SPEECH BY COMMISSIONER JAMES C. TREADWAY, JR.
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Good afternoon. I'm delighted to be here today.

This is my first official speech as a Commissioner. The opportunity to do so before a group having "hands-on" familiarity with the federal securities laws, although I suppose I do so at some risk. Before proceeding, however, I must caution you that the views I express today are mine alone and do not necessarily represent the views of the Commission, any of my fellow Commissioners, or the staff.

Today, I want to talk briefly about two recent developments, in the hope that my comments will provoke some mutually informative discussion and exchange. My comments will address first, the recently proposed amendments to the shareholder proposal rule (Rule 14a-8); and second, the Commission's proposed legislation on insider trading. After my comments, I hope you will be candid in airing your views on these topics and my comments.

SHAREHOLDER PROPOSALS

Shareholder proposals always seem to raise people's blood pressure to a dangerous level. And I might observe that I always have been somewhat mystified by the intensity of emotion and outrage and by the volume of writing on this topic. But, given this history, I expect that our request for comments on Rule 14a-8 will provoke heated response from

all sides. Unfortunately, I fear that much of it may not be rational.

But before addressing the specific proposals, let's look two things: (1) some statistics; and (2) the Commission's present degree of involvement in the process.

Preliminary figures for the year ended June, 1982 show that 850 shareholder proposals were submitted to about 300 of approximately 9,000 public companies. Thus, 97 percent of the public companies didn't receive a proposal. By way of contrast, only 43 companies received 5 or more proposals. Furthermore, almost half of all stockholders proposals submittal were either withdrawn or accepted uncontested.

With these statistics in mind, let's now look at the Commission's role in the process. The current process compels the staff of the Commission to arbitrate disputes through the mechanism of no-action positions. As you know, these staff positions are not Commission decisions, are not legal precedent, and are not appealable as final agency actions. Yet, because of time and other practical pressures such as printing schedules, disputes between management and the proponents of the proposals are resolved without any realistic avenue of appeal or review beyond the staff decision. This is hardly ideal, and the process and results have not drawn rave reviews from anyone -- or at best only a few. Also, some commentators have suggested that the turn-over at the staff level contributes

to a lack of even-handed treatment and consistent decisions.

But, given the small number of proposals and companies involved, despite the admittedly imperfect process, why is so much attention focused on so little activity? It is cost? Is it principle? Is it ego, on all sides?

Well, for one, cost appears to be de minimis. In response to a Commission request for cost data in 1976, only one corporation responded -- ATT. ATT reported that its costs, including postage, printing, employee remuneration, and outside counsel fees, totalled approximately $150,000. That represents about five cents per shareholder. I reiterate, that's per shareholder, not per share. That's hardly an amount which traditionally would be considered material to ATT, by any standard. No other issuer provided any cost data to the Commission. I don't know why, but the absence of any such hard data seems to suggest that what is at stake is principle or ego, not money.

Against that background, let's turn to the staff's recent release on the subject. To begin with, we seek advice as to whether stockholder proposals should be regulated at all under federal law or left totally to resolution under state law. I must admit that the simplicity of that approach has a certain appeal, but I doubt that it will find broad support. The degree of federal involvement in this process,

over a number of years, may simply to too extensive to generate broad support for this approach. However, this threshold issue has been published for comment.

If that appraoch is not practical, the staff has came forth with three possible approaches for continued federal regulation of the shareholder proposal process. Proposal I would retain the current rule, but with certain revisions. Proposal II would permit an issuer, subject to initial and subsequent periodic shareholder approval, to adopt its own procedures for shareholder proposals, with Commission rules preserving certain minimum protections. Proposal III would require management to include any proposal proper under state law and not involving the election of directors, subject to a numerical limitation on the number of proposals required to be included in a proxy statement, based upon the number of shareholders.

Proposal I

The major revision embodied in Proposal I is a heightened eligibility requirement. To be eligible to submit a proposal, a shareholder would be required to own for at least a year 1% of the issuer's securities eligible to vote at the meeting or securities having a market value of at least $1,000. Additionally, a shareholder would be limited to only one proposal a year as opposed to the current limit of two. Certain changes also would be made which would clarify the conditions which allow the issuer to exclude proposals on the ground that they

involve personal grievances, are unrelated to business, or involve the same subject matter as another proposal.

Under Proposal I, we also seek comment on the advisability of discontinuing the practice of issuing no-action letters. Obviously, if this practice were discontinued, an issuer could be subject to suit, both by Commission and shareholders, for improperly excluding a shareholder proposal.

We also seek advice on the advisability of charging proposing stockholders a fee for processing the proposal. The issuer would collect the fees from shareholders and pass them on to the Commission.

Proposal II

Proposal II would permit an issuer to adopt its own procedures. The Commission would continue to regulate the submission, inclusion and exclusion of shareholder proposals (under whatever rules may generally be in effect), but a supplemental rule would permit the shareholders of an issuer to decide the extent to which proponents would have access to management's proxy statement and the resulting costs the issuer would bear. The issuer's plan would require initial shareholder approval, and periodic reapproval. The plan, however, would be subject to some limitations. For example, "overly restrictive elegibility criteria" or "overly broad exclusionary criteria" might be prohibited.

Disagreements between an issuer and a proponent about exclusion of a proposal would be resolved according to the plan and, in the last resort, by the courts. Only in the area of personal grievances would the Commission continue to review proposals, and then only if the staff continued its present practice of issuing no-action letters.

Amendments to an issuer's plan could be proposed by the board of directors or by any shareholder, without regard to the eligibility requirements under the plan.

In recognition of possible delays in court determination of eligibility or exclusion, we have requested comment on the feasibility of relying on the courts to resolve disagreements.

Proposal III

Proposal III was originally proferred by Commissioner Longstreth last December. It is the most ambitious of the three proposals, and yet in many respects the simplest. Under this proposal, an issuer would be required to include in its proxy material all shareholder proposals which are not improper under state law and are not related to the election of directors. This approach would eliminate eleven of the existing thirteen grounds for the exclusion of proposals. Disputes regarding exclusion of a proposal would be resolved by the courts, not by the Commission's staff.

Under this approach, there would be a limit on the maximum number of proposals an issuer would be required to

include, which would be based upon the total number of the issuer's shareholders. If the number of proposals submitted were to exceed the allowable maximum, preference would be given to proposals submitted by proponents who had not had a proposal included in the previous three years. If the number of proposals submitted by these "new" proponents were to exceed the maximum, proposals would be selected by lot from among the proposals submitted by the "new" proponents. If the proposals submitted by "new" proponents were less than the maximum, additional proposals would be drawn by lot from the remaining proposals. The order of receipt of proposals would be irrelevant and duplicative proposals would be considered as one.

Four arguments or principles are said to support this approach. First, the shareholder proposal process serves the public interest, is an important element of shareholder democracy, and assures some degree of management accountability, and in that sense lends validity to the notion of a corporate entity. Second, shareholder proposals provide substantial benefit at minimal cost. Third, in this area of difficult factual and legal judgments, a simpler and more predictable regulatory process would serve both issuers and proponents better. Fourth, the necessity of the Commission's staff involvement in the process would be eliminated, a small, but not unimportant, cost savings to the Commission, particularly in today's period of budgetary constraint.

Conclusion

Without prejudging the outcome, I find that Proposal III, has a certain attraction -- at least worthy of further thought and discussion. Whatever the theoretical merits of shareholder proposals in advancing corporate democracy, and notwithstanding the debate about abuse and cost, simplicity -- and therefore predictability -- appears likely to produce the best result. It would remove all the wheel-spinning, hair-splitting and ego trips that have been commonplace. In making that comment, I am well aware that I may be accused of being simplistic merely to avoid making difficult or controversial decision. We should remember, however, that shareholder proposals are not the only avenue to corporate democracy, and perhaps not even the most important. Nor are the costs involved likely to affect the average balance sheet. And I would point out that this whole debate is over whether and when and how stockholder proposals can be included in or excluded from management's proxy statement. The right to engage in a proxy contest, and to disseminate an insurgent's proxy statement, would remain totally unaffected. Obviously, the right of stockholders to bring lawsuits against management for alleged misconduct would remain unaffected.

As I suggested at the outset, one might easily conclude that this whole matter is the classic "tempest in a teapot." Few companies, few proposals, and perhaps volatively little cost is involved. It strikes me that there comes a time

when the pursuit of regulatory perfection should be abandoned and a practical balance struck. The regulation of shareholder proposals seems to me to be such a case.

Although my comments on shareholder proposals may have raised questions, I would ask that we defer discussion for a few more minutes while we focus on another current topic.

INSIDER TRADING

By way of contrast with what I have characterized as a possible "tempest-in-a-teapot", insider trading is, I believe, a vastly more important matter. Until 1977, the Commission had brought only 36 cases involving insider trading. Since then, the Commission has brought 50 cases, 20 of those in the last year. Yet, the legal restrictions on insider trading are not new, and one might question why it took so long for the Commission to develop a program.

In response, I would say that several things contributed to an increase in insider trading and insider trading cases. First, tender offer activity has increased significantly in the last few years. Second, the volatility of prices and interest rates has magnified the effect of the general economy on corporate profits and losses and the value of underlying corporate assets. Third, the existence of options and leveraged arrangements permit an insider to generate enormous profits for little investment and an even smaller risk. To emphasize the last point, cases have been common where an

investment of a few thousand dollars for a few days has generated hundreds of thousands of dollars of profit.

Some have criticized the Commission for allegedly over-emphasizing the program against insider trading. I believe that criticism is wrong for two reasons. First, the legislative history of both the 1933 and the 1934 Acts reflects a serious concern with insider trading. One Senate report described it as "among the most vicious practices unearthed at the hearings." Section 16 of the Exchange Act was only one result of that concern; the disclosure provisions of both Acts also address that concern. Congressional focus on the problem permeates the statutes, and thus it should be no surprise that the Commission considers the subject deserving of attention.

But there is an imminently practical reason. The Commission's program against insider trading has had several far-reaching, beneficial effects that I believe would not have been possible without the emphasis and publicity the program has received. For example, in August, 1982 the Accord with Switzerland was announced, which provides a method to pierce the veil of Swiss bank secrecy when insider trading is involved. Without the obvious and public importance the Commission has attached to fighting insider trading, I seriously doubt that the Accord could have been achieved. I also believe that the Accord will pave the way for similar arrangements with other bank secrecy havens. I further believe that the Accord will

serve as an important precedent for cooperation in other substantive areas of law enforcement. Thus, in the long run, the Accord has far-reaching and highly positive consequences for international law enforcement.

The insider trading emphasis has had other important collateral effects. The cooperation and interest of United States Attorneys' offices around the country is an important factor in determining whether of violations of the federal securities laws will be criminally prosecuted. Such prosecutions are an obvious important deterrant. The visibility of the Commission's insider trading program has led to increased interest in such activities on the part of U.S. Attorneys around the country. U.S. Attorneys are now beginning to call our Enforcement Division to discuss cases in which they are involved when they believe violations of the federal securities laws may have occurred. And I note that these are not U.S. Attorneys just in New York, Chicago, or Los Angeles. They are much more widespread.

The recent response by Judge Orrick, in the District Court in San Francisco, in one of the Santa Fe cases, reflects a possible hightened awareness of the Commission's insider trading program. There, the judge twice rejected the offers of settlement of two defendents who had agreed to disgorge all their profits and to consent to permanent injunctions. He found the settlement inadequate and questioned, among other things, whether formal criminal referrals would be made.

The pointed questions of Judge Orrick, as well as others, will, I believe, provide impetus for the insider trading legislation the Commission recently forwarded to Congress. This legislation would increase the sanction for insider trading by permitting the courts to impose a penalty of up to three times the profits made. I believe that the prospects for passage of this legislation are good because of the climate produced by the recent cases.

Because each of you is an officer of, or adviser to, a corporation, I think you might want to give careful consideration to one aspect of the legislation. As I mentioned, the legislation provides for a penalty of up to three times the profits made, to be determined by the court, in light of all the facts and circumstances. If this legislation is passed, I would expect that the extent of the penalty may turn, among other things, on the "wilfulness" with which an insider acts. Trading in the securities of the issuer by an insider with full knowledge that he possesses material, non-public information may result in the maximum penalty. But you may wish to consider what would happen if an officer, director, or employee traded only after seeking the advice of counsel and being advised that such trading would not be prohibited. Would this provide a basis for arguing for a substantial reduction of the penalty, or complete elimination? Justifiable reliance on the advice of counsel could be argued to be evidence of good faith and due care, factors which would tend to demonstrate a lack of wilfullness.

As advisers to your companies, you may have an important role to play. Establishing a corporate program to counsel employees intending to trade could both reduce the incidence of trading on material, non-public information and, more importantly to the employee, it could reduce the penalty imposed where counsel's judgment on materiality or other issues was determined by a court to be in error. Such a program would go far toward protecting the well-intentioned employee from the severe effects of the triple-profit sanctions, as well as insulating the corporation itself from embarassment, if not pecuniary loss. After all, it's probably only a matter of time before some bright young lawyer argues that a company's failure to protect its confidential information aided and abetted the trading violation by an insider. This line of reasoning, of course, could subject the company to liability not only for the trader's profits, but also for the profits of any tippees, and possibly even subject officers and directors to personal liability. Thus, even without the potential for treble damages, I think it's good advice to establish a program to counsel employees regarding their trading.

You might also think about the more general problem of establishing procedures to safeguard confidential corporate information. Reasonable procedures to safeguard such information might not only reduce the incidence of insider trading, and thus reduce the incidence of the company's liability, but could also establish a defense of due care to suits by defrauded purchasers or sellers.

Conclusion

Although my tenure at the Commission has been brief, I have had a good deal of experience with the Commission over the years. I recognize therefore that the direction of the Commission's enforcement program is not the same today as it has been under previous Commissions. I believe that this is a result to applauded, however, not criticized. An effective enforcement program must have the flexibility to meet the problems of our time. And times indeed have changed. The issues before the Commission today are not the same as before previous Commissions. The economy is different; the markets are different; there are independent directors and audit committees; and accounting firms are more watchful. Accordingly, the present Commission must turn to the urgent matters now before it, and the enforcement program must follow. Insider trading is one of those urgent matters, and, as I have tried to show, I believe the Commission's efforts to reduce insider trading are being richly rewarded.