Supreme Court of the United States

In the Matter of:

SECURITIES AND EXCHANGE COMMISSION, Petitioner, vs. NATIONAL SECURITIES, INC., et al. Respondents.	**Docket No.** 41

Place Washington, D. C.

Date November 19, 1968

ALDERSON REPORTING COMPANY, INC.

300 Seventh Street, S. W.

Washington, D. C.

NA 8-2345

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IN THE SUPREME COURT OF THE UNITED STATES

October [redacted], 1968

SECURITIES AND EXCHANGE COMMISSION,

Petitioner;

vs. No. 41

NATIONAL SECURITIES, INC., et al.,

Respondents.

Washington, D. C.
Monday, November 19, 1968

The above-entitled matter came on for argument at 2:05 p.m.

BEFORE:

EARL WARREN, Chief Justice
HUGO L. BLACK, Associate Justice
WILLIAM O. DOUGLAS, Associate Justice
JOHN M. HARLAN, Associate Justice
WILLIAM J. BRENNAN, JR., Associate Justice
POTTER STEWART, Associate Justice
BYRON R. WHITE, Associate Justice
ABE FORTAS, Associate Justice
THURGOOD MARSHALL, Associate Justice

APPEARANCES:

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Solicitor General
Department of Justice
Counsel for petitioner

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Counsel for respondents

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P R O C E E D I N G S

CHIEF JUSTICE WARREN: Case Number 41, Securities and Exchange Commission vs. National Securities. Mr. Frank.

ARGUMENT OF JOHN P. FRANK, ESQ.

ON BEHALF OF THE RESPONDENT

MR. FRANK: Mr. Chief Justice, may it please the Court. We heard the Solicitor General express his opinion that the decision of the 9th Circuit in this matter has exempted all securities companies from regulation under the applicable securities act.

It is our belief and our argument to you that the Government gives this case an averbreadth, that the Solicitor General need not be so concerned over the extreme range which he reads in an opinion. In our view it is not truly there.

May we make perfectly clear, I have been in this case for almost four years and presented my arguments, and we have never suggested anything about the SEC not having regulations over the securities companies.

The registration of an insurance company is required by law, indeed, these briefs give citations of the manner in which they are registered. We have no doubt that the inside disclosure laws apply to the insurance company. We have no doubt that all of the regulations as to the daily trading by the insurance companies are fully applicable for that registration under the Act of 1940, as well as 1933's act, are required.

It is our view that this is a decision which was

accurately described by -- let's take the Independent Reader, Judge Herrlands in the Southern District of New York recently had an occasion to apply this 9th Circuit case in a different matter. He said, "In that case the one we are talking about, the Securities and Exchange Commission sought to invalidate the merger of two life insurance companies on the ground that the anti-fraud provisions of the Securities Exchange Act of 1944 were violated."

What National Securities, this case, held was that the Federal statute did not govern because it impaired a detailed State regulatory scheme, specifically and directly aimed at the business of insurance.

Now, let me give you briefly the account, as we see it, of what happened and what the issue is and how it comes here. In the year 1964 an Arizona company, National Life, was largely owned by another concern, National Securities. The National Securities people bought in on a second Arizona company, Producers' Life.

Later in the year 1964, a merger proposal was made to merge these two companies. Now, let me say a word about the Arizona laws to insurance company mergers. What happens under our statutes is that first there must be approval by the directors of the two companies. Then the matter is put up to shareholder vote in each company. Thereafter, if it is approved by the shareholders, the matter then goes to the Director of Insurance

and he must review the legality of the proposal and specifically under our code must consider it from the standpoint of general legality under our laws and in terms of the interest of the shareholders specifically, as well as the policy holders and the merger becomes effective on his approval.

What happened was this: The Directors did approve. The matter went to the National shareholders and they approved without question. The matter went to the Producers shareholders and there was a contest and there was a minority group which contested and there was a rip-snorting good proxy fight to determine how those shareholders would vote on the question of this merger.

Thereupon, the SEC, early in 1965, filed this action and the action which was filed was filed exclusively under Section 10-B of the 1934 Act and under Rule 10-B-5, which I will be speaking about principally. The action at that time, I should mention because this point may be important, the action was brought against our clients, the people promoting the merger, but it was also brought against the selling directors. I ask that that be held in mind for just a moment. The action was brought, but the thrust of the action as brought was that it was to enjoin the merger and to enjoin the shareholders' meeting and to enjoin letting the matter be presented to the Arizona Director of Insurance.

What happened was that an ex parte order was issued of

which we had no notice which did restrain these things and thereupon, we filed the usual motions and the matter came on before Federal District Judge Mathies.

At that point the Court dismissed as to the selling directors and the selling directors are not in the case. They are not in the case now in any way and there has never been an appeal from the order in that respect.

The matter which was held was simply the question of whether our clients could be enjoined from going forward with this merger and specifically, could be enjoined from presenting the matter to the shareholders whose meeting was suspended by the order of the Court as to whether or not they could vote.

In those circumstances, the essence of the complaint as made by the SEC, as fairly summarized in the Government's brief, was that there was objection to four elements of the proxy solicitation which had been going forward in connection with this merger, in connection with the shareholders' meeting. There were, as I said, there had been a minority shareholders' suit and you can see that the matter came on in a crowded courtroom before Judge Mathies with the shareholders present and the SEC present. Judge Mathies said, "No. I believe this is a matter of whether this merger can go forward which properly should be taken up with the Insurance Director of this State."

He said,"we ask that you stipulate there be a fair period

of time and that you give notice to the SEC so that the SEC can present to the Arizona Insurance Commissioner any facts relevant to this merger."

He broadly admonished that if any of the shareholders were dissatisfied they should take their problems to the Arizona Commissioner of Insurance.

At that point the matter came on before the stockholders who overwhelmingly approved the proposed merger and the matter went to the Commissioner of Insurance of Arizona. At that moment we served notice to the SEC that it was being presented to the Director of Insurance.

The SEC presented to the Director of Insurance all of the pleadings in this case, sent them down with the suggestion that the Director of Insurance should take these things into account in deciding whether to permit the merger or not.

Thereupon, after a reasonable period of time, the Arizona Insurance Director did approve the merger. At that point the Commission which had sought no stay there, had not gone to the Circuit or come here, thereupon, amended its complaint, got leave to amend and did amend. It then presented an amended complaint and in the light of the comments of the Solicitor General, I think it perhaps would be worthy of noting that the amended complaint and its operative portions are contained in the appendix.

All I wish to say is that the amended complaint asked that

the merger be nullified.

Q Where is that in the record?

A At Page 99. It asked that no steps be taken toward the merger while it was already done. That was obsolete. The next paragraph is that the merger be nullified and set aside. In the remaining paragraph there is a reference that relates to the original contract of purchase, but that was of no consequence because that was directed at our clients and their actions and the actions of the selling directors, but the selling directors were not parties.

The SEC moved to rejoin them as parties, but that motion was denied and they never appealed it. What they asked for in the end was steps to nullify the merger. The precise question which is here is not some broad issue about the relationship of the securities or insurance industry, but it is simply this question: Does Rule 10-B-5 give the SEC power to stop or reverse a merger of an insurance company or insurance companies on the ground of asserted misleading proxy solicitations?

We say the answer to that question is no and we say no on three independent grounds, any one of which is sufficient for the purpose.

We say no, first of all, on the ground that the McCarren Act, in the light of the Arizona statute, bars this intervention by Federal Court and by the SEC and the 9th Circuit and District Court took that point of view.

Secondly, we say as a wholly independent ground, that the whole thrust of what the SEC was seeking to do here is to enjoin the merger or set it aside on the ground of some alleged impropriety as the proxies. But they bring this action under Section 10, Rule 10-B-5, and Section 10, Rule 10-B-5 does not deal with proxies.

Through another section that does deal with proxies, the proxy rules and provisions did not pertain to this company at all and more than that, Congress has expressly provided by a different Act which was not mentioned yesterday, but which is discussed in the briefs, has expressly provided that insurance proxy solicitations are to be subject to State control and the 9th Circuit in general took our position on that point.

Then there was a third ground which we advanced and I would like to have that clearly in focus. Rule 10-B-5 applies only to the purchase and sale of securities and if, therefore, there was not any purchase or sale, then there is no scope, no place of operation for the rule.

The real question in the case, therefore, at the lower court stage, was whether a so-called statutory merger was a sale of securities at all and hence, whether it was within the scope of this statute and this rule.

As I will develop in just a moment, when Mr. Justice Douglas was at the Commission and when Justice Fortas was at the Commission the Commission took the view that a statuatory

purchase was not a sale and the 9th Circuit so held on the basis of a recommendation of the Commission. In more recent years the Commission has reversed itself and abandoned that position and now seeks to extend Rule 10-B-5 to mergers.

So, what the 9th Circuit said was the most important question in the case, it was whether the Circuit would overrule its opinion in this court.

The 9th Circuit did not have to decide that, having decided the McCarran Act question. One question before this Court is how many of these independent grounds it should consider. We respectfully submit that it should consider them all. The Government says it should not consider the citing of an opinion of Justice White which holds that where there are complex factual issues which were not considered at the Circuit, then the Court in its discretion may allow them to be considered rather than consider them here, but the purchase and sale problem is not a complex factual question; it is a pure question of law and there is no factual record.

The matter went over on affidavits and I submit that this is an independent ground for decisions which you may properly consider.

Q We don't reach that if we agree with the 9th Circuit on the McCarran Act.

A These are truly independent.

Q When you are urging us to consider them all? It is

only if we decide against you in the McCarran Act.

A That is right, and Your Honor, let me now address myself to this proposition, such a misfortune should not occur.

Q You are not confessing judgment on the McCarran Act, are you?

A We are not. If I thought this opinion was as broad as the Solicitor General had said, I would not have said that. We have not made any contention on this broadscale sort.

Q May I ask you one question? Suppose a stockholder of one of the merging companies went into a Federal Court on the basis of diversity of a Federal law and brought an action for injunction. Suppose he proved that material misrepretations and fraudulent statements and representations had occurred in the solicitation of the exchange of securities. As a technical matter, would that be a basis for the grant of injunctive relief?

A Your Honor, it might very possibly be the basis for a grant of conjunctive relief if he went in under the diversive ground and not this Rule 10-B-5. That is what happened.

Q You spoke earlier bout the SEC enjoining the merger but what has happened here is that the SEC has resorted to a court and said that there is a violation of a provision of Federal law that prohibits the use of manipulative or deceptive devices in connection with the sale or exchange of a security.

Forgetting all your other points, the SEC is going in there as a litigant and it is asserting a point of law based upon a specific provision in the Federal act.

Now, I take it that your first task is to persuade us that that is a regulation of the business of insurance and therefore, the McCarran Act applies; is that correct?

A That is correct, Your Honor. In other words, had this been a diversity action based upon state law, then none of these problems would be here. We had such a thing and did litigate it and it was disposed of.

Our problem now is whether the rule under the McCarran Act can be allowed to reach a statutory merger of insurance companies.

Q Suppose in the consummation of this merger there had been a violation of the postal laws. You are not suggesting that the McCarran Act would preclude criminal prosecution under the postal laws. What you are saying is that the remedies sought here, the remedy rather than the cause of action, is precluded by the McCarran Act. Is that it? In other words, let's take it another way, Mr. Frank, let's suppose that the SEC through the Department of Justice, started a criminal prosecution against the company and some of its employees for fraud committed in affecting this merger. You would not argue that that is precluded by the McCarran Act; would you?

A Your Honor, it would depend upon whether there was a

State law dealing truly and effectively with the very same subject.

Q Take this precise situation. Are you saying or are you not that the McCarran Act would preclude a criminal prosecution for a fraud in connection with the exchange of securities in this merger, which fraud was by my hypothesis, a violation of the Federal criminal statutes. Would you say that the McCarran Act precludes that?

A Your Honor, I would have to answer that I believe the answer is no because the State of Arizona has no direct or equivalent criminal law dealing with that same subject. The reason I put it in that tentative fashion, Your Honor,is that your question takes me by surprise and I would have to look back to the code criminal provisions.

Q I don't think it takes you by surprise, Mr. Frank. The point I am asking you to address yourself to, because it seems so inevitable in this case, you objected to the Solicitor General's argument because you said it is too braod and you say there is an area that is not foreclosed by the McCarran Act.

I suggest to you that perhaps that area includes c criminal prosecution and Federal statute for fraud in connection with the sale of securities.

A Mr. Justice, there is the case which probably is in your mind, the case of Sylvanus from the 7th Circut.

Q What you are objecting to here, what you are saying

here, as I follow your argument, may be that the McCarran Act precludes the remedy here which the SEC seeks in the application of Rule 10-B-5. If you think I am wrong, tell me so.

A We do say it is wrong because the pleadings as a whole, the complaint and the amended complaint take the complaint and remedy portions altogether, are solely and exclusively directed to upsetting an Arizona insurance company merger and we say that cannot be done under the McCarran Act, whether you call it a cause of action or a remedy under the two of them.

That is because we have a very express code. Our code provisions are set forth in our own brief. You will see we have on Page 49 the provision and the express language, right in the heart of our insurance code, as to what is the function of the Insurance Department in connection with a merger of insurance companies.

Against this must be balanced the fact that the McCarran Act expressly said that no Federal law will be allowed to invalidate, impair or supercede a State law which deals with the business of insurance.

I have put this question to the Government and I have put it again. I have put it with the upmost urgency. I cannot conceive of how it would be possible more totally to supercede the Arizona Code 20-731 than to sustain the position of the SEC in this case because the entire matter is that they are saying there shall be no merger and the State is saying that there

shall be a merger. The Government in its brief, the question arises: Is the merger and the existence of an insurance company to be regarded as part of the business of insurance? The Government says on Page 17, "Historically, such matters as the chartering and licensing of insurance companies are matters for the State."

This is exactly what we are dealing with here. The question which was presented to the Arizona Insurance Director was whether the marriage of these insurance companies was to be allowed to give birth to what is,for all practical purposes, a new insurance company.

Q Doesn't Arizona also or the Commissioner or some regulatory body there have some proxy rules?

A Your Honor, may I answer that in terms of how it was then and how it is now?

Q How about now?

A At the present time there is comprehensive regulation because, Your Honor, in 1964 Congress passed what is known as the 1964 Amendments with which I assume you are familiar. Those Amendments expressly provided that the States should have proxy control in insurance companies if they would adopt regulations of the National Association of Insurance Commissioners.

The State of Arizona, like all the other 49 States, has adopted such regulations so that we now have a comprehensive regulatory code over proxies.

Q They apply and the proxy rules of the Commission do not apply?

A That is right. It is now clear that the proxy rules of the Commission do not apply and that brings me to the other aspect of the matter, Mr. Justice White. The situation as the Congress has expressed it in the clear language of the 1964 Act, expressly and precisely provided that the proxy rules of the SEC should not apply to insurance companies.

Q This case could never happen again?

A That is right. That is the whole point, Your Honor. Frankly, I make bold to suggest now that this is a case in which the certiorari could be providently granted because this is the last case in the United States where this could come up because all the States now have regulations.

But I want to make clear that we had adequate law on the subject there because Arizona had adopted what they called the "Little McCarran Act" earlier and we had statutes that said: "In order to apply and meet the requirements of the McCarran Act" and this had many statutes applying to irregularities

Q If Arizona then had rules applying to proxies and the SEC had some rules applying to proxies, under the Federal law the situation was bad and under the State law it was good. What then?

A The answer is this: This, I think is the most fundamental single error the Government makes. The Government takes the position in its brief that there must have been no

Arizona law in point because it disagreed with the Commission as to the consequences of these particular statements. Our position is to the contrary. Your decisions under the McCarran Act do not provide or require that the State must automatically agree with the Federal Government.

Q Your answer is that there is not really a conflict. If there was a conflict between Arizona and the Federal law, Arizona law would control?

A The conflict was not in the law so much, but in its application.

Q Let us assume there was; is your position that Arizona would control?

A Our position would be that the Arizona law would control as to the weight to be given to the significance of one of these proxy statements.

Q I think that is part of the Government's point here, that if the securities laws are going to apply at all here they certainly should be able to apply to the extent of being able to say to enjoin the use of a proxy statement which violates the Federal law.

A Yes, Your Honor.

Q Even if under Arizona law that proxy statement is good?

A That is correct. The whole point is that what your cases have said repeatedly is that the States need not simply

automatically echo or rubberstamp the Government. In this instance, there is a problem of whether a given financial fact was not disclosed, but it is possible to argue that the fact was disclosed on some other document. That kind of determination has to be made by somebody.

Our point is that it is a decision that could be made by the Arizona Director. These are,none of them,great mamouth points of departure. It is a question of what weight is going to be attached toone detail.

Q The 1964 Amendments do not apply to this case, do they?

A No, they do not.

Q Second, it was my understanding that these 1964 Amendments which became effective in 1966 applied, were intended so far as here relevant, to displace the Federal Act by the appropriate State acts only with respect to the regulatory provisions and not to displace the manipulator, anti-manipulator and anti-fraud provisions such as 10-B-5. Do you disagree with that?

A Your Honor, I simply approach it differently. It is our position that what was intended, if I may meet that very squarely, what was intended at least was to determine whether proxy solicitations would or would not be subject to Federal or State law.

Q What I am suggesting to you is that you have to

break that now. That is to say, there are regulatory provisions and there are anti-fraud provisions. The question in this case, it seems to me at the moment, anyway, is whether the McCarran Act was intended to displace the anti-fraud provisions,

Number One, certainly it doesn't displace the Postal Act and Number Two, does the McCarran Act have an effect, have some impact, upon the relief that the SEC can obtain in court with respect to a merger which has been approved by State Commissioners?

A Mr. Justice, may I take a moment or two to wind up? Mr. Justice Fortas, all I can say is that if that was the Commission's point of view now it was not when it presented the 1964 Act to Congress, because in 1964 hearings they went in and said, "We need this legislation for the purpose of controlling proxy solicitations in connection with mergers." At no point did they say "We already have this power in some respects" or "We have it for regulatory purposes."

They went to Congress saying that they needed this power. Now, in this case they tell us that they had it all the time. I would like, if I may, to wind up because my time is gone.

I bring to your attention expressly that Congress has repeatedly had before it the question of whether it ought to take hold of insurance mergers and had decided to the contrary. We quote a report of the Senate Judiciary Committee

in which that Committee takes up the subject of mergers and says" "This is clearly an area where amendments to the McCarran Act may be needed, but none such have been passed."

I will not have the opportunity to discuss with you the sale problem because of the expiration of the time, but I commend that to your consideration in the briefs.

When Mr. Justice Douglas and Justice Fortas were with the Commission their position was that these provisions of law did not apply to mergers at all.

It is our position that if this is to apply to mergers it should certainly not be retroactive to our company situation which could not possibly know.

I leave the matter with these questions: How could the SEC more totally supercede our law? I think it would be impossible. It runs the snowplow straight through it.

The real question is: Who has the power to decide whether the two insurance companies may merge or not? But with special attention to the matters which Justice Fortas has raised, why did the SEC tell Congress in 1964 that it needed the proxy amendment to reach mergers if it had already had that power and, finally, the most serious question of all under the McCarran Act, why did Congress, relating to the colloquey with Justice White, why did Congress expressly provide in the 1964 Act that the insurance mergers should be under State control if it intended the insurance proxies to be under State control?

Thank you very much.

(Whereupon, at 10:49 a.m., the arguments in the above-entitled matter were concluded.)