

NEW YORK STOCK EXCHANGE  
COMMITTEE ON STOCK LIST

June 19, 1937.

Mr. Harold H. Neff, Director,  
Forms and Regulations Division,  
Securities and Exchange Commission,  
1778 Pennsylvania Avenue,  
Washington, D. C.

Dear Mr. Neff:

I am replying to your letter of May 28th, commenting, as requested, upon the preliminary draft of the proposed Rules LA1 to LA10 of the Securities Exchange Act of 1934.

Any comment upon this draft, to be useful, must be based upon a sound and practical concept of the relations between management as such, directors and stockholders. In the case of any corporation large enough and with securities well enough distributed to have its securities admitted to trading upon any national stock exchange, it is obviously impossible for the stockholders directly to manage the corporation. Sound theory requires that the responsibilities of management should be delegated to a few chosen for that purpose, and sound practice has resulted in the accomplishment of this through the election of a board of directors by the stockholders and the choosing of managers for the enterprise directly or indirectly by the directors. Although certain broad powers should be and are usually, in practice, reserved to stockholders, and certain powers somewhat less broad should be and are reserved to the directors, nevertheless successful operation requires the maximum practicable delegation of

authority by the stockholders to the directors and by directors to the management.

From this it follows that any proxy rules which are drawn should not contemplate in any sense the reservation of detailed administrative power to the stockholders, or require that they should pass upon matters other than those of vital importance, for the simple reason, among others, that the stockholders can not be sufficiently informed as to the details affecting the business to discharge such functions wisely. Neither should proxy requirements contemplate the necessity of the exercise of distrust of directors and management by stockholders, because business can not be successfully prosecuted under such conditions. Broadly speaking, the powers to be exercised at stockholders' meetings should, with the exceptions stated, be confined to the right to view the results sufficiently in advance of the meeting to permit the displacement of the directorate in cases where stockholders deem it to their interest to do so.

Existing common practice in regard to the solicitation of and the form of proxies accomplishes almost if not quite all of the matters worthy of accomplishment under the foregoing definition of a sound corporate policy. There are many things that are good in the proposed Rules, but the necessity for putting into rules matters that are already common practice, and thereby perhaps preventing development, is not apparent. On the other hand, from my viewpoint, there is much in the Rules which would be harmful to stockholders if made effective, and much more which is so immaterial as to confuse issues in the stockholder's mind and prevent his having an adequate opportunity to protect his interests, because of inability to distinguish, in the mass of information to be afforded, between the essential and the nonessential.

If these Rules go into effect, I believe that they will tend to make it so difficult for the average stockholder to determine wisely whether or not he should execute the proxy that the

tendency will be to throw all such communications into the wastebasket unread, and thus to cause failure to execute the proxy.

Since most, if not all, of those States in which a majority of listed companies are incorporated have laws limiting the percentage of stockholders required to constitute, for most purposes, a quorum for a meeting, the tendency will be to reduce the percentage of stock required for such a quorum to a ridiculously small amount, and thus to insure concentration of power in the hands of a minority to a degree that will be inimical to the public welfare.

The difficulty in securing proxies is already so great that some corporations have reduced the amount required for a quorum to less than 50%, some of them to as low a figure as 10%, and this practice will, I believe, necessarily be carried to the greatest extent permitted by law if these Rules go into effect. If, to prevent this, laws are changed, requiring that there shall be a majority to constitute a quorum, or in cases where specific percentages are required by law for the approval of a plan, I think that the promulgation of these Rules is likely, in the first instance, to prevent any action at all through lack of a quorum, thus freezing existing managements indefinitely in power, and secondly, that where executed by the stockholder the confusion of mind which this data will cause will tend to cause his action to be unwise and not in his own interests.

In addition to the tendency which, it appears to me, will be caused by these Rules to perpetuate existing management, good or bad, for the foregoing reasons, the onerous nature of the proposed Proxy Rules will increase the difficulties of opposition groups in presenting to the stockholders their side of any argument.

It is, of course, possible that some abuses may creep into the proxy situation, but even if so it would not be wise to impair the protection of the stockholder so greatly as is done by

these rules and, in addition, to saddle upon all corporations a burden of expense and delay that might well prove intolerable, for the sake of preventing each abuse, which at best, judging by the past, would be very rare.

I question seriously whether there is a real necessity for any proxy rules, excepting one modeled on your proposed LA5, and whether it would not be better to repeal the existing rules and issue only this one rule in their place. This is not that all of the rules are in themselves directly or indirectly harmful, but that I believe all that are not directly or indirectly harmful are common practice.

The only real abuse that I have seen of the proxy situation is the expense and difficulty to which a stockholder is put if he wishes to vote in opposition to the desires of the management or of other persons soliciting his proxy. In a case where, under the laws of the State of incorporation, a stockholder has no right of appraisal or other legal remedy unless his stock has been voted in opposition to a plan of which he does not approve, it is likewise difficult and expensive for the stockholder to record his dissent properly. The only way in which these objects can be accomplished ordinarily is either through the formation of a protective committee, which is expensive, or through attendance in person or by representative at the stockholders' meeting, which is often both expensive and impracticable.

These difficulties would be cured, and the necessity for protective committees lessened, if the proxy afforded an opportunity for affirmative direction as to the casting of a vote on matters coming before the meeting affecting the property rights of the stockholders, together with a requirement that the vote on such subjects must be cast as directed. I think this can be adequately accomplished by a slight revision of Rule LA5. I am fully in sympathy with the object of Rule LA5, but as it is drafted it seems to me that clause (i) may be interpreted as

providing merely the means for an expression of desire without containing a requirement that action be taken in accordance with that desire, and that although clause (ii) will prevent a vote from being cast otherwise than as desired, it does not require that it should be so cast.

There follows a re-draft, which I think strengthens the Rule in these respects.

You will note that I have called it Rule LA1, because of my hope that the Commission may be in agreement with the thought that it should be the only rule.

RULE LA1. Duty to provide means by which desired action can be directed.

No solicitation subject to Section 14(a) of the Act shall be made unless means shall have been provided whereby (i) the person solicited is afforded an opportunity to specify, in a space provided in the form of proxy or otherwise, the action which such person thereby directs to be taken pursuant to the proxy on each matter described in the proxy statement as intended to be acted upon, other than the election of directors or other officials, and (ii) the authority conferred as to each such matter must be exercised as directed and is limited by the specifications so made; provided, however, that provision may be made as to the authority conferred in the event no such specification shall be made.

I am not, of course, submitting this as a piece of legal draftsmanship, as it will be easy for you, if you are in sympathy with the strengthening of the Rule, to remedy any defects in the form which I suggest.

I have made lengthy studies looking toward a letter to you commenting in detail upon every provision of the proposed Rules, for your use in case the foregoing views were not accepted by the Commission. Upon reflection, it seems to me, however, wiser not to make suggestions for the modification of the proposed Rules, many of which I believe to be seriously and directly harmful, and many more of which I believe to be so immaterial and irrelevant as to

be confusing to the point of harmfulness. To make such detailed suggestions might convey at least a quasi-approval of the issuance of further Rules on this subject. The Rules as drafted seem to me to be unwise, although I think that Rule LA5, modified to cover the points which I have suggested, would in itself be a long forward step.

Although I sincerely believe that it would be better to have no rules other than LA5, modified as above, I think there would be no real harm in continuing in effect the existing rules and adding modified LA5 as LA8, although I think that clauses (ii) and (iii) of existing LA3(3) are immaterial from the standpoint of the person solicited, and tend to prevent minority solicitation of proxies. If the existing rules are continued and Rule LA8 added, it would be necessary to add to existing Rule LA7 the words, "except as provided in Rule LA8." Next to the omission of all proxy rules except modified LA5, I think this course would go farthest to meet the points raised in Mr. Hancock's memorandum to which allusion is made below.

In this connection may I suggest that, if you have not already done so, it should be very helpful to get the opinion of the industrialist committee that helped on Form 10, as the burden on industry of the proposed rules appears to me to be serious.

We have had for the last year a Sub-Committee on Proxies, consisting of Mr. John M. Hancock, Chairman, and Mr. A. A. Berle, Jr. I have submitted a draft of this letter to them, and each of them has been kind enough to give me a memorandum of his own views on the subject and to give me permission to enclose a copy of such memorandum to you, which I am doing with this. I am also authorized by them to say that they concur with the broad thought expressed in this letter as to the reduction of the Rules in this respect to a single Rule and with the details of my comment, excepting to the extent that their own comments amplify what I have said or suggest further points of view.

In this respect I call your attention particularly to the fact that Mr. Berle goes further than Rule LA5 as drafted by you, and further than I have done, in suggesting the use of the existing proxy machinery to nominate and vote for a change of directors, should they so desire. As to this, directors appoint management and the importance of continuity of management is so great, excepting in cases of fraud or proved incompetence, that I am doubtful as to whether it should be made too easy to overthrow existing managements. The cases that require this are generally complex and presumably will be remedied by most existing boards of directors. When it is otherwise, they present, I think, legitimate occasions for the formation of a protective committee to enlighten the stockholders fully.

The members of the Sub-Committee on Proxies also join with me in requesting that, if necessary, this letter and their memoranda should be referred to the Commission before the matter is disposed of. This request is based upon the thought that the recommendations are probably of such a nature as to require action of the Commission, itself, for their favorable consideration. I have been discussing for the last year certain proxy questions with the Sub-Committee on Proxies and have talked this over with Mr. Hancock and Mr. Berle, as it affected our other work. This letter, however, remains an expression of my personal opinion.

Yours very truly,

JMB Hoxsey  
Executive Assistant.

JMBH-K/k

June 19, 1937.

MEMORANDUM TO MR. J. M. B. HOXSEY:

After going very carefully over the problem, reading your drafted reply to Mr. Neff, hearing Mr. Berle's memo dictated and our full discussion today, I am in full accord with the views you express. My added comment can be very brief.

I would be inclined to raise the point that we have been making progress in this field of work for some time, and that I would be afraid of the effect upon corporations' attitude toward more regulation when reasonably satisfactory progress seems to be certainly in the process of being attained now without additional rules. A study of actual abuses would seem to be the way to develop whether there is a need for any more regulation.

I would be inclined to emphasize somewhat more than you or Mr. Berle have the possible forcing of securities off the Exchange.

We have been all striving for years in our own ways to get stockholders to assume responsibility, and it is a very difficult job. I am convinced that this rule is not going to head in that direction at all.

It seems to me that the cost of the operation under the rule will be all out of proportion to any benefits attained by carrying out the rule. I detect a very strong desire on the part of corporation officers to give stockholders more information than ever before. I think it would be very harmful to lessen this spirit of cooperation that is now developing. One marked instance of this is that corporations which fought very hard against the revealing of sales figures are gradually

withdrawing opposition. This process will result if progress is made slowly and if we do not attempt to change the world over at once.

JOHN HANCOCK

JH:hm/b