IN THE
United States Circuit Court of Appeals
FOR THE SECOND CIRCUIT

No. _____

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Appellant,

against

SAMUEL OKIN,
Defendant-Appellee.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF NEW YORK.

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION.

JOHN F. DAVIS,
Solicitor,
CHARLES B. COLLINS,
ROBERT B. HEALEY,
ARNOLD R. GINSBURG,
Attorneys for Securities and Exchange Commission.

MILTON V. FREEMAN,
Assistant Solicitor,

IRVING J. GALPEER,
Of Counsel.

The Legal Intelligencer, 222 N. 15th St., Phila.

STATEMENT OF THE CASE

THE APPEAL

This is an appeal from the judgment and order entered on October 9, 1942, by Judge Samuel Mandlebaum in the District Court for the Southern District of New York. The judgment and order granted the motion of the appellee, Samuel Okin, to dismiss the complaint of the Securities and Exchange Commission for failure to state a cause of action.[1]

Appellant sought to restrain Samuel Okin, a stockholder of Electric Bond and Share Company, from using the mails or the means or instrumentalities of interstate commerce to solicit proxies, consents or authorizations regarding the Company's common stock, in violation of Section 12(e) of the Public Utility Holding Company Act of 1935,[2] ("the Act",) and Rule U-61 and Regulation X-14 adopted by the Securities and Exchange Commission pursuant to this section of the Act. Jurisdiction to entertain the action was conferred on the District Court by Section 25 of the Act. The complaint alleged that Okin had been and intended to continue mailing letters to the stockholders of the Company asking them to refuse to sign proxies solicited by the Company's management for a meeting to be held on October 14, 1942, or to revoke such proxies, if they had been signed. The complaint further alleged that these letters contained false and misleading statements with respect to material facts and omitted to state certain necessary material facts, thus violating the statute and the rules and regulations governing the solicitation of proxies. Oral argument was had on October 6, 1942, on the motion of the Commission for a preliminary injunction and on Okin's motion to dismiss. On October 9, 1942, Judge Mandlebaum issued an opinion and a judgment and order denying the Commission's motion and dismissing the complaint. The Commission filed a notice of appeal on October 10, 1942.

QUESTIONS PRESENTED

The general question before this Court is whether the court below was correct in dismissing the complaint in this case. More precisely, the issue is: Did the sending of Okin's letter involve a solicitation of proxies, consents or authorizations regarding a security of a registered holding company within the meaning of Section 12(e) of the Public Utility Holding Company Act? The lower court found that it did not, and this finding is the error claimed by the Commission.

THE STATUTE AND RULES INVOLVED

Section 12(e) of the Public Utility Holding Company Act of 1935 makes it unlawful for

"any person to solicit . . . by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, power of attorney, consent, or authorization regarding any security of a registered holding company . . . in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors . . . or to prevent the circumvention of the provisions of this title or the rules, regulations or orders thereunder."

Substantially similar provisions appear in the Securities Exchange Act of 1934[3] (Sec. 14(a)) and in the Investment Company Act of 1940[4] (Sec. 20).

The Commission has promulgated, pursuant to Section 14(a) of the Securities Exchange Act, certain "proxy rules" known as Regulation X-14.[5] By virtue of Rule U-61, adopted

under the Public Utility Holding Company Act, Regulation X-14 is made applicable, except in certain cases not pertinent here, to "the solicitation of any authorization regarding any security of a registered holding company." Rule U-60 defines the word "authorization", as used in Rule U-61, to include "any proxy, power of attorney, consent or authorization", as those words are used in Section 12(e) of the Act.

STATEMENT OF FACTS

An annual meeting of the stockholders of Electric Bond and Share Company was scheduled for October 14, 1942. The Company's management sent to the stockholders a notice of meeting, a proxy statement and a form of proxy. This was done after the management had filed copies of such material with the Commission pursuant to its rules.

After the management proxies had been sent out, Okin mailed to the stockholders a letter labeled "IMPORTANT. DO NOT SIGN ANY PROXIES. REVOKE SAME IF YOU HAVE SIGNED THEM." The Securities and Exchange Commission alleged in its complaint that Okin's letter was false and misleading in that (1) it referred to a "deficit" where in fact there was no deficit in earnings and the corporation had a substantial earned surplus, (2) Okin stated that he, by forestalling the immediate subordination of a large claim of Electric Bond and Share Company against one of its subsidiaries, had prevented an "outrageous dissipation of assets" but failed to state that the status of this claim remains undetermined and that it is presently in issue in proceedings before the Commission, (3) Okin stated he used every legal means to conserve the assets of the company and was compelled to commence legal action for this purpose but he did not say that all litigation brought by him had been, to that date, unsuccessful and (4) the letter omitted to state that one of the purposes of Okin's program was to obtain his election as one of the officers of Electric Bond and Share Company. It was also alleged that the letter was false and misleading in other respects and otherwise failed to comply with the proxy rules.

Notwithstanding the fact that Okin's attention was called to the false and misleading character of these statements, he refused to revise the letter and mailed it to the stockholders in its original form. The lower court did not pass on the question of whether the letter was misleading since it thought no solicitation of proxies, consents or authorizations was involved. However, since the court dismissed the complaint for failure to state a cause of action, the allegations that the letter is false and misleading must be deemed to be admitted for the purposes of this appeal.

ARGUMENT

I. THE TRANSMITTAL OF OKIN'S LETTER WAS A SOLICITATION WITHIN THE MEANING OF THE STATUTE.

A. The "proxy" rules require those who solicit proxies, consents or authorizations to make full and fair disclosure of information necessary to an intelligent exercise of the

stockholder's right to give or withhold his proxy. Thus, the proxy rules attempt to carry out the legislative intent of "according to shareholders fair suffrage,"[6] of providing them with adequate knowledge "not only as to the financial condition of the corporation, but also as to the major questions of policy which are decided at stockholders' meetings,"[7] and of preventing such solicitations from affording "the basis for subtle control adverse to the interests of investors who have a right to be kept fairly and properly informed."[8]

It thus appears that the theory of Section 14(a) of the Securities Exchange Act and Section 12(e) of the Public Utility Holding Company Act authorizing the adoption of proxy rules by the Commission is that stockholders should have adequate and truthful information furnished to them so that they may make an informed judgment with respect to the matters submitted to them for action. These Acts are remedial in nature and therefore should be broadly construed to the end that the purpose of Congress shall be carried out.[9] The narrow construction adopted by the court below is manifestly contrary to the intent of Congress that stockholders shall be protected against false and misleading statements. The management of the company was required to and did file its material and solicit according to the Commission's rules. (R. 4a ¶ 5). The court below held that Okin in opposing the management was not required to abide by those rules. A decision which requires one person seeking to influence stockholder action to be truthful and permits another person opposing the action to be untruthful can give rise only to confusion. The fact that the first asks that a piece of paper be signed and returned and the second does not is not sufficient ground for distinction.

The congressional objective of obtaining informed stockholder action is jeopardized by permitting one of the persons in a controversy to distort the facts. There is nothing in the Commission's rules which discourages strong argument about the issues confronting stockholders. The thought of Congress clearly was that the lot of stockholders would be better if the issues affecting their interests were debated before them. In its administration of the rules adopted pursuant to the instruction of Congress the Commission has always recognized the value of this principle. But Okin has gone beyond strong argument and has employed false and misleading statements. The Congressional policy of securing informed judgments by security-holders is impeded and not furthered by statements that there are deficits when in fact there are none, that great accomplishments for stockholders have been achieved where, in reality, none have been obtained.

Carrying out the Congressional scheme requires that all persons asking shareholders to exercise their corporate franchise shall be subject to the same duty of full and fair disclosure. If the decision of the court below is sustained it means that the stockholders of listed corporations, of investment companies and of public utility holding companies and their subsidiaries are subject, through tricky and technical devices, to practices in many respects as bad as those which existed before these remedial statutes were passed.

It follows that, in order to effectuate the aims intended by Congress, the phrase solicitation of a "proxy, consent or authorization" must be construed to include all attempts to influence action by stockholders on matters which have been submitted to them. It must include efforts to induce stockholders to withhold proxies and to revoke

proxies previously given as well as direct efforts to induce them to execute formal proxies.[10]

B. Even looking at the statute more narrowly, Okin solicited a "proxy, consent or authorization" within the meaning of the statute by sending his letter exhorting stockholders not to sign proxies or to revoke them if they had been signed. Congress did not limit the Commission's authority to the regulation of the solicitation of proxies. By including in Sections 12(e) of the Holding Company Act and 14 of the Securities Exchange Act consents and authorizations as well as proxies, it indicated an intention to regulate all attempts to influence security-holders in the exercise of their rights as security-holders. The execution of a proxy is only one of the ways in which a security-holder may exercise his rights. He may also withhold the proxy or revoke one after it has been given. In either case his action affects the corporation's activity and the rights of his fellow stockholders.

Clearly the Act is not limited in its application to solicitations of stockholders to sign a piece of paper which may be denoted a proxy, consent or authorization. Such a view would be entirely formalistic. Many corporate actions are taken in which the failure of a stockholder to take any action is sufficient proxy, consent or authorization without more. Thus, under various state laws, reorganization plans may be effected by consent evidenced only by failure to dissent, e.g. *Gilfillan v. Union Canal Co.,* 109 U.S. 401; *In re 1175 Evergreen Avenue*, 270 N.Y. 436, 1 N.E. (2d) 838 (1936). Numerous corporate charters provide that additional debt may be issued only after notice to stockholders and failure of a certain percentage of the outstanding stock to register objection. Clearly then, the manner in which the stockholder expresses his position, whether by direct action, by inaction or by revocation of action previously taken, does not alter its nature as a "proxy, consent or authorization."

So in the present case, Okin asked stockholders to support his proposals, although he did not request that any formal writing be directed to him.

Okin asked stockholders to give their "consent" to his plan of causing the meeting to be adjourned, such consent to be accomplished by revoking their proxies or withholding them. Stockholders who acceded to Okin's request enlisted themselves as his followers as effectively as if they had given him a specific "proxy" or "consent" to vote their shares at the meeting for the purpose of securing an adjournment."

Okin asked stockholders to give the company an "authorization" to disregard proxies previously given. The effect was the same as if they had given Okin a specific "authorization" to notify the corporation of the revocation of their proxies instead of making the notification themselves. Indeed, Okin asked stockholders to notify him of their revocations "so I can make certain your proxy is not used at the stockholders meeting" (R. 20a). Clearly, Okin here solicited an "authorization" to represent stockholders at the meeting for the purpose indicated. To say that Okin's conduct did not involve the solicitation of proxies, consents and authorizations would be to exalt form over substance.

It is submitted that Okin's activity is a solicitation subject to the Commission's jurisdiction under any construction which will give effect to the policy of the Congress in enacting the statute.

II. THE TRANSMITTAL OF OKIN'S LETTER INVOLVED A SOLICITATION OF PROXIES BECAUSE IT WAS THE FIRST STEP IN AN ADMITTED PROGRAM OF REQUESTING PROXIES.

The effect of the decision of the court below on the aims of Congress can be illustrated in another way. The opinion would permit a person who contemplated asking for proxies to condition the minds of stockholders with untrue statements and then to send an innocuous statement with a proxy form in order to collect his proxies. Such is the situation in the case at bar.

The court below failed to recognize that Okin's letter was the first step in a program of requesting proxies. The Commission's complaint alleges (paragraphs 8(d) and 12, R. 6a, 7a) that the letter fails to state the fact "that in the event the stockholders' meeting is adjourned the defendant intends to solicit proxies for the election of a slate of directors to be named by a stockholders' committee which he proposes to form, and that if such slate of directors is elected the defendant expects to be named an officer of Electric Bond and Share Company."

These allegations are admitted by the motion to dismiss the complaint. Judge Mandelbaum stated that the allegation as to Okin's intent was "unsubstantiated" and that it "amounts to no more than anticipation or prediction as to what Okin will do in the future."[12] But the allegation is not required to be substantiated. The issue before the court was the sufficiency of the complaint as a matter of law. Obviously, an assumption that the plaintiff had not proved its allegations has no bearing on this question. It must therefore be regarded as admitted that Okin intended his letter as a preliminary to a request for proxies.

A construction which excludes from the protection of the Act initial communications to stockholders preliminary to a formal request for proxies would permit investors to be misled to their detriment by false statements of fact with the excuse that the false statements were made before the investors are asked to act. Situations parallel to that here presented arise under the Securities Act of 1933 which provides that investors must receive adequate information when securities are offered or sold to them. This act has been held to prevent preliminary "puffing" of securities and the excuse that no offer was as yet being made has been rejected.

In Securities *and Exchange Commission v. Starmont*, 31 F. Supp. 264 (E.D. Wash. 1939), the court had before it the question whether certain preliminary acts in the offering of a

security for sale constituted a "sale" or "offer to sell" within the meaning of the Securities Act of 1933. In granting an injunction, the court stated that:

"A remedial enactment is one that seeks to give a remedy for an ill. It is to be liberally construed so that its purpose may be realized. That is important for it means that those definitions of 'sale' and of 'security' are to be liberally construed. Their construction is to be at least as broad as the language of the Act. (p. 267) . . .

"It appears to me at this time on this preliminary application that the position of the plaintiff is well taken; that the defendants are incorrectly seeking to evade the provisions of the statute by offering for sale a security as a part of the preliminary negotiations with some ones other than underwriters. . . .

"*I appreciate that the argument of the defendants is that the Commission is becoming alarmed before anything is being sold*; that no money is to be collected until the prospectus is issued as provided by law, and until the corporation is organized and registered according to law. *But this Act itself appreciates the importance of preliminary negotiations being, free from falsity, and so the purpose of this remedial legislation is that the remedy shall be applied while it can be effective. There is no use to apply a remedy to protect the public after the public has been infected by the virus, and so long after it has been affected by the virus that the remedy will be of no avail.*" (p. 268) [Italics ours].

Similarly, the sections under which the proxy rules are adopted should be interpreted to prevent circumvention of the policies of Congress by the use of false "preliminary" statements. To do otherwise would sanction a device whereby stockholder action can be influenced by false and misleading statements in disregard of the safeguards which Congress intended that investors should have.

It is submitted that the transmission of Okin's letter involved a solicitation of a proxy subject to the Commission's jurisdiction.

III. THE COMPLAINT STATES A CAUSE OF ACTION TO PREVENT A WRONGFUL INTERFERENCE WITH THE ADMINISTRATION OF THE COMMISSION'S PROXY RULES.

Even if the Court should hold that Okin's letter was not otherwise subject to the proxy rules, the complaint states a cause of action to prevent a wrongful interference with the administration of the Commission's proxy rules.

Under general equity powers the courts will not permit a wrongful interference with lawful activities. Here Okin has made false and misleading statements. The Commission has an interest in the matter—that of maintaining the integrity of the proxy machinery administered by it under law.[13] Solicitations of security holders are required to be truthful. But the circulation of false statements prevents the truthful soliciting material

from receiving the credence which it deserves. Failure of the Court to enjoin the circulation of false statements will, therefore, interfere with the administration of the proxy rules and will impede the Congressional objective of obtaining informed judgments from security holders. The courts should lend their equity powers to prevent the obstruction of a procedure authorized by Congress for the protection of investors. The false and misleading character of Okin's material is adequately set forth in the complaint and is admitted for purposes of the present motion. It is, therefore, submitted that in the exercise of the general equity powers of the courts, Okin's solicitation should be held to be subject to injunction.

CONCLUSION

The judgment and order dismissing the complaint for failure to state a cause of action should be reversed.

Respectfully submitted,

JOHN F. DAVIS,
Solicitor,
CHARLES B. COLLINS,
ROBERT B. HEALEY,
ARNOLD R. GINSBURG,
Attorneys for the Appellant.

MILTON V. FREEMAN,
Assistant Solicitor,

IRVING J. GALPEER,
Of Counsel.

[1]The court also denied the Commission's motion for a preliminary injunction but since the basis for denial of the injunction was the same as the ground for dismissal of the complaint, the right of the Commission to an injunction would seem properly to be a question to be determined by the District Court in the event of reversal. No argument is therefore addressed on this appeal to the denial of the injunction.

[2]Act of August 26, 1935, c. 687, 49 Stat. 803, 15 U.S.C. Sec. 79 *et seq*. (Copies of the Act and the rules and regulations referred to herein are submitted with this brief for the Court's convenience.)

[3]Act of June 6, 1934, c. 404, 48 Stat. 881, 15 U.S.C. Sec. 78a *et seq*.

[4]Act of August 22, 1940, c. 686, 54 Stat. 789, 15 U.S.C. Sec. 80a-1 *et seq*.

[5]Generally the term "proxy" will be used to mean "proxy, consent, or authorization."

[6]H.R. Rep. No. 1383, 73rd Cong., 2d Sess. (1934) 14.

[7]Sen. Rep. No. 792, 73rd Cong., 2d Sess. (1934) 12.

[8]Sen. Rep. No. 621, 74th Cong., 1st Sess. (1935) 35.

[9]*Cf. Securities and Exchange Commission v. Crude Oil Corp.*, 93 F. (2d) 844, 846-847 (C. C. A. 7th, 1937); *Securities and Exchange Commission v. Associated Gas & Electric Co.*, 99 F. (2d) 795, 797 (C. C. A. 2d, 1938); *Otis & Co. v. Securities and Exchange Commission*, 106 F. (2d) 579, 583 (C. C. A. 6th, 1939); *Securities and Exchange Commission v. Payne*, 35 F. Supp. 873, 877 (S. D. N. Y. 1940). This rule of statutory construction was followed in the only decided case involving the proxy rules: *Securities and Exchange Commission v. O'Hara Re-Election Committee*, 28 F. Supp. 523 (D. Mass. 1939).

[10]The Securities and Exchange Commission is charged with the duty of adopting proxy rules to carry out the intention of Congress and of administering these rules. Under governing decisions, the interpretations of an administrative agency regarding the statutes and rules administered by it are entitled to great weight. As this Court stated in *Securities and Exchange Commission v. Associated Gas & Electric Co.*, 99 F. (2d) 795, 798 (C.C.A. 2d, 1938):
"We are dealing with a new act the administration of which is the peculiar function of the Securities and Exchange Commission. One of the principal reasons for the creation of such a bureau is to secure the benefit of special knowledge acquired through continuous experience in a difficult and complicated field. In no other way can the objects of the act be attained without constant and disconcerting friction. *Norwegian Nitrogen Products Co. v. United States*, 288 U. S. 294, 315 . . ."

[11]Indeed, the procedure used was far more effective than the execution of a proxy since the task of obtaining adjournment could more easily be accomplished by preventing a quorum than by securing a majority vote to approve adjournment at the meeting.

[12]It should be noted however that this allegation was uncontroverted except insofar as appellee's oral statement may be regarded as contradictory and this was declared by the court to be not impressive (R69a). Further, it is evident that Okin's letter is artfully phrased in an effort to divorce it from the proxy material he intended to send to stockholders in the future and thereby escape the prohibition against false and misleading statements. He states that adjournment of the stockholders' meeting should be compelled "so that the stockholders can arrange to protect their valuable interests" (R. 19a). The last paragraph of the letter also says: "As soon as possible, I intend to again communicate with you. . . ." (R. 20a). Such statements indicate Okin's intention to ask for formal proxies.

[13]Cf. *S. E. C. v. U. S. Realty and Improvement Co*., 310 U.S. 434 (1940).