MEMORANDUM

November 7, 1963

TO: Charles E. Rickershauser, Jr.
Special Adviser to the Division
of Corporate Finance

FROM: James B. Halpern

RE: Suggested 7(f) of the Proxy Rules

Describe briefly, and where practicable state the approximate amount of, any material interest, direct or indirect, of any of the following persons in any [material] transactions since the beginning of the issuer's last fiscal year, or in any [material] proposed transactions, to which the issuer or any of its subsidiaries was or is to be a party:

(1) Any director or officer of the issuer;

(2) Any nominee for election as a director;

(3) Any security holder named in answer to item 5(d); or

(4) Any associate of any of the foregoing persons.

Comment: The text of the item would encompass all transactions in which the specified persons have material interests, with exemptions provided in the instructions. This drafting technique is used in the other parts of item 7. A broad operative provision with separate exemptions is, of course, the pattern of the Securities Act.

It is suggested that the persons specified in 7(f) remain the same. Perhaps after experience is gained with broader disclosure requirements, the list of persons specified should be extended. I have not limited category (3) to beneficial holders because I feel that broker-dealers, for example, whose customers own 10% of an issuer's voting securities, have a sufficiently strong position in relation to the issuer to warrant disclosure of potential conflicts of interest. Similarly, I have not suggested narrowing category (4) since I feel that the potential conflicts are likely to exist when any associate is involved; companies appear to have been able to identify the necessary persons without undue burden.

See the comments to instructions 5, 6 and 7 for discussions of the extent to which it is proposed to extend the information required under 7(f).

Instruction. 1. [See instruction 1 to paragraph (a).] This paragraph applies to any person who had any of the specified positions or relationships during the period specified.

However, information need not be given for any portion of the period during which such person did not have one of the specified positions or relationships.

Comment: Instruction 1 to paragraph (a) provides: "This item applies to any person who was a director or officer of the issuer at any time during the period specified. However, information need not be given for any portion of the period during which such person was not a director or officer of the issuer." (Underlining added.) The change would make it clear, for example, that transactions involving a nominee who had not previously served as an officer or director may be omitted if they took place before the person became a nominee. If the purpose of 7(f) is to disclose insiders' self-dealing, transactions outside the period when a person is an insider need not be covered by the item. If the suggestion is followed, the same change should be made in the first instruction to 7(e).

2. Include the name of each person whose interest in an transaction is described and the nature of the position or relationship by reason of which such interest is required to be described. Where it is not practicable to state the approximate amount of the interest, the approximate amount involved in the transaction shall be indicated.

Comment: An officer, for example, should perhaps be viewed as having a particular position rather than relationship.

3. [2] As to any transaction involving the purchase or sale of assets by or to the issuer or any subsidiary, otherwise than in the ordinary course of business, state the cost of the assets to the purchaser and the cost thereof to the seller if acquired by the seller within two years prior to the transaction.

4. [3] The instruction to paragraph (a) of item 4 shall apply to this [item] paragraph.

Comment: After the adoption of this instruction to 7(f) [SEA Rel. 4775], item 4 was amended and the instruction made applicable only to the first paragraph of the item [SEA Rel. 5276]. The amended instruction would refer to paragraph (f) [called a sub-item in the instruction to 4(a)], making the terminology more consistent.

5. [4] No information need be given under this paragraph as to any remuneration or other transaction reported in response to (a), (b), (c), (d) or (e) of this item.

6. [5] No information need be given under this paragraph as to any transaction or any interest therein where:

(i) The rates or charges involved in the transaction are fixed by law or determined by competitive bids;

(ii) The interest of the specified person in the transaction is solely that of a director of another corporation which is a party to the transaction;

(iii) The transaction involves services as a bank depositary of funds, transfer agent, registrar, trustee under a trust indenture, or other similar services;

(iv) The interest of the specified person does not exceed [$30,000] $10,000; or

(v) The transaction does not involve remuneration for services, directly or indirectly, and (A) the interest of the specified persons arises from the ownership individually and in the aggregate of less than 10% of any class of equity securities of another corporation which is a party to the transaction, (B) the transaction is in the ordinary course of business of the issuer or its subsidiaries, and (C) the amount of such transaction or series of transactions [is less than 10% of the total sales or purchases, as the case may be, of the issuer and its subsidiaries] does not exceed $30,000.

Comment: The main purpose in amending 7(f) is to require reporting of some transactions that are not important to a company if measured by the dollars involved. The reduction of the standard of 5(v)(C), like the elimination of the requirement that the transaction be material, would implement this purpose.

Though 5(iv) is worded in terms of interests, its effect is to exempt certain transactions as well, since if a transaction involves less than the amount specified, no interest in the transaction can exceed that amount, and no information concerning the interest or the transaction is required. Reducing the figure in 5(iv) to $10,000 would reflect a determination that the interests and transactions deemed relevant to investors should be broadened.

Since instruction 3 to paragraph (d) of item 7 uses $10,000-per-individual and $30,000-aggregate tests with options, the suggested tests are not out of harmony with the rest of item 7. Prior to 1954, there were no instructions exempting the transaction covered by 5(v) and 6. In that year the "scope of the paragraph relating to transactions with insiders [was] limited by revising the instructions thereto to permit the omission of information in certain cases." (SEA Rel. 4979) Thus, to some extent, the proposal would return to pre-1954 practice. However, the proposal would eliminate the possibility of omission on the theory that a transaction was not "significant", a standard that appeared in the Rules from 1947 to 1954. From 1942, when disclosure was first required of "transaction" in general and not merely to acquisitions out of the ordinary course of business, to 1947 the standard for omission was "immaterial and insignificant".

If the $30,000 test of 5(iv) is retained, then no interests or transactions would be exempted by instructions 5(v)(C) and 6 if they include $30,000 tests. Therefore, if the $30,000 test of 5(iv) is retained, it is suggested that a $50,000 test be used in 5(v)(C) and 6.

7. [6] Information shall be furnished under this paragraph with respect to transactions not excluded above which involve remuneration, directly or indirectly, to any of the specified persons for services in any capacity unless: (i) the interest of such persons arises solely from the ownership individually and in the aggregate of less than 10% of any class of equity securities of another corporation furnishing the services to the issuer or its subsidiaries; and (ii) the amount of such transaction or series of transactions does not exceed $30,000.

Comment: Instruction 6, in its present form, gives a broader exemption to holders of less than 10% interests who receive remuneration for services than 5(v) gives such holders who engage in transactions not involving remuneration. The letter must show that the transaction is in the ordinary course of business and that the amount of the transaction is less than 10% of the total sales or purchases of the issuer and its subsidiaries, though this is often not a very onerous test. Since transactions involving remuneration for services involve the same potential conflict of interest and present especially difficult problems in the determination of the value of the services rendered, it is suggested that the test used in 5(v)(C) be used in 6. The instructions are not combined since retaining the structure of 5(v) and including the substance of 6 in that instruction would permit omission of information covered by the instruction, in a particular case, on the theory that the interest was not material, pursuant to instruction 7. Conversely, eliminating this argument by putting 5(v)(C) in 6 should perhaps await experience with a new standard; perhaps in the case of suppliers and customers the Commission will want to conclude that a transaction literally within the amended 5(v) does not create a material interest.

I have assumed that the specific provision in 6 stating that information shall be furnished is not altered by the general provision of 7. The substance of instruction 7 was suggested by Sullivan & Cromwell in a letter of November 14, 1953. The letter shows concern with the negative implications that would arise from the present instruction 5 if there were no instruction 7 and thus supports my analysis. If it is considered necessary to spell out the relationship between the present 7 and 6, "Except as provided in instruction 6" can be added at the beginning of 7.

> 8. [7] This paragraph (f) does not require disclosure of any interest in any transaction unless such interest [and transaction are] is material.

Comment: The omission of the general requirement that the transaction be material is the most important suggested change. See comment to instruction 5; see also comment to instruction 6 on the relationship of instruction 7 to instructions 5 and 6. Perhaps after the Commission gains experience with narrower exemptions instruction 7 should be eliminated altogether.