IN THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE THIRD CIRCUIT

TRANSAMERICA CORPORATION and its Officers and Directors,
Appellants,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

{No 9240}

SECURITIES AND EXCHANGE COMMISSION,
Appellant,

v.

TRANSAMERICA CORPORATION and its Officers and Directors,
Respondent.

{No. 9259}

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION

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STATEMENT OF QUESTIONS INVOLVED

I. Whether the management of a corporation subject to Section 14 (a) of the Securities Exchange Act of 1934 and Rules X-14A-7 and X-14A-2 thereunder may, through the device of a limited notice of meeting, justifiably refuse to include in its proxy solicitation material a timely and otherwise proper proposal of an individual security holder and the supporting statement and provision for ballot thereon required by the rules.

II. Whether stockholders in a Delaware corporation may act upon the following matters under Delaware law:

(A) A proposal to eliminate a by-law requirement that by-law amendments suggested for stockholder action be set forth in the notice of meeting;

(B) A proposal to permit the stockholders to elect the auditors; and

(C)A proposal that an account of the proceedings at the annual meeting be sent to the stockholders.

III. Whether the judgment of the court below directing resolicitation of the stockholders on the auditor proposal was improvidently granted in that

(A) It required a notice of meeting setting forth the auditor proposal to be sent to all the stockholders;

(B) It enjoined Transamerica generally from violating Section 14(a) and Rules X-14A-7 and X-14A-2 thereunder;

(C) It was an abuse of discretion.

PRELIMINARY STATEMENT

These consolidated causes represent cross-appeals from an order of the United States District Court for the District of Delaware, entered September 9, 1946 (81a-85a). The District Court proceeding had been instituted by the Securities and Exchange Commission ("the Commission") to enjoin Transamerica Corporation and its officers and directors ("Transamerica") from violating Section 14 (a) of the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder. The final judgment of the Court granted in part and denied in part the relief sought by the Commission, and the parties have taken cross-appeals from this judgment. This brief is in support of the Commission's appeal in No. 9259 and in opposition to Transamerica's appeal in No. 9240. Judge Goodrich, on November 19, 1946, ordered consolidation of the cases for purposes of argument. Record references in this brief are to the Appendix filed by

Transamerica. The Commission has not found it necessary to print additional portions of the record.

STATUTE INVOLVED

The statute involved is Section 14 (a) of the Securities Exchange Act of 1934, 48 Stat. 895, 15 U.S.C.A. § 78n (a), which provides as follows:

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

The rules adopted by the Commission under this subsection are entitled Regulation X-14 and are printed in their entirety in the Appendix to Transamerica's brief as pages 1R, et seq.

The statute[1] and rules are described more fully at pages 12-22, *infra*, as part of an extended discussion of the policy embodied in the federal program of proxy regulation. Here it may be noted briefly that the rules are designed to ensure that stockholders will be adequately informed concerning matters that will arise at the meeting and to make their voting rights effective. One of these rules is X-14A-7, which provides that if a management soliciting proxies is informed by a "qualified security holder" of the company that he

"intends to present for action at a meeting of security holders of the issuer a proposal which is a proper subject for action by the security holders, the management shall set forth the proposal and provide means by which security holders can make a specification as provided in rule X-14A-2. Further, if the management opposes such proposal, it shall, upon the request of such security holder, include in its soliciting material the name and address of such security holder and a statement of such security holder setting forth the reasons advanced by him in support of such proposal: *Provided, however*, That a statement of reasons in support of a proposal shall not be longer than 100 words."

The construction of this rule is the principal issue in this proceeding.

THE FACTS

Transamerica Corporation, a Delaware corporation, has outstanding approximately 9,935,000 shares of $2 par value capital stock, which are registered with the Commission and listed on the New York Stock Exchange, the Los Angeles Stock Exchange and the

San Francisco Stock Exchange, all of which are national securities exchanges (21a). The shares are held by approximately 151,000 shareholders (53a).

John J. Gilbert, a duly qualified stockholder of Transamerica Corporation, early in January, 1946, by letter to the management, submitted four proposals which he intended to present for action by shareholders at the next annual stockholders' meeting, to be held on the last Thursday in April, 1946. The proposals were as follows (App. 10a-13a):

(1) To have the independent public auditors of the books of the corporation elected by the stockholders, beginning with the annual meeting of 1947, and a representative of the auditing firm last chosen attend the annual meeting each year;

(2) To amend By-Law 47 so as to eliminate therefrom the requirement that notice of any proposed alteration or amendment of the By-laws be contained in the notice of meeting (this proposal would be advanced at the meeting, Gilbert said, only if the management persisted in its practice of ruling stockholders' proposals out of order on the ground that they had not been set forth in the notice of meeting)

(3) To change the place of annual meeting of the corporation from Wilmington, Delaware, to San Francisco, California; and

(4) To require that an account of the proceedings at the annual meeting should be sent to all stockholders of the corporation.

The first proposal appeared to be in the form of a by-law amendment, and the Commission and the company so regarded it (see p. 38, *infra*). The second and third proposals were identified by Gilbert as by-law amendments. The fourth was identified as a "resolution."

Gilbert requested that, pursuant to Rule X-14A-7, these proposals be set forth at length in the management's proxy statement, and, in the event that the management intended to oppose his proposals, that his name and address and his supporting statements of less than 100 words each also be included in the proxy statement (lla-12a).

The management of Transamerica Corporation in a letter to the Commission acknowledged timely receipt of Gilbert's proposals and requests, but indicated that if Gilbert should attempt to introduce the proposals the officer presiding at the meeting would rule them out of order (26a-28a).

The resolution to send the stockholders a report of the meeting was claimed to be a subject of management discretion beyond the scope of stockholder control (27a-28a), and the other three proposals, assumed to be by-law amendments, were said not to be proper subjects for stockholder action because they had not been set forth in the notice of meeting as required by by-law 47.[2]

By telegram dated February 12, 1946, the Commission advised the company to comply with the proxy rules, to include all of Gilbert's proposals in the proxy statement, and to provide in the form of proxy a means whereby solicited security holders could ballot on these proposals (29a). This position was reiterated to the company by telegram dated February 15, 1946, telegram dated February 20, 1946, and letter dated March 29, 1946 (30a, 82a, 37a).

The notice of meeting, proxy statement, and proxy were mailed to stockholders beginning March 18, 1946 (36a, 45a), more than two months after the company received Gilbert's proposals and requests. The notice of meeting made no mention of Gilbert's proposed amendments; the proxy statement did not set forth Gilbert's name or address, his proposals, or his statements in support of his proposals; and the form of proxy did not provide a place where solicited security holders could specify, by ballot, their approval or disapproval of such proposals (15a-20a). Instead the proxy statement, under the heading "Other Matters", made the following general statement (18a):

"The management has been notified by a stockholder, owning of record 17 shares, that he intends to present for action at the meeting amendments to the Corporation's by-laws designed to permit the adoption of further amendments at stockholders' meetings without setting forth any information concerning the amendments in the notice of the meeting, and to require that independent public auditors should be elected by the stockholders at the annual meeting beginning in 1947, and that a representative of the auditing firm last chosen should attend the annual meeting each year. These proposals are not mentioned in the notice of the meeting and Section 47 of the by-laws provides that the by-laws may be altered by stockholders if notice of the proposed alteration is contained in the notice of the meeting. Consequently, if the meeting convenes under said notice without amendment thereto, the Chairman of the meeting will rule that any proposal for amendment to the by-laws does not properly come before the meeting and is out of order. Said stockholder has further stated that he intends to present for action at the meeting a resolution not involving an amendment to the by-laws designed to require an account of the proceedings at annual meetings to be sent to all stockholders. The directors do not consider that such an account would be of sufficient interest to justify the expense of compiling and mailing it and since such matters are in the discretion of the directors, the stockholders' resolution would have no binding effect and therefore the Chairman of the meeting will rule that the resolution does not properly come before the meeting and is out of order.''

Thereafter followed correspondence in which the Commission asked that proxies be resolicited by Transamerica in compliance with its rules (38a), and the management insisted on adhering to its course (39a-42a). On March 26 the directors amended by-law 3 to change the place of the stockholders' meeting from Wilmington to San Francisco; and amended by-law 47 to provide that a valid by-law amendment would be noticed for the annual meeting if proposed in writing by stockholders owning one per cent or more of the stock (35a, 52a, 63a).

On April 16, 1946, the Commission instituted an action in the United States District Court for the District of Delaware, under Section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, asking that the management be enjoined from (1) exercising any power conferred by any proxies so obtained; (2) holding any meeting of the stockholders except for the purpose of adjournment; and (3) violating Rule X-14A-7 (5a-13a).

At a hearing immediately prior to the scheduled annual meeting, the court below declined to grant the first two items of relief sought, and entered an order permitting the meeting to be held for the purpose of election of directors and consideration of matters other than Gilbert proposals, but the order of the Court also ordered that the meeting be adjourned pending determination by the Court whether the Gilbert proposals were proper subjects for action by the security holders (56a-57a). Thereafter the Commission made a motion for summary judgment on the ground that there was no genuine issue as to any material fact and that the Commission was entitled to judgment as a matter of law (59a).

The Court rendered its opinion on July 11, 1946, holding that the proposal that the stockholders elect the company's independent auditors at the annual meeting was a proper subject for action by the security holders and that the failure of the management to include it in its proxy materials was a violation of Rule X-14A-7 (62a-75a). The Court held to be improper subjects for stockholder action the proposal that by-law 47 be amended to eliminate the requirement that proposed by-law amendments be set forth in the notice of meeting, and the resolution that reports of the annual meetings be sent to the stockholders. The Court made no ruling with regard to the proposal that the place of meeting be changed to San Francisco, that proposal already having been adopted by the management. Underlying the decision of the Court, and what we regard to be the fundamental error therein, was the holding that the management had the power, in excluding proposed by-law amendments from the notice of meeting under by-law 47, to exempt from the requirements of Rule X-14A-7 proposals which would otherwise be proper subjects for stockholder action under state law. A petition by Transamerica for rehearing was denied, the Court rendering a supplemental opinion (79a-80a).

On September 9, 1946, the Court entered its final judgment in the cause, denying the relief sought by the Commission except as to the auditor proposal, and (1) enjoining Transamerica from violating Section 14 (a) and Rules X-14A-7 and X-14A-2 thereunder; and (2) ordering Transamerica to mail to all its stockholders a notice of adjourned annual meeting to be held for the purpose of considering Gilbert's proposal for the election of auditors; to resolicit all the previously solicited security holders with respect to Gilbert's auditor proposal; and to convene the adjourned annual meeting when the proxies so solicited were received (81a-85a).

Transamerica and the Commission have taken cross-appeals from the final judgment to the extent that it is adverse to each of them. The annual meeting of the stockholders is being adjourned from month to month on order of Court (87a).

ARGUMENT

To cope with evils more fully described below, Congress gave the Commission broad authority to regulate the proxy-soliciting practices of corporations listed on the national securities exchanges in accordance with such rules as it might prescribe as "necessary or appropriate in the public interest or for the protection of investors." The Commission has deemed it necessary and appropriate to incorporate into its program of proxy regulation a requirement that a corporate management soliciting proxies must include in its proxy-soliciting materials any proposal advanced by a qualified security holder which is "a proper subject for action by the security holders," and that it must afford the security holders an opportunity to vote upon such proposal.

Neither Transamerica nor the District Court question the validity of such a requirement. Transamerica, however, construes the rules as in effect permitting the management in its discretion to determine through its control of the notice of meeting what may become a "proper subject" for the stockholders to act upon. This contention is derived from the fact that Rule X-14A-7 deals only with such security holders' proposals as are a "proper subject for action by the security holders," and from a published administrative interpretation of the Rule to the effect that a "proper subject" is one that the security holders may act upon under the law of the state of incorporation. Transamerica also maintains that under Delaware law and the company's by-laws the management had power to exclude the particular proposals from action at the meeting by failing to mention them in the notice of meeting although referring to them in the proxy statement.

The Court below, in general, accepted the validity of Transamerica's approach to the construction of the rules, but, in giving judgment for the Commission with respect to a portion of the relief sought, ruled that the management had misconceived the extent of its power to exclude certain matters from coming before the stockholders under Delaware law.

Transamerica argues that the decision of the Court below involves inconsistencies in the interpretation of Delaware law. But if Rule X-14A-7, by its terms, requires these proposals to be submitted to the stockholders, the Rule, promulgated under paramount federal law, renders irrelevant any considerations of the power of management to create procedural obstacles under state law. It is the Commission's position that since Gilbert gave the management notice of his proposals in ample time to include them in the proxy-soliciting materials, it was necessary to determine only whether, under a proper construction of state law, the proposals were matters on which the stockholders could act, and it was unnecessary to determine whether, apart from the proxy rules, the management of Transamerica could have prevented the particular proposals from coming before the stockholders. The basic purpose of the Commission's proxy rules was to prevent the management of a corporation, whose securities have been distributed in interstate commerce and are listed upon a national securities exchange, from taking advantage of the dispersal and anonymity of their stockholders to frustrate the theoretical voting rights of the stockholders as conferred by state law. We believe, therefore, that the phrase "a proper subject for action" must be construed in the context of the rules as meaning a subject which stockholders have a theoretical right to act upon, apart from the practical

difficulties which arise in the case of the larger corporations whose securities are listed on exchanges and traded in interstate commerce. This right the proxy rules undertake to effectuate by, among other means, affording some practical machinery whereby individual security holders may initiate proposals and get them before their fellow stockholders.

We believe that the Court below misconceived the basic relationship between the protection accorded by the proxy rules and the preexisting rights under state law, and that its construction of the proxy rules has the effect of making the federal regulation for initiation of proposals by stockholders unavailable except to the extent that protection might be afforded apart from that regulation under state law. While we believe the rules speak for themselves, the situation is one in which we believe the courts may properly give great weight to the administrative construction. The case is not one in which an attempt is made to enforce a penalty for action not known to be in contravention of the construction put upon the rules by the enforcement agency. Transamerica had the problem specifically called to its attention in ample time for compliance and was advised of the views of the administrative division directly in charge of the matter.

Presumably because of the importance of the time factor in proxy matters, the statute does not provide for administrative proceedings culminating in orders to enforce the proxy rules but merely authorizes suit for injunctive relief. In consequence administration of the rules means, by and large, the rendering of advisory rulings by the division charged with the scrutiny of proposed proxy statements. Assuming that such informal rulings of an administrative agency do not have the full force of formal interpretations in the course of administrative adjudication, nevertheless an agency's construction of its own rules has been said to be "of controlling weight unless it is plainly erroneous or inconsistent with the regulation." *Bowles v. Seminole Rock & Sand Co*., 325 U.S. 410, 413 (1945). Even agency interpretations of statutes they administer are said to be entitled to substantial weight. *Skidmore v. Swift & Co*., 323 U.S. 134 (1944). In these cases the agency interpretation was set forth in a general interpretative bulletin. Here, however, the Commission's interpretation was addressed to the specific controversy which had arisen between the company and its stockholder and was in the nature of an administrative adjudication, although an informal one.

The propriety of Gilbert's proposals in the instant case, apart from the procedural obstacles raised by the management, has never been seriously in issue. With respect to every proposal but the one to send a report of proceedings at the annual meeting to the stockholders, the management, in its communications to the Commission (26a, 29a, 31a, 34a, 39a) and in the Court below, relied exclusively on its asserted authority under by-law 47 to prevent the proposals from being presented to the stockholders. And of the four proposals that the management said it would rule "out of order" (18a), one was subsequently adopted by the directors intact (the change in place of meeting from Wilmington to San Francisco); another was adopted by the directors in part (the "one per cent amendment" to by-law 47); and a third was found by the Court below to be eminently proper (the auditor proposal).

We shall show that Gilbert's proposals were proper subjects for stockholder action under Delaware law. We believe, further, that even under Delaware law and apart from the proxy rules the management could not prevent stockholders from voting upon these proposals by procedural obstacles claimed to be valid under by-law 47; but as to this issue we rely on the broader argument that such conduct is violative of federal policy as expressed in the Securities Exchange Act and in the Commission's proxy rules. To that question we now turn.

POINT I

PROPERLY CONSTRUED, THE PROXY RULES REQUIRE GILBERT'S PROPOSALS TO BE SUBMITTED TO THE STOCKHOLDERS IF THEY CONCERN SUBJECTS UPON WHICH STOCKHOLDERS MAY VOTE UNDER STATE LAW, AND THIS REQUIREMENT CANNOT BE EVADED BY MEANS OF PROCEDURAL OBSTACLES WHICH IT IS CLAIMED ARE NOT UNLAWFUL IN THE STATE OF INCORPORATION.

(A) *The Federal Policy*.

It seems to us that the error of the Court below derives from a failure to construe the rules in the light of what Congress, and the Commission pursuant to the mandate of Congress, are trying to accomplish in the regulation of proxy soliciting practices. The Securities Exchange Act of 1934 resulted from an intensive two-year Congressional investigation.[3] It is a many-sided statute. The regulation of exchange practices,[4] the outlawing of manipulative and deceptive devices,[5] the supervision of brokers and dealers,[6] the regulation of credit practices[7]—these provisions which have a direct impact on securities transactions represent only partial phases of that legislation. The Act was broadly designed to stabilize the national economy against the shocks produced by a faulty investment system which had not adjusted itself to modern conditions.[8] That purpose could not be achieved piecemeal. As stated by the Congress:[9]

"Speculation, manipulation, faulty credit control, investors' ignorance, and disregard of trust relationships by those whom the law should regard as fiduciaries, are all a single seamless web. No one of these evils can be isolated for cure of itself alone."

At the heart of the problem was the development of large corporations and the geographical diffusion of their shareholder-owners. Thus, it was found that nearly one-half the corporate wealth of the nation was vested in the 200 largest non-banking corporations which were "owned in each case by thousands of investors and . . . controlled by those owning only a very small proportion of the corporate stock."[10] The consequence was divorce of ownership from control and the disintegration of ethical and other sanctions which had prevailed in the days when officers and directors knew personally all or most of the stockholders whom they represented, and when stockholders knew and could exchange ideas with each other.[11]

Stability could come only through investor confidence, and investor confidence could not be restored until corporate trustees truly represented their *cestuis* and were rendered amenable to internal controls.[12] With this end in mind the Act required that full publicity be given to the affairs of registered corporations (Secs. 12, 13), and curbed trading abuses by corporate insiders (Sec. 16). More directly bearing on the instant case was an attempt to restore "fair corporate suffrage" by employing the federal power to curb abuses of the proxy machinery by which entrenched minorities had denied to security holders any effective voice in the management of their corporations. The problem was put as follows by the House Committee on Interstate and Foreign Commerce:[13]

"Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies. Insiders having little or no substantial interest in the properties they manage have often retained their control without an adequate disclosure of their interest and without an adequate explanation of the management policies they intend to pursue. Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights. Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according to shareholders fair suffrage. For this reason the proposed bill gives the Federal Trade Commission power to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders."

To achieve these purposes a broad grant of power was made to the Commission in Section 14 (a) of the Act, making it unlawful for any person to use the mails or instrumentalities of interstate commerce

"to solicit any proxy . . . 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."

The typical practice prior to the adoption of the Securities Exchange Act was to send the stockholder a proxy card authorizing the proxy agents to elect directors, and giving the proxy agents blanket authority to vote upon any matter that might come up at the meeting and blanket authority to ratify all past acts of the management. If the stockholder was given notice of special matters that would be considered at the meeting, such as management compensation plans, service contracts and option agreements, it was usually without adequate disclosure of the personal interest of the officers and directors or of other matters essential to an intelligent exercise of voting rights. The stockholder was merely accorded the opportunity to sign his name and mail back the proxy. Comment or criticism was not invited, and opposition could be expressed only by expensive counter-solicitation directed to the removal of the management. Such a course was usually far

beyond the means of the average investor. Since, by reason of diffusion of the stockholders, it was impossible to get a quorum through personal attendance, the solicitation of proxies in effect took the place of the annual meeting, and the meeting was significant only as affording the occasion for the presentation and counting of proxies.[14]

The Commission has conceived its function to be to supply through the proxy machinery the nearest practical equivalent to the conditions for effective self-government by stockholders such as prevailed at the old type of meeting which was personally attended by stockholders who knew each other and their officers and directors.[15] This has been a complex task, which has required consideration and solution of a variety of problems as they arose in the Commission's administration of Section 14 (a).[16]

In general, the Commission's proxy rules forbid the solicitation of proxies unless they are accompanied by a written proxy statement containing specified items.[17] The proxy statement must describe in sufficient detail to make them intelligible the matters to be acted upon, such as option and pension plans, amendments to the charters and by-laws, and recapitalizations.[18] The nominees must be identified and, if newly proposed for the position of director, their past experience must be described.[19] If the solicitation is by the management there must also be disclosure of the remuneration of directors and high-salaried officers and their personal interest, if any, in the matters to be acted upon.[20] Proxy statements must be set in readable type and arranged in ballot form to permit a separate vote by the security holders on individual items or groups of items.[21] On the other hand, the security holder is also afforded an opportunity to give full discretion in these matters to the persons soliciting the proxies.[22]

The rules apply to solicitations by any person, informational requirements varying depending on whether the solicitation is by a management or non-management group. Two of the rules are specifically designed to facilitate solicitations and proposals by minority stockholders. Rule X-14A-6 provides that, as a condition to soliciting its own proxies, the management must undertake to mail out independent proxy materials supplied by minority stockholders, all mailing material to be furnished and expenses borne by the latter (5R-6R).

Rule X-14A-7 (added in 1942) provides an alternative procedure for stockholders who do not wish, or as a practical matter are unable, to bear the expense of proxy solicitation, and who do not seek to elect an independent slate. This Rule provides as follows:

"In the event that a qualified security holder of the issuer has given the management reasonable notice that such security holder intends to present for action at a meeting of security holders of the issuer a proposal which is a proper subject for action by the security holders, the management shall set forth the proposal and provide means by which security holders can make a specification as provided in rule X-14A-2. Further, if the management opposes such proposal, it shall, upon the request of such security holder, include in its soliciting material the name and address of such security holder and a statement of such security holder setting forth the reasons advanced by him in support of such proposal: *Provided, however*, That a statement of reasons in support of a proposal

shall not be longer than 100 words: *And provided further*, That such security holder and not the management shall be responsible for such statement. For the purposes of this rule notice given more than thirty days in advance of a day corresponding to the date on which proxy soliciting material was released to security holders in connection with the last annual meeting of security holders shall, prima facie, be deemed to be reasonable notice."[23]

Transamerica construes this Rule as permitting the management to render improper and beyond the scope of the Rule a proposal for action by the security holders otherwise proper under the law of the state of incorporation, through the dubious expedient of excluding the proposal from the notice of meeting and thereafter, solely on the ground of such exclusion, arguing that the proposal would be ruled "out of order" at the meeting. The Court below adopted this construction, with a qualification rested upon certain considerations under Delaware law with respect to part of the proposals in issue.

The Commission, on the other hand, construes its own Rule as requiring a management to submit to its security holders any proposal upon which the security holders have the power to act under the law of the state of incorporation.[24] The Commission emphatically does not recognize the right of a management to evade this requirement through procedural devices which are in derogation of the privilege expressly accorded by the Rule to every qualified security holder to present to his fellow security holders proposals which are within the province of stockholder action. This purpose, which we think is obvious on the face of the Rule, is highlighted by the fact that under an earlier version of the rules (which did not contain the equivalent of Rule X-14A-7, but which, like the present rules, forbade the use of misleading practices, whether through false statements or material omissions), the Commission found that it would be misleading for a management having knowledge that a security holder intended to make a proposal at the meeting to withhold that knowledge from the body of security holders, and that this duty of disclosure could not be evaded by rendering the proposals "out of order" through refusal to include them in the notice of meeting. A prominent member of the corporation bar commented (albeit unfavorably) on this Commission practice as far back as 1939.[25]

Rule X-14A-7, adopted in 1942, has codified this practice, and has provided that, in addition to disclosure of the proposal, opportunity must be afforded to the proponent to submit a statement not exceeding 100 words in support thereof and to the security holders generally to vote on the proposal.[26] Rule X-14A-7 is an integral part of the proxy rules, for it is obviously as important for the owner-stockholder to know just what his agents are going to vote against as to know what they are going to vote for; it is important that he know what proposals they intend to defeat without a formal vote; and that he be able to make his wishes in these matters felt. Finally, it is of paramount importance that he be able to advance proposals for consideration by his fellow stockholders as he could in the days before stock ownership had taken on a fundamentally interstate character.

(B) *The Decision of the Court Below Frustrates the Policy Reflected in the Proxy Rules.*

Transamerica's construction, and the ruling of the Court below, render Rule X-14A-7 largely, if not completely, nugatory. In looking exclusively to state law to determine whether a proposal is a "proper subject for action by the security holders," the Court below seems to have ignored entirely whether such a course might result in conflict with federal policy. Apparently the Court below misconstrued an opinion of the Director of the Commission's Corporation Finance Division which appeared in Securities Exchange Act Release No. 3638, and which is reprinted as Exhibit A to this brief (p. 53). Briefly, a corporation had requested the Commission's advice with respect to the status under Rule X-14A-7 of a resolution submitted by a stockholder which proposed modification of the Federal income tax and anti-trust laws. The corporation was advised that these proposals were not proper subjects for action by the company's stockholders "within the meaning of that phrase as used in Rule X-14A-7." The opinion further stated, in pertinent part:

"You state that these proposals are obviously of a political and economic nature and that your corporation is an industrial corporation which is not empowered to engage in political activity nor is such activity within the scope of its business operations.

"Speaking generally, it is the purpose of Rule X-14A-7 to place stockholders in a position to bring before their fellow stockholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized. It was not the intent of Rule X-14A-7 to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or economic nature. Other forums exist for the presentation of such views."

Obviously, the statement in the opinion regarding proper subjects under state law had reference to matters which, from the substantive viewpoint, stockholders could act upon, *qua* stockholders, pursuant to state law. Indeed, this is apparent on the face of the Commission's release, for in the leading paragraph the ruling is summarized as follows (p. 54, *infra*): "The opinion of the Director interprets the phrase 'proper subject for action' to mean proposals which *relate directly to the affairs of the particular corporation* and concludes that proposals which deal with general political, social or economic matters are not, within the meaning of the rule, 'proper subjects for action by security holders.'" (Emphasis supplied.) The irrelevance of resolutions as matters of a general political, social or economic nature is not, and could not reasonably be, described as depending upon the scope of the notice of meeting. Moreover, as noted at pp. 20-21, *supra*, the Commission has consistently taken the view that the rules could not be evaded by means of procedural limitations claimed to be valid under state law.

Under the provisions of Section 14 (a) it is within the rule-making power of the Commission to prescribe the conditions under which effective action by stockholders may take place. The issue in this case is not whether Transamerica's by-law 47, as employed by the management, imposes a reasonable limitation on the rights of corporate suffrage granted by Delaware law, but whether the Commission's requirement that every qualified security holder be afforded an opportunity to present "proper" proposals to his fellow security holders is a reasonable exercise of the authority granted to the

Commission by Section 14 (a). In the context of the Securities Exchange Act, dealing with problems created by the interstate dispersion of stockholders and their consequent inability to exercise effectively the theoretical voting rights extended to them by state law, it is submitted that the Commission's requirement is reasonable.

The court below did not approach the problem from the viewpoint of the purposes of the Securities Exchange Act, but in the tradition of Delaware law (not known to be particularly favorable to the rights of minority stockholders), and in that context it assumed the management's use of by-law 47 to be a reasonable limitation of voting rights. This ruling suggests, although perhaps inadvertently, disagreement with the policy of Section 14 (a) and of the proxy rules thereunder.

In any event, looking to the language of Judge Leahy's opinion, we find, after the statement that determination of what is a "proper subject" must be made by reference to the law of the state incorporation, a holding that Delaware law does in fact give stockholders the right to make and amend the by-laws of their corporation (69a). The question then, as he saw it, was whether by-law 47 was an unreasonable limitation of that right. He found that it was not, for two reasons: (1) Under by-law 8 (50a) a majority of the stockholders, or, under the later amendment to by-law 47 (52a), one percent of the stockholders, could always compel the calling of a special meeting on a particular proposal by making a request therefor in writing. (2) The power of the management to keep matters from coming up at the meeting was a "very reasonable way to conduct the internal affairs of a modern corporation." Otherwise "any of the several hundred thousand stockholders, or all of them," including "cranks", might put forward suggestions which would be expensive to print and which possibly would consume the time of the meeting to such an extent as to make it "doubtful whether such meetings could be concluded before the time for the succeeding annual meeting" (71a-72a).

These considerations were advanced by Judge Leahy not for the purpose of showing that Delaware law required the Transamerica management to act as it did, but to show that Delaware law *did not forbid* such conduct.

Our argument is that if the state law does not condemn what the Transamerica management has done, the federal law, as implemented by the Commission's regulations, does. To assume that the Commission intended to permit managements to do anything the states did not forbid them to do is to assume that the Commission has intentionally abandoned its functions under Section 14 (a) of the Securities Exchange Act.

The Commission's construction of its rules affords, we submit, a more realistic approach to the problem of "fair corporate suffrage" in its interstate context than is possible under the limitations imposed by the decision of the Court below. It is not mere inertia on the part of the stockholders which makes possible continued control by small minorities. Possession of the proxy machinery and the ability to make the corporation pay for the cost of proxy solicitation[27] give the management an overwhelming strategic advantage.[28]

Successful proxy fights have been rare and spectacular. The fight of John D. Rockefeller, Jr., for control of Standard Oil Company of Indiana,[29] and the fight of A. P. Giannini to regain control of Transamerica Corporation after his retirement some fifteen years ago,[30] are among these financial museum pieces. It has been the experience of the Commission that even under its liberal proxy rules successful proxy fights usually require resources beyond the means of the average investor.

Transamerica Corporation has presently outstanding 9,935,650 shares of stock. This stock is held by 151,000 persons. The combined holdings of the directors of Transamerica amount to only one-half of one per cent of the outstanding shares; and this is inclusive of the 21,500 shares held by a trust which is managed by L. M. Giannini (15a-16a). To say that a stockholder cannot even suggest by-law amendments unless, proceeding at his own expense, he first obtains the agreement in writing of persons owning a majority of the stock, is effectually to deny him the right to amend the by-laws. The inevitable consequence of such a procedure is to give absolute control over the by-laws to the management, except in the case where there are a few large stockholders commanding a majority of the stock, or where the individual stockholder is a Rockefeller or a Giannini.

The subsequent amendment of by-law 47 to provide that a proposed by-law amendment would be noticed for the annual meeting if requested in writing by persons owning one per cent of the stock (52a-53a) was thought by the Court below to be "so obviously a reasonable limitation of the amendatory power of stockholders that no difference of opinion can arise in the future" (71a). We wish only to note that the closing price of Transamerica stock on the New York Stock Exchange on November 23, 1946, was 13 1/2.[31] One per cent of the stock would have a market value exceeding $1,300,000. The average stockholder of Transamerica holds 66 shares, with a present market value of $891. It would thus be necessary for approximately 1,500 average stockholders, scattered and unknown to each other, to combine in requesting a by-law amendment before they could have the matter acted upon by the body of the security holders.

When it came to the auditor proposal, which is so obviously a proper and fitting[32] subject for stockholder action, the Court below seems to have mistrusted the logic of its argument that by-law 47, as employed by the management, did not effectively prevent stockholders from advancing independent proposals. The selection of auditors was a matter of "such fundamental importance," the Court said, "that it should be considered and passed upon by the stockholders themselves at a meeting and is not such a matter which it may be said that the stockholders have already delegated, to others" (80a). And "there is no special reason," the Court stated, "why the vote on independent auditors should be required to assume the form of a new by-law. Such a vote is simply a mandate from the stockholders to the directors which may be carried into execution by following its terms" (75a).[33]

If the stockholders effectively retained their rights to amend the by-laws they already had full control over the selection of auditors. The Court's attempt to escape from the implications of its ruling on by-law 47 by finding special grounds to support the propriety

of the auditor question would seem to indicate something less than entire satisfaction with the assumptions underlying that ruling.

The suggestion by the Court that Rule X-14A-7, as construed by the Commission, would result in crackpot proposals that would endlessly consume the time of the meeting was advanced before, when the Commission solicited industry comment on the proposed 1942 revision of the rules,[34] and in an unsuccessful attack on the rules after their adoption.[35] The Commission is of the opinion that these predictions have not been justified by events. Thus, of the 151,000 security holders of Transamerica, only Gilbert advanced independent proposals at the 1946 meeting. This hardly indicates an abuse of the Rule.

This Court, of course, is not compelled to reach its own conclusion as to the reasonableness of the Rule, but only to decide whether the exercise of the discretion confided in the Commission by the Congress is an arbitrary one and subject to being set aside on that ground. There is no suggestion of invalidity in the opinion of the Court below. The Court assumed the validity of Rule X-14A-7 but refused to accept the Commission's construction of its own Rule.[36] Similarly, Transamerica does not question the power of the Commission in an appropriate case to require disclosure of stockholders' proposals and to require that an opportunity be afforded to the other stockholders to vote upon them. Transamerica argues only that because the state law permits it to interpret by-law 47 the way it does (a proposition with which we disagree), Gilbert's proposals were not proper subjects for action by the security holders.[37]

Under the circumstances, it is submitted that the Commission's construction of its own Rule should be permitted to prevail, particularly since, as we have shown, the ruling below would render X-14A-7 quite meaningless and seriously impair the usefulness of the entire program of proxy regulation.

(C) *Transamerica's Argument that Rule X-14A-7 is in Effect Nullified by Other Provisions of the Rules.*

Transamerica has also advanced certain technical arguments to the effect that, even if Gilbert's proposals were "proper subjects for action by the security holders" within the meaning of Rule X-14A-7, there was no need to comply with Rule X-14A-7 because that Rule is, in effect, nullified by other provisions of the rules. These arguments we consider *seriatim*.

It is argued that Rule X-14A-7 is applicable only when the management intends to act upon a security holder's proposal pursuant to the proxy. In such a case it is conceded that affording to the security holders an opportunity to vote upon the proposal is eminently proper. But where the management intends to kill a proposal not by voting against it but by ruling it out of order it is argued that the management may safely ignore the provisions of Rule X-14A-7. Authority for this construction is claimed to exist in another section of the rules—Item 18 of Schedule A. Item 18 provides as follows (25R):

"If the persons making the solicitation are informed that any other person intends to present any matter for action at any meeting of security holders at which action pursuant to the proxy is to be taken, and if the persons making the solicitation intend that such matter shall not be acted upon pursuant to the proxy, make a statement to that effect, identifying the matter and indicating the disposition proposed to be made thereof at the meeting in the event the disposition thereof is within the control of the persons making the solicitation."

It is argued that Item 18 sets forth the procedure to be followed when a management does not intend that a proposal shall be acted upon pursuant to the proxy, that the management has complied with Item 18, and that accordingly the proxy rules have not been violated even if Gilbert's proposals were "proper subjects for action by the security holders" within the meaning of Rule X-14A-7. Thus, Transamerica recognizes that it must make disclosure of a stockholder's proposal but that the rules do not require it to afford the proponent an opportunity to submit a short statement in behalf of the proposal or to afford the stockholders an opportunity to vote upon it. Transamerica argues in effect that the rules do no more than codify the practice that prevailed in 1939, prior to the adoption of Rule X-14A-7, when management disclosure of a stockholder proposal was said by the Commission to be necessary to prevent a proxy statement from being misleading (see pp. 20-21, *supra*). The requirements added since then for submission of the proposal to the stockholders and for inclusion in the management's proxy materials of a short statement by the proponent are urged to be in effect optional with the management. This is not the Commission's view of the rules.

Item 18 is intended to serve the disclosure policy of Section 14 (a) and the rules thereunder, and not to provide a loophole which would nullify Rule X-14A-7. Disclosure affords a minimum sanction in close cases where the Commission does not challenge the management's contentions that the subject is not "proper." Item 18 serves other purposes as well. It serves to limit the scope of a proxy. As we have noted, Regulation X-14 applies to the solicitation of proxies by any person. If a minority stockholders' group solicits proxies for a limited purpose, it is desirable that the limited purpose be set forth and that the proxy statement specify that authority is not sought with respect to other matters which it is known may come up at the meeting. It would indeed be a distortion of the purposes of Item 18 to construe it as permitting managements to prevent "proper" subjects from being acted upon by the security holders.

The mere disclosure of Gilbert's proposals by the Transamerica management in "compliance" with Item 18 (see p. 6, *supra*), does not satisfy the federal policy of ensuring "fair corporate suffrage" which the Commission's rules are designed to implement. In this connection reference may be made to the argument advanced by Transamerica below, but abandoned on this appeal, that the Commission may not compel a management to afford security holders an opportunity to vote upon concededly proper subjects. The argument was that under the statute the Commission may not compel the solicitation of proxies, but may only regulate solicitation if the management decides to solicit; that as a practical matter a management must solicit proxies to obtain a quorum; and that to impose the condition that the management give security holders an

opportunity to vote on proper proposals under Rule X-14A-2 is to require the management in effect to solicit proxies on behalf of the person advancing the proposals. Such reasoning of course leads nowhere, for the question still to be resolved is whether the condition imposed by the Commission is a reasonable one in the light of the purposes of the Act. If management, in order to hold a meeting, must treat absent security holders as if present at the meeting, it follows that they must permit security holders to vote on individual matters as they could if present at the meeting. To permit the security holders to vote "yes" or "no" on only such matters as the management chooses to submit to a vote would not, in our opinion, be giving the security holders the opportunities they had at the old type of personally-attended meeting and would not prevent "the recurrence of abuses which have frustrated the full exercise of the voting rights of stockholders."[39]

Similar considerations indicate the unsoundness of Transamerica's argument that it may evade the rules if it intends to kill a stockholder's proper proposals not by voting against them but by ruling them out of order or by similar methods. Transamerica apparently does not claim that such conduct would be lawful, but insists that the proper remedy is an action by the security holder for a mandamus or injunction in the state courts of Delaware (Tr. Br. 17-18). It argues that such litigation is litigation in support of a state-created right, and cites in support thereof *Securities and Exchange Commission v. O'Hara Re-Election (or Proxy) Committee*, 28 F. Supp. 523 (D. Mass. 1939). That case held only that where the Commission has sought and obtained an injunction against the use of misleading proxies, and the injunction has not been violated, the Court will decline a subsequent invitation by the respondent in the case to "supervise and adjudicate the election of officials of . . . a Rhode Island Corporation."[40]

However, the rights accorded to security holders by Section 14 (a) of the Securities Exchange Act and Rule X-14A-7 thereunder are federally-created rights, although, like many other federal rights, they are designed to implement in the interstate field rights that have their origin in state law. So patent an attempt to frustrate those federal rights should be restrained by the federal district courts, which have jurisdiction "to enforce any liability or duty created by this title or rules and regulations thereunder, or to enjoin any violation of such title or regulations."[41] Construing the similar jurisdictional language of the Securities Act of 1933, the Supreme Court held in *Deckert v. Independence Shares Corporation*, 311 U.S. 282, 288 (1940), that "the power to enforce implies the power to make effective . . right [s] . . . afforded by the Act," and the Court broadly ruled that the District Court had power to accord any relief necessary to make the statutory rights effective.[42]

Transamerica argues that acceptance of its construction of the rules will not leave a stockholder without means of obtaining a proxy vote on his proposal (Tr. Br. 24). It notes that Rule X-14A-6 provides that a management may not solicit proxies—

"unless the issuer performs or has performed such of the following acts as may be duly requested by any qualified owner of any security of the issuer . . .

* * *

"(b) At the written request of the applicant, copies of any form of proxy or other communication furnished by the applicant shall be mailed by the issuer to holders, of record or otherwise, of any class of securities who have been or are to be solicited by or on behalf of the management or to any smaller group of such holders which the applicant shall designate. Such material shall be mailed with reasonable promptness after receipt of a tender of the material to be mailed, of envelopes or other containers therefor, of postage or payment for postage, and of reasonable reimbursement of all expenses incurred in connection with such mailing; . . ."

Rules X-14A-6 and X-14A-7 provide the stockholder with alternative procedures for communicating with his fellow stockholders, but, as is clear from the face of the rules, it is the stockholder who may make the choice, not the management. The provisions of Rule X-14A-6 antedate Rule X-14A-7. The latter was added to give greater facility to communications between security holders.[43] The language of Rule X-14A-7 is mandatory:

"In the event that a qualified security holder of the issuer has given the management reasonable notice . . . of . . . a proposal which is a proper subject for action . . . the management *shall* set forth the proposal and provide means by which security holders can make a specification . . . Further, if the management opposes such proposal it *shall*, upon the request of such security holder, include in its soliciting material the name and address of such security holder and a statement of such security holder setting forth the reasons advanced by him in support of such proposal . . . (Emphasis supplied)

Transamerica's argument that Rule X-14A-7 is nullified by Rule X-14A-6 is no more persuasive than its argument that Rule X-14A-7 is nullified by Item 18 of Schedule A.

As previously noted, the Commission's present proxy rules have evolved as the result of years of study and experience. The comparative absence of litigation is at least some indication that they have been workable and sensible in their operations. Transamerica's fanciful construction of the rules, under which independent provisions are said to cancel each other out, would render the rules unworkable.

POINT II

GILBERT'S PROPOSALS ARE PROPER SUBJECTS FOR ACTION BY THE SECURITY HOLDERS

We have argued that otherwise proper subjects for action by the security holders cannot be rendered improper by means of procedural limitations which prevent the security holders from acting on matters which, under state law, they may act upon. The emphasis in the legislative history is on securing to stockholders the free exercise of voting rights which have been curtailed through proxy abuses, and not on any purpose to redistribute

powers and prerogatives as between security holders and directors. Accordingly we must turn to the law of the state of incorporation, in this instance Delaware law, to determine whether the specific proposals are in fact proper subjects for stockholder action.

Preliminarily, we may state our opinion that the propriety of the proposals under Delaware law has never been seriously in issue. The management in its communications with the Commission (26a, 29a, 31a, 34a, 39a) and in the Court below relied almost entirely on its asserted powers to exclude proposals under by-law 47. Only as to the resolution that a report of the annual meeting be sent to the stockholders, which, not being a by-law amendment in form, was apparently not subject to the provisions of by-law 47, did they suggest that the subject matter was exclusively within the province of management under Delaware law (27a-28a, 40a). Of the proposals which the management told the Commission and the stockholders that it would rule out of order (18a), one was subsequently adopted by the management in its entirety (change in place of meeting to San Francisco); another was adopted by the management in part (the one per cent rule); and a third was found by the Court below to be eminently proper.

The proposal to change the place of the annual meeting has been mooted by its adoption by the management. We discuss the other proposals below.

1. *The Proposal to Amend By-Law 47 to Eliminate the Requirement that Notice of a Proposed Alteration or Amendment Be Contained in the Notice of Meeting.* Transamerica cites cases to show that a by-law requiring notice of proposed by-law amendments is valid under Delaware law (Tr. Br. 14-15). Undoubtedly, that is true, and such a by-law serves a wholesome purpose, except where it is subverted to prevent security holders from voting on proposals the management does not like. Gilbert's statement in support of his proposal, which the management refused to insert into its proxy statement, shows that his purpose was not to deny notice to the stockholders -- notice was assured under the Commission's proxy rules -- but to prevent the management from misusing by-law 47. Thus, in giving notice of this proposed by-law amendment to the management, Gilbert said that it was "to be introduced only if the management again resorts to what I consider the extremely undemocratic method of trying to avoid a vote, for approval or rejection, of the other resolutions, by ruling them out of order" (11a).

The question whether the stockholders may validly act upon this matter, if the directors permit them to do so, presents no problem. The General Corporation Law of Delaware provides in Section 12 (Del. R.C. 2044 (1935)):

"The original by-laws of a corporation may be adopted by the incorporators. Thereafter, the power to make, alter or repeal by-laws shall be in the stockholders, but any corporation may, in the certificate of incorporation, confer that power upon the directors."[44]

It will be observed that stockholders are not limited by the statute to the amendment of certain types of by-laws; they may amend the by-laws generally. This is conceded by

Transamerica. Hence, the right of the stockholders to vote on this proposal, if they are permitted to vote on it, is not disputed.

2. *The Proposal to Have the Independent Public Auditors of the Company Elected Annually by the Stockholders.* The Court found that this was a proper subject for action by the security holders and that it should have been submitted to the security holders under Rule X-14A-7. With this conclusion we agree.

The Court advanced cogent reasons as to why stockholders in a Delaware Corporation have the right to select the auditors themselves. The Court had previously held, however, that by-law 47, as applied by the management, was not an unreasonable limitation on the rights of the stockholders to amend the company's by-laws. From this conclusion it would appear that the stockholders could adopt a by-law provision for election of auditors only by mustering the necessary majority (or one per cent) needed to initiate a by-law amendment. But the District Court held the matter of election of auditors not to present a question of amendment to the by-laws, stating:

"The matter of independent auditors is . . . of such fundamental importance that it should be considered and passed upon by stockholders themselves at a meeting and is not such a matter which it may be said the stockholders have already delegated to others." (80a).

On the other hand, the Court said:

"There is no special reason why the vote on independent auditors should be required to assume the form of a new by-law. Such a vote is simply a mandate from the stockholders to the directors which may be carried into execution by following its terms." (75a).

* * * *

"I still think that independent auditors are of such fundamental importance that their selection should be decided by the stockholders and I think this is what Gilbert had in mind. He says nothing about amending the by-laws for the purpose stated" (80a).[45]

As stated by Transamerica (Tr. Br. 11), both the Company and the Commission have looked upon this proposal as one to amend the by-laws. It was not directly identified as such by Gilbert. It is true that at the conclusion of his letter to the company Gilbert commented on his fourth proposal—the one to require a report to be sent to the stockholders—as follows (13a):

"Your attention is called to the fact that this last resolution will not be offered as a by-law amendment, but as a straight resolution."

Transamerica has briefed the auditor question along two lines: (1) Considering the proposal as a by-law amendment, it argues that the directors could exclude it under by-law 47 (Tr. Br. 11-18). (2) Considering the proposal as something other than a by-law amendment, Transamerica argues that it was nevertheless not a proper subject for

stockholder action because under Delaware law only the directors may choose the auditors—a point not argued below (Tr. Br. 18-22).

We agree with Transamerica, as we have throughout the proceeding, that the proposal was a by-law amendment. Assuming that in matters concerning the actual conduct of the corporate business, the directors are vested with a full discretion that cannot be usurped by the stockholders,[46] nevertheless, as recognized by the court below in its decision on the auditor question, in matters concerning the internal government of a corporation, and particularly the relations between directors and their *cestuis*, the stockholders may adopt general rules of conduct. The reasons for according full discretion to directors are of course lacking in this context.[47]

The fundamental authority of the stockholders to act, whether by resolution or by-law, is a function of this corporate division of powers; it depends not on the form in which the stockholders act (nor on the form in which the directors cast their action) but rather on whether they are legislating with respect to the business of the corporation or its internal government. The differentiation between a by-law and a resolution thus is unrelated to the question of stockholder authority to act. It is based only on the scope of the action. The distinction is stated as follows in 8 *Fletcher on Corporations* (1931 Ed.) § 4167:

"Generally speaking, by-laws and resolutions are recognized and treated by the courts as distinct and different, not merely in name, but with regard to their respective offices, functions and operation. The most substantial distinction is that a resolution is ordinarily special and limited in its operation, applying usually to some single specific act or affair of the corporation or to some specific person, situation or occasion, while a by-law is a relatively permanent and continuing rule which is general in its operation and nature and is to be applied on all future occasions to all persons, affairs or situations of the class affected thereby.

* * * * * *

. . . "while it is a matter of general knowledge that by-laws are commonly adopted as such by that name and in some more or less commonly-accepted form, neither name nor form can be relied upon as a test to distinguish them from resolutions or other rules. Thus, that which is a resolution in form and name may have the force and effect of, and function as, a by-law, while a by-law in name may be a resolution in its essential characteristics and in force and effect."

Also see *Dornes v. Supreme Lodge, Knights of Pythias*, 75 Miss. 466, 23 So. 191, 192 (1898); *Drake v. Hudson River R. Co*., 7 Barb. 508, 540 (N.Y. 1849); II *Thompson on Corporations* (3rd Ed. 1927) §§ 1087-88.

Other citations to the same effect are collected in Transamerica's brief (12-18). The proposal that the stockholders select the company's auditors at the annual meetings "beginning with the Annual Meeting of 1947" (12a) was clearly a by-law amendment within the meaning of the rule above stated. And since, under Delaware law, the security

holders have the right to amend the company's by-laws (the by-laws generally, not certain types of by-laws), there can be no question of the power of the stockholders of Transamerica to act upon this subject.

Transamerica's alternate argument is that, if not considered as a by-law, the auditor proposal is nevertheless a subject peculiarly within the discretion of the directors. Apart from the Commission's own objections to the argument, which are stated below, this secondary line of reasoning is directly in opposition to what appears to be Transamerica's primary contention—that the proposal is a bylaw amendment in purpose and effect. For if the proposal does involve an amendment to the by-laws, it is concededly a subject that can be validly acted upon by the stockholders if the directors let them or if they compelled action by a petition signed by a majority (or one per cent). But the proposal could not be a proper by-law amendment if it impinged upon an area that was inherently one of management discretion.

Transamerica claims that if the auditor proposal is considered as a resolution rather than a by-law the matter is made one of management discretion by Delaware law, and cites the following portion of Section 9 of the Delaware Corporation Law (§ 2041 R.C. Del. 1935):

"The business of every corporation organized under the provisions of this Chapter shall be managed by a Board of Directors, except as hereinafter or in its certificate of incorporation otherwise provided * * *".

Obviously the section is a statement of the general rule concerning the management's discretion with respect to the "business" of a corporation. But Transamerica argues from the statute that "since neither the Delaware Corporation Law nor the Certificate of Incorporation grants stockholders the power to elect auditors, the effect of Section 9 is to vest that authority in the directors" (Tr. Br. 19). This curious dialectic would practically read out of the Delaware General Corporation Law the power of the stockholders to adopt by-laws for the internal management of the company.

Transamerica notes further that Article XIII of the Certificate of Incorporation confers upon the directors "all of the powers of this Corporation insofar as the same may be lawfully vested . . ." (App. 49a). Authority for this is said to reside in Section 5 (8) of the General Corporation Law (§ 2037(8) R.C. Del. 1935), which states that a corporate charter may contain any provision—

"* * * which the incorporators may choose to insert for the management of the business and for the conduct of the affairs of the corporation, and any provisions creating, defining, limiting and regulating the powers of the corporation, the directors and the stockholders . . . provided, such provisions are not contrary to the laws of this State."

Again, we see nothing in this section which derogates from the rights accorded to the stockholders by Section 12 of the General Corporation Law to amend corporate bylaws.

It is difficult to imagine a subject which is more fittingly within the sphere of action of the stockholders than the selection of independent auditors. As Judge Leahy said, it would be a strange rule which permitted a trustee to be the sole judge of who is to examine his books. We do not know of any cases holding that Delaware law denies this right to the stockholders. We do know that a number of prominent Delaware corporations have submitted to their stockholders, under the proxy rules, the question whether the auditors shall be elected by the stockholders,[48] and that many more actually follow the practice of permitting the stockholders to elect the auditors. The practice is prevalent enough to have caused the Commission to adopt specific disclosure requirements concerning the election of auditors in its proxy rules.[49] We think that the decision of the court below concerning this proposal was correct.

3. *The Proposal that a Report of Proceedings Be Sent to the Stockholders*. Gilbert's fourth proposal, offered as a "straight resolution", was (12a-13a):

"That following the annual meeting, a reasonably complete and impartial account of the proceedings be sent to all the stockholders of the corporation."

The District Court erred in finding this proposal to be an improper subject for stockholder action. It is submitted that the reasons which show the auditor question to be a proper subject for stockholder action apply with equal force to the propriety of the "resolution" that a report of proceedings at the annual meeting be sent to the stockholders. Again the proposal reaches to the trustee-beneficiary relationship and not to the conduct of the corporate business.

The Court below indicated that the "propriety of the expense" of issuing such a report was a problem for determination by the directors.[50] The management had argued below that the cost of sending out such a report would be $20,000, which presumably represents the minimum cost of mailing a brief report to 151,000 stockholders. But expenses incurred in giving stockholders vital information concerning their enterprise (if they want money to be spent for that purpose) are obviously in a different category from expenses incurred in the course of ordinary business operations. The auditor proposal, for example, could not be rendered an improper subject for stockholder action by proof that the management's auditors are less expensive than auditors selected by the stockholders. Similarly, if the stockholders were to feel that the expense of sending out reports of the meeting is of lesser importance than the desirability of their keeping in touch with the affairs of the corporation so as to afford them a basis for judging whether to continue their support of the management or for other proper action on their part, such decision would seem clearly to be within the scope of their powers.

And again, while we do not know of any cases holding that Delaware law denies to stockholders the right to request such reports, we do know that stockholders of Delaware corporations commonly vote upon such proposals.[51]

An additional argument for the propriety of the "resolution" as a subject for stockholder action is that, as a permanent rule for the internal government of the corporation, it is a

by-law in purpose and effect, and, as we have seen (pp. 36-37, *supra*) , stockholders in Delaware corporations may amend their by-laws generally. Having argued that the auditor proposal, from its "inherent character", was a by-law amendment even though not expressly identified as such (Tr. Br. 12-13), Transamerica can hardly be heard to argue that the same test should not be applied to Gilbert's proposal that a report of proceedings at the annual meeting be sent to the stockholders.

POINT III

TO THE EXTENT THAT THE FINAL JUDGMENT GRANTED THE RELIEF SOUGHT BY THE COMMISSION, IT WAS PROPER IN SCOPE AND DID NOT REPRESENT AN ABUSE OF DISCRETION.

(A) *The District Court Properly Ordered Transamerica to Prepare and Mail to all its Stockholders a Notice of Adjourned Annual Meeting for the Stated Purpose of Considering Gilbert's Auditor Proposal.*

Transamerica argues (Tr. Br. 16-17) that even if Gilbert's auditor proposal were a proper subject for action by the security holders, the District Court had no power to order, as it did, that Transamerica prepare and mail to all its security holders a notice of adjourned annual meeting for the stated purpose of considering Gilbert's auditor proposal. This argument involves more than a technical point about the statutory powers of the District Court. It would have the far-reaching effect of making the other relief granted by the Court futile and meaningless and making the statutory policy defenseless against stratagems devised by managements to frustrate the will of security holders. These consequences are apparent from the argument in Transamerica's brief, which, as we understand it, runs somewhat as follows:

Under Section 14 (a) the Commission can regulate the solicitation of proxies but cannot compel proxies to be solicited; the management did not solicit proxies from the 1300 security holders of Transamerica residing abroad, and neither the Commission nor the courts can compel them to do so; since the statute is concerned only with the regulation of proxy-soliciting practices, neither the Commission nor the courts can dictate the contents of the notice of meeting sent to the foreign security holders; having plenary control over at least *that* notice of meeting, the management can exclude therefrom proposed by-law amendments which are proper subjects for stockholder action under the proxy rules; even if adopted by the security holders, such by-law amendments would be subject to attack by security holders who did not receive the requisite notice (Tr. Br. 14-15); hence the action of the Court in compelling a management to include in its proxy statement stockholder proposals it does not favor would be rendered futile. Such an argument is not of course dependent on the existence of foreign security holders. If Transamerica is correct, a management subject to the Commission's proxy rules can arbitrarily select any group of security holders, large or small, which will not be the subject of proxy solicitation and which will receive an inadequate notice of meeting expressly adapted to the purpose of invalidating any action the overwhelming majority of stockholders may take.

The question is whether this particular method of frustrating the rules is one that the courts are powerless to counter. Undoubtedly the Commission could have expressly written into the rules a condition that as a prerequisite to solicitation management must comply with all procedural requirements necessary to make the vote effective. We think such a condition is already impliedly in the rules, for to assume otherwise is to assume that the Commission did not intend the rules to have any force. To assume otherwise would make the rule-making function a hopeless task, for the agency would always be behind in the race to find and plug loopholes. We think that the rules, fairly construed, require adequate notice of meeting as a condition to solicitation, and that in enforcing the rules in this respect the District Court was serving minimum needs of investors, in view of Transamerica's asserted position. The District Court, moreover, was ensuring the integrity and effectiveness of its order that the adjourned meeting be convened for consideration of the auditor proposal.

Another facet of this problem is apparent in Transamerica's argument, urged obliquely here (Tr. Br. 16), and more directly below (74a), that a district court is limited to enjoining the unlawful *solicitation* of proxies because Section 14(a), by its terms, does no more than make unlawful *solicitations* in violation of the Commission's rules. The answer to this contention, and it illuminates the entire problem, is that a federal district court which has the statutory jurisdiction "to enforce any liability or duty created by this title or rules and regulations thereunder"[52] has authority to make any order necessary effectually *to enforce* a liability or duty created by the Act. See *Deckert v. Independence Shares Corporation*, 311 U.S. 282 (1940), involving the power of the district courts to grant diverse types of injunctive relief to make effective a statutory right of civil recovery created by the Securities Act of 1933.[53] That Act, as appears from the opinion, contains jurisdictional language similar to that in Sec. 27 of the Securities Exchange Act. And the cognate provisions of the Investment Company Act of 1940 have likewise been construed to permit the Courts to grant any forms of relief reasonably necessary to enforce the policy of the statute, even though the statute does not specifically provide for such forms of relief. See *Aldred Investment Trust v. S.E.C.*, 151 F. 2d 254, 260-61 (C.C.A. 2, 1945), cert. denied, 326 U.S. 795 (Prelim. Print) (1946): *S.E.C. v. Fiscal Fund*, 48 F. Supp. 712 (D. Del. 1943) (appointment of receivers, notwithstanding lack of statutory provision therefor).

Instances may also be found in the enforcement of the proxy rules. Thus, notwithstanding the fact that the statute literally renders unlawful only solicitations in violation of the Commission's rules, one district court has enjoined the use of proxies improperly obtained, *S.E.C. v. Okin*, 58 F. Supp. 20 (S.D.N.Y., 1944), and another has enjoined the holding of the annual meeting until such time as new and valid proxies might be obtained, *S.E.C. v. O'Hara Reelection (or Proxy) Committee*, 28 F. Supp. 523 (D. Mass., 1939).

In view of the indirect but unmistakable argument in Transamerica's brief to the effect that a management can frustrate the will of its security holders by sending an incomplete notice of meeting to a selected group, it is apparent that the order of the district court

directing that a notice of meeting setting forth the auditor proposal be sent to all the security holders was necessary if the rights accorded by the proxy rules were to be given content and meaning.

(B) *The District Court Properly Enjoined Transamerica from Soliciting Proxies Without Complying Fully With Section 14 (a) and Rules X-14A-7 and X-14A-2 Thereunder.*

Transamerica argues (Tr. Br. 29-32) that since it was found to have violated the proxy rules only with regard to the auditor proposal, Paragraph (3) of the Court's order, enjoining Transamerica from soliciting proxies "without complying fully with Section 14 (a) of the Securities Exchange Act of 1934 and Proxy Rules X-14A-7 and X-14A-2 thereunder" (82a), is too broad.

Transamerica relies upon *National Labor Relations Board v. Express Publishing Co*., 312 U.S. 426 (1941), a case which was recently followed in *May Department Stores Co. v. National Labor Relations Board*, 326 U.S. 376 (Prelim. Print) (1945).

These cases state the familiar rule that a court or agency may not as a matter of course "enjoin violations of all the provisions of the statute merely because the violation of one has been found."[54] On the other hand, these cases also recognize that—

"a federal court has broad power to restrain acts which are of the same type or class as unlawful acts which the court has found to have been committed or whose commission in the future, unless enjoined, may fairly be anticipated from the defendant's conduct in the past. * * *

"To justify an order restraining other violations it must appear that they bear some resemblance to that which the employer has committed or that danger of their commission in the future is to be anticipated from the course of his conduct in the past."[55]

Whether a general injunction is justified thus depends on the facts of each case, and the matter is necessarily one in which the District Court is permitted a considerable discretion. The *May Department Store* case contains extensive annotations on the practice under the National Labor Relations Act, the Emergency Price Control Acts, the Sherman Act, and the statutes administered by the Federal Trade Commission, showing numerous instances in which a general injunction issued on the basis of a single violation has been upheld, and other instances in which general injunctions were held to be unjustified.

In the *Express Publishing Co.* case the Supreme Court held that the N.L.R.B. was without authority to order an employer to cease and desist both from refusing to bargain collectively and from interfering with its employees in their efforts to organize themselves, it appearing that the employer had been found guilty only of the first offense. In the *May Department Store* case, the N.L.R.B. had ordered an employer to desist (1) from refusing to bargain collectively with a particular union as the exclusive

representative of all its employees at its St. Louis store, and (2) from in any other manner interfering with those employees "in the exercise of their right to self-organization . . . [and] to bargain collectively . . . as guaranteed in Section 7 of the National Labor Relations Act."[56] The second part of the order was held to be improper because the violation on which the first part of the order was based was—

"so intertwined with the refusal to bargain with a unit asserted to be certified improperly that, without a clear determination by the Board of an attitude of opposition to the purposes of the Act to protect the rights of employees generally, the decree need not enjoin company actions which are not determined by the Board to be so motivated."[57]

The rule announced by these cases is not, as urged by Transamerica, that the scope of the injunction must be limited to the act found to be wrongful. It is that the injunction is limited to but should be broad enough to encompass "the reasonable area of threat created." *Bowles, Price Administrator v. Leithold*, 155 F. (2d) 124, note 10 (C.C.A. 3, 1945). The measure of its scope is not the specific past violation but the breadth of the claim of the right to violate. Here the management has claimed and is claiming that it need not comply with Rule X-14A-7 in any regard because the rule is in effect optional; because it has the privilege of ruling any proposals "out of order" under By-Law 47; because of its power to render a "proper" proposal adopted by the stockholders nugatory by sending an inadequate notice of meeting to the stockholders not solicited; and because security holders are said to be given virtually no rights under Delaware law. Since the management's claim thus amounts to an assertion that Rule X-14A-7 may be disregarded or defeated, the injunction properly was made broad enough to insure that the threat to the statutory processes implicit in it is not carried out.

(C) *The District Court Properly Exercised Its Discretion in Directing the Resolicitation of Proxies on Gilbert's Auditor Proposal and the Consideration of That Proposal at an Adjourned Meeting.*

Transamerica' s final argument (Tr. Br. 32, 34) is that it was an abuse of discretion for the District Court to order the management to resolicit proxies on the auditor proposal from stockholders previously solicited and to convene the adjourned annual meeting for the purpose of voting on the proxies so received (83a-84a).

The arguments advanced to show an abuse of discretion are unconvincing, particularly in the light of the importance of the question to investors. The suggestion that Gilbert is a small shareholder who "has made it his business . . . to police [corporate] by-laws" (Tr. Br. 33) is of course irrelevant. The suggestion that very few stockholders have commented favorably on the proposals (it does not appear that any have commented unfavorably), comes with little grace and less force when it is considered that the management did not include in its proxy materials Gilbert's statements in support of his proposals and did not afford the security holders an opportunity to vote upon them. The argument that the resolicitation of proxies will be expensive could be used to defeat any action to enforce compliance with the proxy rules.

The argument that the vote on the election of auditors should be postponed to the 1947 meeting is likewise without merit. It assumes that the stockholders would be equally protected if the question of whether the company should have independent auditors was voted upon at the same time as the question of which particular auditing firm should be selected, and that since the latter question cannot be passed upon until the 1947 meeting[58] the former should be postponed to that time. This assumption, however, ignores the fact that an independent stockholders' group seeking responsible auditors to "run," perhaps against opposition, for the job of auditing the company's books may be handicapped by their inability to assure prospective candidates that the company's policy is, in fact, to let the stockholders elect the auditors. Furthermore, security holders who are primarily interested in the proposition that the stockholders elect the auditors, and who are not the proponents of any particular auditing firm, may be reluctant to join the general proposal with a proposal to elect a particular firm, for fear that stockholder approval of the first may be neutralized by opposition to the second.

Under the circumstances, the District Court's order that proxies be resolicited on the auditor question was clearly not an abuse of discretion. It is our view that the order was incorrect only insofar as it did not direct proxy resolicitation on all of Gilbert's proposals.

CONCLUSION

The judgment should be modified to compel resolicitation on all of Gilbert's proposals and to enjoin violation of the statute and the rules with respect to such proposals, and in all other respects the judgment should be affirmed.

Respectfully submitted,

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December, 1946

EXHIBIT A

For IMMEDIATE Release Wednesday, January 3, 1945

SECURITIES AND EXCHANGE COMMISSION

Philadelphia

SECURITIES EXCHANGE ACT OF 1934
Release No. 3638

HOLDING COMPANY ACT OF 1935
Release No. 5536

INVESTMENT COMPANY ACT OF 1940
Release No. 735

The Securities and Exchange Commission today released an opinion of Baldwin B. Bane, Director of its Corporation Finance Division, dealing with the meaning of the phrase "a proposal which is a proper subject for action by the security holders", as used in Rule X-14A-7 of Regulation X-14 of the General Rules and Regulations promulgated pursuant to the provisions of the Securities Exchange Act of 1934, which relates to the solicitation of proxies under several of the Acts which the Commission administers. Rule X-14A-7 requires companies subject to Regulation X-14 to include in management proxy statements proposals intended to be presented by a stockholder which are proper subjects for action by the security holders and to provide means by which the security holders can vote for or against such proposal. It further provides that if the management opposes such a proposal, it shall, upon the request of the security holders, include in its soliciting material the name and address of such security holder and a statement of not more than one hundred words by such security holder setting forth the reasons in support of such proposal. The opinion of the Director interprets the phrase "proper subject for action" to mean proposals which relate directly to the affairs of the particular corporation and concludes that proposals which deal with general political, social or economic matters are not, within the meaning of the rule, "proper subjects for action by security holders." The text of the opinion follows:

"This is in reply to your recent letter in which you inquire whether certain proposals presented to you by a stockholder of the company for inclusion in the management proxy statement pursuant to the provisions of Rule X-14A-7 of Regulation X-14 of the General Rules and Regulations promulgated pursuant to the provisions of the Securities Exchange Act of 1934 are proper subjects for action by your company's security holders at its next annual meeting. The resolutions presented by such stockholder propose that dividends paid to stockholders shall not be subject to Federal Income Tax where the income from

which such dividends are paid has already been subject to corporate income taxes; that the anti-trust laws and the enforcement thereof be revised; that all Federal legislation hereafter enacted providing for workers and farmers to be represented should be made to apply equally to investors. Other resolutions which are proposed are of similar nature. You state that these proposals are obviously of a political and economic nature and that your corporation is an industrial corporation which is not empowered to engage in political activity nor is such activity within the scope of its business operations.

"Speaking generally, it is the purpose of Rule X-14A-7 to place stockholders in a position to bring before their fellow stockholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized. It was not the intent of Rule X-14A-7 to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or economic nature. Other forums exist for the presentation of such views.

"It is my conclusion that the proposals which have been presented to you are not 'proper subjects for action' by your company's stockholders within the meaning of that phrase as used in Rule X-14A-7. Consequently, it will be unnecessary for you to include the proposals in the management's proxy statement if you do not wish to do so."

FOOTNOTES

[1] Pamphlet copies of the Securities Exchange Act will be filed with the Court together with this brief.

[2] The Company's By-law 47 provides in pertinent part:

"These by-laws may be . . . amended by the affirmative vote of a majority of the stock issued and outstanding . . . at any regular or special meeting of the stockholders if notice of the proposed . . . amendment be contained in the notice of meeting" (51a-52a).

[3] *Stock Exchange Practices*, Hearings Before the Senate Committee on Banking and Currency on S. Res. 84, 72d Cong., and S. Res. 56 and S. Res. 97, 73rd Cong. (1932-34).

[4] Sections 6, 19.

[5] Sections 9, 10, 15.

[6] Section 15.

[7] Sections 7, 8.

[8] See statement of purposes in Section 2 of the Act.

[9] H. Rep. No. 1383, 73rd Cong., 2nd Sess. (1934) 6.

[10] H. Rep. No. 1383, 73d Cong., 2d Sess. (1934) 3. Earlier Berle and Means had shown that only 11 per cent of these companies and six per cent of their wealth were controlled by management groups owning half or more of the outstanding securities. Berle and Means, *The Modern Corporation and Private Property* (1932) 114. A later study undertaken by the Securities and Exchange Commission for the Temporary National Economic Committee revealed that the officers and directors of the 200 largest non-financial corporations owned on the average no more than 5.5 per cent of the equity securities. T.N.E.C. Monograph No. 29, *The Distribution of Ownership in the 200 Largest Nonfinancial Corporations* (1940) 58. Cf. T.N.E.C. Monograph No. 11, *Bureaucracy and Trusteeship in Large Corporations* (1940) 11-12; Twentieth Century Fund, Inc., *Big Business: Its Growth and Its Place* (1937)

It is interesting to note that all the directors of Transamerica are the beneficial owners of only one-half of one per cent of the outstanding securities (15a-16a). This includes 21,500 shares held by a trust managed by L. M. Giannini (16a).

[11] H. Rep. No. 1383, 73d Cong., 2nd Sess. (1934) 5; also see dissenting opinion of Justice Brandeis in *Liggett Co. v. Lee*, 288 U.S. 517, 564-67 (1933).

[12] H. Rep. No. 1383, 73d Cong., 2nd Sess. (1934) 5.

[13] H. Rep. No. 1383, 73d Cong., 2nd Sess. (1934) 13-14. Also see S. Rep. No. 792, 73rd Cong., 2nd Sess. (1934) 12.

[14] See *Stock Exchange Practices*, Hearings before the Senate Committee on Banking and Currency on S. Res. 84, 72d Cong., and S. Res. 56 and S. Res. 97, 73d Cong. (1934) Part 14, pp. 6206-6218; Securities and Exchange Commission, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part VII (1938) 232-292; Berle and Means, *The Modern Corporation and Private Property* (1932) 80-84; Ripley, *Main Street and Wall Street* (1932) 145-51; Dean, *Non-Compliance with Proxy Regulation: Effect on Ability of Corporation to Hold Valid Meeting* (1939) 24 Cornell L.Q. 483, 489-90; Douglas, *Democracy and Finance* (1940) 51.

These practices are generally still followed by unregistered corporations, as appears from a recent study undertaken by the Commission in connection with a recommendation to Congress that the proxy provisions and certain other requirements of the Act be extended to unregistered corporations having a substantial number of public security holders. *A Proposal to Safeguard Investors in Unregistered Securities* (1946) H. Doc. No. 672, 79th Cong., pp. 18-20, 75-86. In 89 per cent of the cases studied, there was no disclosure even of the names of the persons whom the proxy agents intended to elect as directors. *Id*. 18, 76.

[15] As stated by former S.E.C. Chairman Purcell:

". . . the rights that we are endeavoring to assure stockholders are those rights that he has traditionally had under State law to appear at the meeting; to make a proposal; to speak on that proposal at appropriate length; and to have his proposal voted on. But those rights have been rendered largely meaningless through the process of dispersion of security ownerships through the country.

"Today [the stockholder] can only address the assembled proxies which are lying at the head of the table. The only opportunity that the stockholder has today of expressing his judgment comes at the time he considers the execution of his proxy form, and we believe . . . that that is the time when he should have the full information before him and ability to take action as he sees fit."

Securities and Exchange Commission: Proxy Rules, Hearings before the Committee on Interstate and Foreign Commerce, 78th Cong., 1st Sess., on H.R. 1493, H.R. 1821, and H.R. 2019 (1943) 172, 174.

Former S. E. C. Commissioner O'Brien has said:

"It seems to me that the heart of the problem lies in the failure of corporate practice to reproduce through the proxy medium an annual meeting substantially equivalent to the old meeting in person. I know that the old-fashioned meeting cannot be revived. Admittedly, that is impossible. It is not impossible, however, to utilize the proxy machine to approximate the conditions of the old-fashioned meeting. The proxy machine can be used to afford to the stockholders a means of communicating with each other, to give them the opportunity to submit proposals to their fellow stockholders, and to secure the collective judgment of those stockholders on their proposals. Accordingly, our regulations have for sometime been designed to provide the shareholder with an opportunity for a more active participation in the affairs of his corporation. * * *"

Stockholders and Corporate Management, Address of Robert H. O'Brien, former Commissioner, Securities and Exchange Commission, before The Conference Board, New York City, January 21, 1943. A copy of this speech is being submitted to the Court together with this brief.

[16] "In a field where practices constantly vary and where practices legitimate for some purposes may be turned to illegitimate and fraudulent means, broad discretionary powers in the administrative agency have been found practically essential, despite the desire of the Committee to limit the discretion of the administrative agencies so far as compatible with workable legislation." H. Rep. No. 1383, 73d Cong., 2d Sess. (1934) p. 6-7.

The evolution of the rules is discussed in the *Tenth Annual Report of the Securities and Exchange Commission* (1945) 51-52.

[17] Rule X-14A-1 (1R).

[18] Rules X-14A-1, X-14A-3, X-14A-5, Schedule 14A (1R et seq.)

[19] Schedule 14A, Items 5 and 6 (12R-16R).

[20] Schedule 14A, Items 4 and 5 (11R-15R).

[21] Rules X-14A-2, X-14A-3 (2R-4R).

[22] Rule X-14A-2 (2R-3R).

[23] Rule X-14A-2 provides in pertinent part:

"Means shall be provided in the form of proxy whereby the person solicited is afforded an opportunity to specify by ballot a choice between approval or disapproval of each matter, or each group of related matters as a whole, which is intended to be acted upon pursuant to the proxy and the authority conferred as to each such matter or group of matters shall be limited to voting in accordance with the specifications so made." (2R)

[24] Not involved in this case is the question whether a "proper subject for action by the security holders" includes matters which, while exclusively within management discretion, may nevertheless be the subject of advisory resolutions by the security holders.

[25] See Dean, *Non-Compliance with Proxy Regulations: Effect on Ability of Corporation to Hold Valid Meeting* (1939) 24 Cornell L.Q. 483, 502. Also see Bernstein and Fischer, *The Regulation of the Solicitation of Proxies: Some Reflections on Corporate Democracy* (1940) 7 Univ. of Chicago L. Rev. 226, 233-35.

[26] Actually the requirement for an opportunity for security holders to vote was imposed as early as 1940, through amendment to other portions of the rules. See Bernstein and Fischer, *The Regulation of the Solicitation of Proxies: Some Reflections on Corporate Democracy* (1940) 7 Univ. of Chicago L. Rev. 226, 233-35.

[27] Transamerica management makes the corporation pay for its solicitations (15a).

The propriety of this course is generally recognized by state law except in special circumstances which need not be discussed here. See *Lawyers Advertising Co. v. Consolidated Railway Lighting & Refrigerating Co.*, 187 N.Y. 395, 80 N.E. 199 (1907); *Hall v. Trans-Luz Daylight Picture Screen Corp*., 20 Del. Ch. 78, 171 Atl. 226 (1934); Note (1940) 53 Harv. L. Rev. 1165, note 23.

[28] See Securities and Exchange Commission, *Investment Trusts and Investment Companies*, Part Three, Ch. V, pp. 1876-78. Also see Berle and Means, *The Modern Corporation and Private Property* (1932) 80-84.

[29] See Berle and Means, *The Modern Corporation and Private Property* (1932) 82-84.

[30] The story of this proxy battle is in the public files of the Commission. File No. 1-2964, St. 11.

[31] New York Herald-Tribune, Nov. 24, 1946, Sec. IV, p. 10.

[32] The annual election of auditors by the stockholders was one of the recommendations the Commission made to Congress after the McKesson & Robbins scandal. See Securities and Exchange Commission, *In the Matter of McKesson & Robbins, Inc.: Report on Investigation* (1940) 365-370.

[33] Later the Court said that Gilbert had not expressly identified his proposal as a by-law amendment (80a).

[34] See statement of an industry group quoted in *Securities and Exchange Commission: Proxy Rules*, Hearings Before the House Committee on Interstate and Foreign Commerce, 78th Cong., 1st Sess., on H.R. 1493, H.R. 1821, H.R. 2019 (1943) 159.

[35] *Id*., 164-65, 200, 230.

[36] Thus, the Commission's brief below stated (p. 20): "Even if there were any provision of the company's charter or by-laws which permitted the management to disregard proposals of security holders when it was soliciting proxies, such provisions would be illegal because they would be in violation of federal law."

[37] In the Court below Transamerica asserted that Rule X-14A-7 is invalid to the extent that it compels the management to afford the security holders an opportunity to vote on the independent proposal as provided by Rule X-14A-2. This argument has been abandoned by Transamerica, but we discuss it at pp. 31-32, *infra*, for its illumination of the issues.

[38] See note 15, *supra*.

[39] H. Rep. No. 1388, 73rd Cong., 2nd Sess. (1934), p. 14.

[40] 28 F. Supp. at 525.

[41] Section 27 of the Securities Exchange Act.

[42] *Cf. Goldstein v. Groesbeck*, 142 F. 2d 422 (C.C.A. 2, 1944), cert. denied, 323 U.S. 737 (1944); *Baird v. Franklin*, 141 F. 2d 238, 244-45 (C.C.A. 2, 1944), cert. denied 323 U.S. 737 (1944). Also see cases discussed at p. 47, *supra*.

[43] *Securities and Exchange Commission: Proxy Rules*, *cit*. note 15, *supra*, 102.

[44] Article 10 of the Company's Charter provides as follows (49a):

"In furtherance and not in limitation of the powers conferred by statute, the board of directors is expressly authorized:

(a) To make and alter the by-laws of this corporation, without any action on the part of the stockholders; but the by-laws made by the directors and the powers so conferred may be altered or repealed by the stockholders."

[45] As we have indicated at pp. 27-28, *supra*, the tenor of this argument suggests that the Court mistrusted the logic of its conclusion that by-law 47 as applied by the management, was not an unreasonable limitation, from the viewpoint of Delaware law, on the voting rights of stockholders.

[46] 5 *Fletcher on Corporations* (1931 Ed.) §§ 2097, 2104; *Stevens on Corporations* (1936) 544-50.

[47] 5 *Fletcher on Corporations* (1931 Ed.) § 2097; 8 *Id*. §§ 4166-67, 4170-72, 4177-78; I *Morawetz on Corporations* (1886) §§ 491-92; I *Cook on Corporations* (8th Ed. 1923) § 4a, IV *Id*. § 708; Ballantine, *Manual of Corporation Law and Practice* (1930) §§ 178, 180.

[48] The Commission's public proxy files reveal that this has been done by the following Delaware corporations:

General Motors Corporation, File No. 11-1009
Bethlehem Steel Corporation, File No. 11-171
Standard Brands Inc., File No. 11-532
Allied Stores Corporation, File No. 11-894

[49] Schedule 14A, Item 8 (16R-17R).

[50] The authorities cited by the Court (67a) deal with the general problem of management discretion, and do not concern the type of resolution here involved.

[51] The Commission's public proxy files reveal that this proposal has been submitted to stockholders by the following Delaware corporations:

Allied Stores Corporation, File No. 11-894
Marine Midland Corporation, File No. 11-1686
Bethlehem Steel Corporation, File No. 11-171
Cities Service Corporation, File No. 53-241
Curtis-Wright Corporation, File No. 11-757
General Motors Corporation, File No. 11-1009
Thompson-Starrett Company, Inc., File No. 11-1288
Kelsey-Hayes Wheel Co., File No. 11-823

[52] Section 27 of the Securities Exchange Act.

[53] This case is discussed more fully at p. 33, *supra*.

[54] *National Labor Relations Board v. Express Publishing Co.,* 312 U.S. at 437.

[55] *Id*., 435, 437. I

[56] *May Department Stores Co. v. National Labor Relations Board*, 326 U.S. at 387 (Prelim. Print).

[57] *Id*., 392.

[58] It may be noted that Item 8 of Schedule 14A (16R-17R), applicable where action is to be taken on the selection of auditors, requires disclosure in the proxy statement of the names of the proposed auditors and of any material relationships they may have with the corporation and its affiliates.