of directors, disclosure of directors' and top officers' salaries, or any plan for financial remuneration in which such individuals will participate, such as a profit sharing plan, pension plan, or plans granting options to buy securities.⁵¹ So that the interests of the participant are disclosed, the new Schedule 14B requires the filing of information concerning his residence, his interests in the securities of the issuer, and the circumstances under which and for which he became a participant. Thus, it is clear that the revisions forecast a tightening up of the conduct of future contests. Some of the stiffer proposals are noted above. They represent rules which the Commission feels necessary to carry out its legislative mandate of protecting the security holder and his interests in the corporation of which he is part owner. In essence, they are aimed at fuller disclosure of the basic facts about the subject and persons connected with a proxy solicitation.

III

THE PROXY

No less control is exercised by the Commission over the proxy itself. So far as the proxy is concerned, the Commission is very particular about its content, and has stated that it shall not contain any statements endeavoring to persuade the voter. Like the ballot sheet of a political election, it is to be impartial, stating what is to be acted upon at the shareholder's meeting, and providing a space for favorable or unfavorable voting by the shareholder.⁵² Of course, the proxy may not

46. Securities Exchange Act Release No. 2376, Jan. 12, 1940; Exchange Act Release No. 1823, August 11, 1938; 10 SEC ANN. REP. 51 (1944).

47. Schedule 14A, Item 9.

48. Schedule 14A, Item 10.

49. Schedule 14A, Item 14.

50. Schedule 14A, Item 16.

51. Schedule 14A, Item 7.

52. Rule X-14A-4.

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be concerned only with an election; it may simply be asking for authority to act for the shareholder. The management proxy in the New York, New Haven and Hartford Railroad Company fight of 1954 was one such proxy, and when signed and returned constituted an authority for the proxies "to appear, act and vote for and on behalf of the undersigned and with all the powers the undersigned would possess if personally present at the annual meeting of the Company . . . with respect to all shares of stock standing on the books of the Company in the name of the undersigned or in respect of which the undersigned is entitled to vote for the election of directors and upon all other matters that may properly come before the meeting, including any matters dealing with the conduct of the meeting . . ."⁵³ But whether it be a solicitation of authority or of a vote, the proxy must be identified and must not contain statements which might influence the stockholder.⁵⁴

IV

THE FRAUD RULE

One of the basic changes is that in Rule X-14A-9, which deals with false and misleading statements.⁵⁵ The anti-fraud rule is aimed at enforcing adherence to the rules of disclosure. It prohibits the use of any material containing false or misleading statements of a material fact. The failure to state a fact, thus rendering other stated material either false or misleading, is specifically included within the provisions of the rule. Before discussing the new rules, it will be of interest to note the Commission and court interpretation of the rule.

*S. E. C. v. O'Hara*⁵⁶ was an action by the Commission to restrain O'Hara and others from using proxies received as a consequence of a letter containing false and misleading statements. Referring to the "innuendos" in the letter, the court said that the letter and spirit of the Securities Exchange Act and the rules promulgated under Section 14 "prohibit the making of false or misleading statements no matter how susceptible of explanation the false and misleading statements may be."⁵⁷ The injunction was granted.

53. New York, New Haven, and Hartford Co. Management Proxy, mailed with solicitation dtd. March 17, 1954.

54. Discretionary authority may be requested only if the proxy states that it is requested for matters which the soliciting party is not aware will be presented at the meeting. Rule X-14A-4(a).

55. Rule X-14A-9 reads: "No solicitation subject to this regulation shall be made by means of any proxy statement, notice of meeting, or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statement therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading."

56. *SEC v. O'Hara*, 28 F. Supp. 523 (1939).

57. *Id.* at 525.

With this decision, it became clear that the Commission would sue to enjoin the use of proxies when the solicitation contained, in its judgment, false and misleading statements, or perhaps only innuendoes. It should be noted that the Commission, *per se*, does not have power to enforce its judgment that material should not be used because believed by the Commission to be false or misleading. Congress did not confer such authority on the Commission. What coercive strength the Commission is able to exercise is based on its seeking to enforce its decision by suing in a federal court to enjoin the use of the proxy statements or votes procured thereunder.⁵⁸ Not only is it established that the S. E. C. will sue to enjoin the use of false and misleading statements, but it can and will direct that the false and misleading information already disseminated be corrected by transmittals containing the proper information.⁵⁹

The language of the court in the *O'Hara* case is interesting for two reasons. First, it did not set up any requirement of a causal connection between the allegedly false or misleading statement and the vote of the stockholder, nor did it seem to leave much room for the usual give and take of any kind of contest. With respect to the former, it may be said the assumption that the votes acquired were influenced by the misleading statements of the solicitor was implicit in the decision, though the court did not deal with the question explicitly. It stated only that proxies received "as a consequence" of the solicitation containing the misleading statement were not usable. The question of the influence of the statement upon the vote of the stockholder was mentioned in *Phillips v. The United Corporation*.⁶⁰ In that case a proxy solicitation was attacked by a stockholder because the solicitation material did not advise that an adjournment of the stockholder meeting was probable. The court did not view this as misleading, because a non-attending shareholder would not be affected, and stated that to be misleading the statement would have to be such as would influence his vote.

The case of *Rogers v. Guaranty Trust Co. of New York*⁶¹ was a case dealing with the loyalty of directors. Relief was denied the stockholder on procedural grounds. The suit was to have the shares allotted to the directors returned to the company because the notice of the stockholders' meeting was alleged to have been misleading. The notice stated that a proposed Employee's Stock Subscription Plan would be considered. The only hint of the intention of the management to participate in the proposed plan read that "[n]o employee, or person actively engaged in the conduct of the business of the Corporation, or its subsidiaries,

58. Securities Exchange Act of 1934, §21(e), 48 STAT. 900 (1934), 15 U.S.C. 78u (1952).

59. *SEC v. Okin*, 132 F. 2d 784 (2d Cir. 1943); *SEC v. Okin*, 48 F. Supp. 928 (S. D. N. Y. 1943).

60. CCH FED. SEC. L. REP. No. 90, 395 (1947).

61. 288 U. S. 123 (1933).

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shall be deemed ineligible to the benefits of the Plan by reason of being also a director of the Corporation or of any of its subsidiaries or of holding any office therein." There were 56,712 shares distributed under the plan, out of which 32,370 went to directors, the president getting 13,440, the market value of each share was \$112.00. Mr. Justice Stone, in a dissenting opinion, criticized this conduct, and asserted that the shareholders were entitled to read the solicitation material in the light of the fiduciary relationship of the corporate directors to its shareholders.

The *Rogers* case occurred in 1933, and complained of acts done in 1931. There was no Commission regulation then, but the case is pointed out as an example of the sort of thing which the rules now would prevent from occurring. The fraud rule could also be used to take the punch out of the accusations of insurgent or contesting groups. Thus far this has not been the case,⁶² fights for control and ownership of corporations very often become heated contests, for essentially the "ins" assert that the "outs" are incompetent to do the job, while the allegations in reverse are that the "ins" have bungled badly. Some of the proxy contests of recent years, particularly for control of the New York Central Railroad and Montgomery-Ward Company, are excellent examples of the high pitch to which a proxy contest can ascend. This contributes to the public interest attracted to the contest, and must certainly stir the stockholder from the lethargy for which he is infamous.

*S. E. C. v. Okin*⁶³ is an interesting case both for its definition of the area of permissible accusations and for its enforcement of the rule. The plaintiff charged the defendant with contempt in that he published statements alleged to be false and misleading. The defendant had stated that certain investments of the company in question were yielding "income . . . so comparatively small with respect to the entire income of the company that it was obvious{ly} . . . in my opinion causing substantial losses to {the company} . . ."⁶⁴ The use of the phrase "substantial losses" was admitted by the defendant not to mean that outgo exceed income, but rather that the capital invested could be more profitably invested elsewhere. This the court held to be within the forbidden mandates of the S. E. C. rules. Likewise, the use of capitalizations in a phrase directly quoted but out of context, thus giving an improper inference, was held violative of the rules. On another point, where the defendant asserted that a proposed business transaction of the company would have been "most disastrous" had it been carried through, the court ruled that in view of some doubt as to the complete accuracy of either contestant's views concerning the transaction, the use of the hyperbole must be

62. See *SEC v. Okin*, 48 F. Supp. 928 (S. D. N. Y. 1943).

63. *Ibid.*

64. *Id.* at 930.

read with regard to the fact that it is in a piece of contentious writing, and "that the art of advocacy has always taken some liberties with the whole truth."⁶⁵ The court said that it must also be considered that this assertion was used by a minority stockholder in opposition to the management and, therefore, can be expected to be answered. It went on to caution, however, that this "factor does not constitute a license to lie."

Okin had also disseminated a letter stating that he desired to remove eight of nine directors and named those eight men in the letter. The unnamed director had announced on his own that he would not serve with Okin. The plaintiff thus felt that the defendant's statement was misleading as to the intentions of the ninth director, making it appear that the ninth director was willing to serve with the defendant. In rejecting the Commission's stand, the court said the rule is "intended to govern ordinary mortals, not saints. They should not be so construed as to impose canons of conduct too lofty for human acceptance."⁶⁶

Thus, it seems clear that the courts have given a workable and reasonable scope to the operations of the rule. However, the heat generated by some of the recent proxy contests moved the Commission to include among its amendments and additions some major overworkings of the fraud rule. The original paragraph remains substantially intact under the revisions, but added to it is a note attempting to establish specific standards for determining false and misleading statements. A statement qualifying under any of the categories there listed would be deemed misleading within the meaning of Rule X-14A-9. It is difficult to estimate the scope of the new rule, but conceivably it could have far-reaching effects on the conduct of proxy fights and the content of proxy material.

Under subdivision (1) of the note, predictions of specific future business and financial results are deemed misleading within the meaning of the rule. The question may be asked, how specific must the prediction be to be "specific" within the terms of the provision?

In the proxy statement mailed out by the Alleghany-Young-Kirby Ownership Committee in the fight for the New York Central management, there appears a reference to the system's real estate holdings in New York City. The group estimated its value at \$150 million, though it was being carried at \$48,760,000 on the books of the Railroad. The statement reported that the estimated value was yielding less than 5 per cent, and then proposed that a "substantial improvement in the Company's financial condition can be achieved" by selling such property and using the proceeds to buy up New York Central bonds which were then

65. *Ibid.*

66. *Id.* at 931.

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quoted at a 30 per cent discount.⁶⁷ This was a statement of opinion, and an expression by the opposition group of what it believed to be one of the major steps to be taken in the future. It may be asked if the section here in question will restrain the inclusion of such matter in solicitation material. Perhaps it will.

More likely, however, to be the subject of inclusions under the prohibition are promises of increased dividend rates,⁶⁸ increase in services, savings, and other plans.⁶⁹ On the other hand, the provisions of the new rule ought not to prohibit the competing groups from making promises and counter-promises as part of their proposed program for improvement of the company. To be against management, there must be dissatisfaction with it. Complaining alone would never win any insurgent group an election. Some concrete objections to the practices and policies, and their consequences, of the management must be presented. A contest without concrete objections would be a contest of form without substances. To offer a solution of them almost of itself requires predictions of what would happen if new practices and policies—to wit, those of the contesting group—were installed.⁷⁰

Aside, however, from whatever merit the argument that a contest of necessity will include predictions may have, another very important point of difficulty with the provision is present. Under certain circumstances, the corporation's annual report is deemed proxy material by the new rules.⁷¹ Presumably, under such circumstances it will be prohibited to include in the annual report any specific predictions concerning the results of proposed operations of the company, irrespective of the degree of probability that such plans will be put into operation and that the predicted results will follow. Such a prophylactic technique hardly seems warranted in this situation, and indeed may work counter to the disclosure policy of the proxy regulation.

The S. E. C. also proposed by the August rules that "irrelevant statements

67. See New York Times, April 9, 1954.

68. See, e.g., advertisement titled "Central Head Pledges Dividend Rise When Earnings Permit," New York Times, April 9, 1954, and New York Central Ry. Co., Annual Stockholders Report for 1953.

69. See Advertisement, "Destination—Dividends," New York World-Telegram, May 13, 1954.

70. See Letter to the Shareholders from Investors in the Minneapolis & St. Louis Ry. Co. (the non-management group in the contest for control of that Railroad) Part I, "Dividends, Merger and Increased Value," dtd. April 26, 1954.

71. Rule X-14A-11(f) provides that ". . . the annual report . . . shall be filed with the Commission as proxy material . . . five business days prior to the date copies of the report are first sent or given to security holders." The August proposals provided that the annual report would be deemed proxy material in "any solicitation in opposition to management." Proposed Rule X-14A-12(b) (3), August, 1955.

which confuse or mislead" be deemed within the prohibitive features of the rule.⁷² Here it might be pointed out that the use of the word "mislead" was unnecessary, unless the Commission planned to broaden its view of what is misleading. The new rules as announced omit the use of this phrase, but a fourth category of what will be deemed misleading is curiously stated to be "Claims regarding the results of solicitation."⁷³ In the light of the August wording, changed in response to much criticism, it may well be asked, what breadth does this include? Indeed, is it another way of saying that "irrelevant statements which confuse or mislead" will be deemed prohibited by the rule? This is too stringent. It seems almost impossible to wage a fight of the magnitude of that for the control of the New York Central, or any other of the numerous proxy contests of the past several years, without producing some confusion. Charges and counter-charges are always replete with confusion, usually reflected by the disinterested or interested observer in the form of the question: "Whom should I believe?"⁷⁴

Few would quarrel that impeccable honesty on the part of all participants in any arena of interaction, and especially in the goings-on of the business community, is desirable, and that laws, customs, and traditions geared to approach the impossible state of perfection are to be favored. It does not follow from this, however, that laws should, as in this case for example, impose impracticable restraints upon the conduct of person with person. Confusion is almost a necessary ingredient of contest, a product of it. What one contestant asserts as true, the other refutes. The interchange may appear confusing to some and not to others, or may be confusing to all. This attracts the attention of both the public and the shareholder, and facilitates the latter's focusing attention upon the drama that will affect his corporate investment, and therefore should enable him better to be able to decide for whom to vote.

Further restrictions are placed upon issuing material which directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, unless factual data supporting such assertions are filed with the Com-

72. Proposed Rule X-14A-9(b)(2), August, 1955.

73. Rule X-14A-9, Note (4).

74. Nor is it clear what would be considered irrelevant. In the New York Central contest, the abilities of Robert R. Young and William White were repeatedly pitted against each other by reference to their records with other companies, Young with the Chesapeake and Ohio Ry. (see "What Manner of Man Is Robert R. Young?," *New York Times*, April 16, 1954), and White with the Delaware, Lackawanna & Western (see "Words Won't Wipe Out the Record," *New York Herald Tribune*, May 18, 1954, and "Beware This Ruse!," *New York Times*, May 20, 1954). Query: Should the issues be kept strictly to matters existing within the organization concerned, and proposed remedies? Also, see the advertisement, "Mr. Murphy Didn't Intend Any Harm," which referred to the resurrection of testamentary gifts in 1943 by a railway equipment manufacturing company executive to certain railway executives, with the suggestion of anti-competitive agreements.

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mission prior to such use.⁷⁵ With respect to these restrictions, too, it is difficult to predict what effect they will have on the conduct of the campaign in a proxy contest. None would urge reckless impugning of character, but when arguments are presented to debauch the record of the incumbents, or of the nominee directors of a contesting group, it sometimes is inevitable to cast aspersions upon their personal reputations. Perhaps the established bounds of slander and libel are an insufficient guide to the ethics striven for by the Commission; nevertheless, the lengths to which these rules may conceivably be extended seem quite far.

In the proxy statement of the Alleghany-Young-Kirby Ownership Board in the New York Central campaign, reference is made to the salary paid to Mr. White, then president of the railroad.⁷⁶ It is claimed that the salary in question "can remove much of the incentive for hard work, and in our opinion is inimical to your (the stockholder's) interest." The inference here is that Mr. White was in his position for self aggrandizement, and not to benefit the company. Further on in the same material appears this sentence: "You can be sure that if your new Board continues his {White's} present salary of \$120,000 a year it will be only if he revises his pessimistic view about the earnings possibilities of your Company and only so long as he turns in a good day's work."⁷⁷ This surely is the use of innuendo. It is an attack on the personal integrity of the president of the Railroad in that it implies his lack of effort. Yet, considering the nature of a proxy contest such as this, is it unreasonable, even unexpected? Statements such as these are to be read and understood in their context; they reflect the heat typically accompanying a major fight for control of a huge corporation.⁷⁸

Thus, the new Rule X-14A-9 is one of the major changes among those announced January 17 last; it has received a great deal of criticism. Testifying before the Senate Banking and Currency Committee, Robert R. Young said the requirement that the S. E. C. approve all statements made by the contestants in a proxy fight, including press releases, was a "distinct hardship" to both sides in the contest. Referring to it as censorship, he expressed his opinion that the regulations ought to be changed so that after the initial proxy statement is published, either side would be free of the requirement to secure S. E. C. approval, though

75. Rule X-14A-9, Note (2).

76. The statement quoted the salary to be \$120,000 a year until age 65, when he was to retire; \$75,000 a year until 70, and \$40,000 a year thereafter.

77. Alleghany-Young-Kirby Ownership Board Proxy Statement, under section titled "The Lifetime Contracts of White and Metzman," April 8, 1954.

78. For further examples of what might come within the purview of Rule X-14A-9, see advertisements, "Little White Lies," New York Herald Tribune, April 27, 1954, and "Big Black-and-White Truths," New York World-Telegram, May 5, 1954. This rule was promulgated April 11, 1956, effective as of January 30, 1956. SEC Release 5276, Jan. 17, 1956.

remaining subject to the restrictions imposed by the applicable statute with respect to misleading statements and libel.⁷⁹

In a recent issue of *Fortune*, a leading article commented on X-14A-9 in this way. "The enforcement of such rules would be a very difficult and expensive job. Even if they could be enforced, it is not at all clear that they should be. The whole crux of any challenge to a sitting management is a claim that the challenger could produce better financial results for the company. If the challenger wants to make the 'specific' claim that he can increase earnings from \$2 a share to \$5, it's up to the shareholders whether they believe him, just as it's up to the voters to decide whether a candidate for Senator can really accomplish everything he says he would. The main content of a proxy fight *is* claim, counterclaim, and opinion, not facts susceptible of legal proof."⁸⁰

V

CONCLUSION

The efforts of the S. E. C. to vitalize the concept of stockholder ownership and to instill in management a sense of responsibility toward the shareholder have been significantly successful in its administration of the proxy rules. In recent years the proxy-policing duties have assumed new importance, due largely to the increase in proxy contests and the greater use of mass media of communication to disseminate information respecting the contests. What effect certain changes in the rules will have is left for future fights to determine; it is urged that the Commission move slowly.

79. New York Times, June 10, 1955, p. 29, col. 1.

80. Saunders, *How Managements Get Tipped Over*, *Fortune*, October, 1955, p. 182.