THE SHAREHOLDER PROPOSAL RULE: CRACKER BARREL, INSTITUTIONAL INVESTORS, AND THE 1998 AMENDMENTS

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INTRODUCTION

The federal securities law provisions concerning shareholder proposals have generated controversy since their enactment in 1934.[1] In particular, Rule 14a-8, commonly referred to as the Shareholder Proposal Rule (the Rule),[2] allows shareholders to submit a proposal in the company's proxy statement for a vote at the annual shareholder meeting.[3] It also serves as an important means for shareholders to communicate with each other and with management.[4] In 1996, Congress directed the Securities and Exchange Commission (SEC) to review the process to determine "whether shareholder access has been impaired by recent statutory, judicial, or regulatory changes."[5] One of the primary reasons for this directed study was the SEC's adherence to its decision in Cracker Barrel Old

1. *See* 17 C.F.R. §§ 240.14a-1 to -15 (1998); *infra* Part I.
2. 17 C.F.R. § 240.14a-8.
3. *See id.*; *infra* Part I.
4. *See* Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-39093, 62 Fed. Reg. 50,682 (1997), *available in* 1997 SEC LEXIS 1962, at **2–3 [hereinafter Release].
5. National Securities Markets Improvements Act of 1996, Pub. L. No. 104-290, § 510(b), 110 Stat. 3416 (1996); *see infra* Part IV.

Country Stores, Inc. (Cracker Barrel).[6]

As a result of this study, in September 1997, the SEC issued proposed amendments that would have made substantial changes to the Rule.[7] The proposals created significant controversy among shareholder proponents and companies alike.[8] After an extension of the comment period and a deluge of critical comment letters, the SEC finally issued its amendments to the Rule in May 1998.[9] The amendments reflect a significant retreat from those originally proposed. The most noteworthy feature of the new Rule is the reversal of Cracker Barrel — the SEC's controversial interpretation of the "ordinary business exclusion."[10]

First, this Comment applauds the SEC's reversal of Cracker Barrel.[11] In Cracker Barrel, the SEC declared that all employment-related proposals may be omitted from company proxy statements.[12] This decision denied shareholders the right to address significant policies that affect both long-run corporate financial success and corporate impacts on society as a whole. Prior to this decision, the SEC excluded employment-related proposals on an ad hoc basis; however, in an attempt to minimize subjective line-drawing, the SEC threw the baby out with the bath water.[13] Thus, the SEC's decision to reverse Cracker Barrel is a step in the right direction. However, with the return to a case-by-case analysis, only time will tell the true effect of the reversal.

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6. *See* Linda L. Quinn & Andrea J. Menaker, *Shareholder Proposal Reform Redux*, 11 INSIGHTS, Dec. 1997, at 19.

7. *See* Release, *supra* note 4; *infra* Part IV.

8. *See* Carolyn Mathiasen, *SEC Reverses Cracker Barrel*, IRRC CORP. SOC. ISSUES REP., May 1998, at 14; *infra* Part IV.

9. *See* Merrill B. Stone & Devika Kewalramani, *Final Shareholder Proposal Rules Fall Short of Reform*, NAT'L L.J., June 22, 1998, at B9 (col. 2). The SEC received over 2000 comment letters. *See id.* The amendments to the Rule became effective June 29, 1998. *See* Amendments to Rules on Shareholder Proposals, 63 Fed. Reg. 29,106 (1998) (to be codified at 17 C.F.R. pt. 240) [hereinafter Amendments].

10. *See* Cracker Barrel Old Country Stores, Inc., SEC No-Action Letter [1992–1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,418 (Oct. 13, 1992), *available in* 1992 SEC No-Act. LEXIS 984, at **2–3 [hereinafter Cracker Barrel No-Act]. In Cracker Barrel, the SEC announced its decision that employment-related proposals would no longer be saved from exclusion if they related to a significant social policy. *See id.* at **1–3; *infra* Parts I.E, II, IV.2.

11. *See* Cracker Barrel No-Act, *supra* note 10, at **2–3; *infra* Part II.

12. *See* Cracker Barrel No-Act, *supra* note 10, at **1–3.

13. *See* Julian R. Kossow, Dolan v. City of Tigard, *Takings Law, and the Supreme Court: Throwing the Baby out with the Floodwater*, 14 STAN. ENVTL. L.J. 215, 233 (1995).

Increased emphasis by both the Department of Labor (DOL) and institutional shareholders evidence the importance of employment-related proposals.[14] Former SEC Commissioner Steven Wallman, a prominent critic of the Cracker Barrel decision, stated that he always considered workplace issues important to overall corporate competitiveness, and thus, proper subjects for shareholder debate.[15] Responding to the Cracker Barrel decision, former DOL Secretary Robert Reich stated, "[t]here's a legitimate argument to be made that if a company is substantially involved in an important issue facing the country that transcends that individual company, then shareholders ought to be able to vote on that company's role."[16]

Second, this Comment suggests that institutional investors should utilize organizations such as the Council of Institutional Investors (CII), the Investor Research Responsibility Center (IRRC),[17] and LENS, Inc. (LENS) to coordinate their actions.[18] Currently, institutional investors have the most success with shareholder proposals due to the amount of shares they typically own. However, increased coordination between institutional investors would help minimize freerider[19] problems and retaliation from companies.[20]

Finally, this Comment analyzes the SEC's amendments to the Rule — noting that what the SEC chose *not* to adopt is actually

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14. *See infra* Part III.B.

15. *See* Steven M.H. Wallman, *Reflections on Shareholder Proposals: Correcting the Past; Thinking of the Future*, *in* 970 PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1997, at 419, 425–26 (PLI Corporate Law and Practice Handbook Series No. B4-7173, 1997).

16. Marleen A. O'Connor, *Organized Labor as Shareholder Activist: Building Coalitions to Promote Worker Capitalism* 1, 28 (1997) (citing Stuart Silverstein, *Proxy Vote on Hiring Matters Urged*, L.A. TIMES, Nov. 5, 1996, at D2) (unpublished manuscript, on file with the *Stetson Law Review*).

17. The IRRC is an organization that collects, analyzes, and publishes information concerning the shareholder proposal process. *See* Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy,* 23 GA. L. REV. 97, 109 n.14 (1988).

18. *See infra* Part III.

19. "Free riding is usually described as the diversion of value from a business rival's efforts without payment to that rival." Daniel E. Lazaroff, *Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals*, 50 RUTGERS L. REV. 33, 72 n.197 (1997). Professor Lazaroff demonstrates that free riding is "analogous to the classic external benefit issue raised when one person finances a lighthouse and many other travelers benefit from it without contributing to the cost of building or maintenance." *Id.*

20. *See id.*

more significant than what it did adopt.[21] Among the more controversial proposals not adopted were: the increased resubmission thresholds;[22] the new administration of the personal grievance exclusion;[23] the shift to a strict economic relevancy test;[24] and the elimination of 14a-8(e).[25] Popular criticism of these proposals indicated that their enactment would seriously impair shareholders' access to proxy statements, which is contrary to the intent of National Securities Markets Improvements Act of 1996.[26] In proposing the changes, the SEC attempted to balance the competing concerns of both shareholders and companies,[27] while removing themselves as much as possible from the inherently subjective role of arbiter.[28] Unfortunately for the SEC, and as reflected in the final amendments, both companies and proponents prefer that the SEC continue in this role.[29]

Part I of this Comment discusses the legislative intent behind the Rule and outlines the significant amendments to the Rule since its enactment.[30] This section considers the reasons for and against the Rule and discusses the ordinary business operations exclusion[31] — which creates a foundation for understanding the Cracker Barrel controversy and the amendments to the Rule.

After establishing this framework, Part II addresses the Cracker Barrel controversy, including the Cracker Barrel no-action letter and the subsequent district and appellate cases.[32] This section suggests that the Cracker Barrel controversy has undermined the secu-

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21. *See* Amendments, *supra* note 9, at 29,106.

22. *See infra* Part IV.B.3.

23. *See infra* Part IV.B.1.

24. *See infra* Part IV.B.2.

25. *See infra* Part IV.B.5.

26. *See* Mathiasen, *supra* note 8, at 14; National Securities Markets Improvements Act of 1996, § 510(b), Pub. L. No. 104-290, 110 Stat. 3416 (1996).

27. *See* Release, *supra* note 4, at *14.

28. The SEC noted that the unadopted proposals shared the common theme: "[T]o reduce the Commission's and its staff's role in the process and to provide shareholders and companies with a greater opportunity to decide for themselves which proposals are sufficiently important and relevant to the company's business to justify inclusion in its proxy materials." Amendments, *supra* note 9, at 29,106.

29. "We've learned that while we think people want bright line tests, sometimes they prefer gray." Mathiasen, *supra* note 8, at 15 (quoting SEC Counsel Brian Lane).

30. *See infra* Part I.A–B.

31. *See infra* Part I.E.

32. *See infra* Part II.A–B.

rity of the no-action process.[33]

Part III comments generally on institutional shareholder activism in the context of the Rule. This section notes that institutional investor activism is hindered by both regulatory and internal factors.[34] It further posits that institutional investors have the capacity to effectuate beneficial change for both corporate governance and social policy. However, to maximize this ability, institutions must coordinate their efforts. Further, this section also discusses the importance of employment-related proposals warranting inclusion in a company's proxy statement.[35]

Finally, Part IV details the amendments to the Rule,[36] including a discussion on the proposed amendments that the SEC chose not to adopt. This section commends the SEC's decision to reverse its Cracker Barrel position. Additionally, this section discusses the reactions to the final amendments.

I. THE SHAREHOLDER PROPOSAL RULE: THE LEGISLATIVE INTENT BEHIND ITS ENACTMENT, SUBSEQUENT AMENDMENTS, AND THE REASONS FOR AND AGAINST THE RULE

A. The Rule and the Legislative Intent

In 1942, the SEC promulgated the Shareholder Proposal Rule pursuant to its authority under Section 14(a) of the 1934 Securities Exchange Act.[37] The Rule requires corporate management to in

33. *See infra* notes 262–64 and accompanying text. When a company desires to omit a shareholder's proposal, it may seek a no-action letter from the SEC expressing that the SEC will not take action if the proposal is omitted. *See infra* notes 109–17 and accompanying text.

34. *See infra* Part III.A.

35. *See infra* Part III.B.

36. The SEC also enacted amendments to Rule 14a-4 regarding the exercise of discretionary voting. Any amendments to this rule are beyond the scope of this Comment.

37. As a result of widespread abuse in proxy solicitation, Congress enacted section 14(a) of the Securities Exchange Act of 1934, thereby conferring authority on the SEC to promulgate rules regulating the proxy system as are "necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. § 78n(a) (1994). The text provides:

> It shall be unlawful for any person, by use of the mails or by any means or instrumentality of interstate commerce . . . or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or

clude shareholder proposals in its proxy materials, at no cost to the proponent, for a vote at the annual shareholders' meeting.[38] According to the Rule's original rationale, shareholders were entitled to be informed of proposals that the company knew would be presented at the annual meeting.[39] Now, Rule 14a-8 serves as a channel of communication for shareholders to communicate with other shareholders as well as with management regarding both corporate governance and social issues.

Although this Rule is not the only means by which shareholders may effectuate this level of communication, it is the most popular.[40] The Rule's popularity is largely attributable to the relatively low cost of such proposals as well as the ability of shareholders' proposals to share space in the proxy materials with management's proposals.[41] When discussing these rules, it is important to remember that the explicit purpose behind the enactment of Section 14(a) is "the protection of investors."[42] In *Medical Committee for Human Rights v. SEC*,[43] the court eloquently restated this purpose: "It is obvious to the point of banality to restate the proposition that Congress intended by its enactment of [S]ection 14 . . . to give true vitality to the concept of corporate democracy."[44]

> to permit the use of his name to solicit any proxy . . . in respect of any security (other than an exempted security) registered pursuant to . . . this title.

Id.

38. *See* 17 C.F.R. § 240.14a-8 (1998).

39. *See* George W. Dent, Jr., *Proxy Regulation in Search of a Purpose: A Reply to Professor Ryan*, 23 GA. L. REV. 815, 819 (1989) (citing *SEC Proxy Rules: Hearings on H.R. 1493, H.R. 1821 & H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce*, 78th Cong. 169–70 (1943)); *see also* Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 677 (D.C. Cir. 1970) (reiterating this rationale and explaining that this was the reason the SEC's early actions under this authority were "directed primarily toward the achievement of full and fair corporate disclosure regarding management proxy materials"), *vacated as moot*, 404 U.S. 403 (1972).

40. *See* Release, *supra* note 4, at **4–5. "It is not the only avenue for communication, since a shareholder may undertake an independent proxy solicitation or may seek informal discussions with management or other shareholders outside the proxy process." *Id.*

41. *See id*. at *4.

42. J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964); *see Medical Comm. for Human Rights*, 432 F.2d at 672.

43. 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

44. *Id.* at 676. The court then quoted legislative history worth repeating:

> Even those who in former days managed great corporations were by reason of their personal contacts with their shareholders constantly aware of their responsibilities. But as management became divorced from ownership and came

However, "[a]s a corporate democracy tool, . . . Rule 14a-8 is a blunt instrument."[45] Despite the Rule's popular appeal, it has three significant drawbacks.[46] First, because a proponent must submit any proposal well before the meeting, the subject may be so outdated as to render the proposal useless.[47] Second, the only opportunity a proponent is given to rebut the company's response to the proposal is at the meeting itself – which, considering the lack of attendance at these meetings, basically amounts to no rebuttal.[48] Third, a proponent must convey significant issues in 500 words or less.[49]

There are two general categories of shareholder proposals: (1) corporate governance, and (2) social policy. Corporate governance proposals focus more clearly on maximizing share value by challenging management accountability.[50] Typical proposals of this type include opposition to anti-takeover devices, unstaggering boards, advocating independent directors, and splitting the office of Chief Executive Officer and Chairman of the Board.[51] The growth of corporate governance proposals in this decade has been attributed to institutional shareholder activism.[52]

The second type of proposal, the social policy proposal, stimulates the most criticism and debate. Critics exclaim that these proposals are used "chiefly by time-worn gadflies or religious and polit-

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> under the control of banking groups, men forgot that they were dealing with the savings of men and the making of profits became an impersonal thing. When men do not know the victims of their aggression they are not always conscious of their wrongs . . . . Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies.

Id. (quoting H.R. REP. NO. 1383, at 5, 13 (1934)).

45. Wallman, *supra* note 15, at 420.

46. Former Commissioner Wallman highlighted these three drawbacks in his speech. *See id*.

47. *See id.*

48. *See id.*

49. *See id.* Even with these limitations, for the 1996 proxy season, the IRRC reported more than 550 corporate governance proposals and 300 social policy proposals submitted to over 400 companies. *See id.*

50. *See* Release, *supra* note 4, at *136. "Proposals addressing corporate governance matters tend to receive the most substantial shareholder support, and we [the SEC] believe, are most likely to affect shareholder wealth." *Id.*

51. *See* Patrick S. McGurn, *Shareholder Proposal Boom Expected for 1996 Proxy Season*, IRRC CORP. GOVERNANCE BULL., Oct.–Dec. 1995, at 1.

52. *See infra* Part II.A.

ical groups unable to achieve their ends through legitimate political mechanisms."[53] Some of the more prevalent themes of social policy proposals include equal employment,[54] global labor and environmental standards,[55] and tobacco proposals.[56] Each year, only a handful of social policy shareholder proposals receive enough shareholder approval to pass.[57] Nevertheless, these proposals may still have a dramatic influence on a company's management even if they do not pass.[58]

B. The Rule's History and Amendments

This Comment only touches on the Rule's tumultuous history.[59] Originally, the Rule only required inclusion of proposals that were "a proper subject for action by the security holders."[60] In 1945, the SEC announced that state law controlled what constituted a proper subject and that "matters of a general political, social, or economic nature" were inappropriate subjects for shareholder proposals.[61] However, the dearth of existing state law on the subject led the SEC to determine for itself what constituted a "proper subject for action" — thus, building a common law of its own.[62]

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53. Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 901 (1994) (quoting Dent, *supra* note 39, at 820 n.6); *see also infra* Part I.D.

54. *See* Meg Voorhes, *1998 Proxy Season Shapes up as Proponents File,* IRRC CORP. SOC. ISSUES REP., Jan. 1998, at 1.

55. *See id*.

56. *See id*.

57. *See* Release, *supra* note 4, at **135–36. Relying on information from the IRRC, the SEC reported that from January 1, 1997, to September 18, 1997, only 19 of 234 proposals submitted to a shareholder vote received enough shareholder approval to pass. *See id.* All 19 reported were governance proposals, specifically: nine to repeal classified boards, nine to redeem shareholder rights plans, and one concerning executive "golden parachute" payments. *See id.*

58. *See id.* at *136. "In some instances management has made concessions to shareholders in return for the withdrawal of a proposal." *Id*.

59. For a comprehensive history of the Rule, see Susan W. Liebeler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425 (1984). *See also* Ryan, *supra* note 17, at 109 n.41.

60. Liebeler, *supra* note 59, at 427 (citing Exchange Act Release No. 3347, 7 Fed. Reg. 10,655, 10,656 (1942)).

61. Investment Company Act, Exchange Act Release No. 735, 11 Fed. Reg. 10,990, 10,995 (1945). Wallman marks this as the "beginning of the line-drawing that has been a part of the Rule's history ever since." Wallman, *supra* note 15, at 421.

62. *Medical Comm. for Human Rights*, 432 F.2d at 677 (explaining that "the paucity of applicable state law giving content to the concept of `proper subject' led the Com-

The 1947 amendments added the no-action process[63] and clarified that the Rule excluded proposals regarding director elections.[64] Then, in 1948, the SEC added three grounds for omitting shareholder proposals that: (1) seek to redress a personal claim or grievance; (2) are offered by a shareholder who, in the prior two years, without good cause, failed to appear and present a proposal included in the proxy materials; or (3) are substantially similar to proposals submitted at the previous meeting, which failed to amass at least 3% of the vote.[65]

In 1951, a shareholder submitted a proposal recommending that a national bus company abolish segregated seating in the South.[66] In response, the bus company sought and received a no-action letter from the SEC concurring with the omission of the proposal.[67] The following year, amendments to the Rule added a provision for management to omit proposals submitted "primarily for the purpose of promoting general economic, political, racial, religious, social, or similar causes."[68] In 1954, the SEC codified the 1945 Release that "state law determined `proper subjects for action.'"[69] Additionally,

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mission to seek guidance from precedent existing in jurisdictions which had a highly developed commercial and corporate law and to develop its own `common law' relating to proper subjects for shareholder action"). For more sources expressing this view, see Kevin W. Waite, *The Ordinary Business Operations Exception to the Shareholder Proposal Rule: A Return to Predictability*, 64 FORDHAM L. REV. 1253, 1261 n.51 (1995) (citing 4 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2012 (3d ed. 1990) (contending that "[i]nevitably the Commission while purporting to find and apply a generally nonexistent state law, has been building up a `common law' of its own as to what constitutes a `proper subject' for shareholder action")).

63. *See infra* notes 109–17 and accompanying text.

64. *See* Exchange Act Release No. 4037, 12 Fed. Reg. 8768, 8770 (1947); Liebeler, *supra* note 59, at 428; Ryan, *supra* note 17, at 113.

65. *See* Exchange Act Release No. 4185, 13 Fed. Reg. 6678, 6679 (1948); Liebeler, *supra* note 59, at 428–29; Ryan, *supra* note 17, at 113. This latter change created resubmission levels, and proposed changes to raise those levels spawned serious criticism. *See infra* Part IV.B.3.

66. *See* Peck v. Greyhound Corp., 97 F. Supp. 679, 680–81 (S.D.N.Y. 1951) (denying a request for an injunction because the plaintiff had failed to exhaust all of his administrative remedies). The proposal read: "A Recommendation that Management Consider the Advisability of Abolishing the Segregated Seating System in the South." *Id.* at 680.

67. *See id.*

68. Liebeler, *supra* note 59, at 429 (citing Exchange Act Release No. 4775, 17 Fed. Reg. 11,431, 11,433 (1952)). This amendment essentially codified the SEC's position since 1945. *See* Ryan, *supra* note 17, at 113–14 (citing Investment Company Act, Exchange Act Release No. 735, 11 Fed. Reg. 10,990, 10,995 (1945)).

69. Ryan, *supra* note 17, at 114 (citing Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4979, 19 Fed. Reg. 246, 247 (1954) [hereinafter Adoption of

the 1954 amendments added two more grounds for exclusion to the Rule by: (1) permitting the omission of proposals relating to the company's ordinary business operations;[70] and (2) broadening the resubmission exclusion.[71]

The 1960s brought a renewed focus on the Rule — which, up until that time, shareholders primarily had used for corporate governance proposals.[72] Shareholders began to question the corporation's role in society, and corporate responsibility echoed within the proposals. The era's most influential and famous case was Campaign GM led by Ralph Nader,[73] which in turn provided the inspiration for

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1954 Amendments]).

70. This Rule, first codified as 14a-8(c)(5), is currently (c)(7). *See* 17 § C.F.R. 240.14a-8(c)(7) (1998). See also *Medical Comm. for Human Rights*, 432 F.2d at 678–79, in which the court explained:

> The policy motivating the Commission in adopting the Rule . . . is basically the same as the underlying policy of most State corporate laws to confine the solution of ordinary business problems to the board of directors and place such problems beyond the competence and direction of the shareholders. . . . [Further, Congress realized] management cannot exercise its specialized talents effectively if corporate investors assert the power to dictate the minutiae of daily business decisions.

The Rule aligns with the rationale underlying the Business Judgment Rule — that certain decisions should be left to management and not imposed upon by the courts or shareholders. *See* Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985); Kamin v. American Express Co., 383 N.Y.S.2d 807, 810–13 (N.Y. App. Div. 1976). *See generally* WILLIAM L. CARY & MELVIN A. EISENBERG, CORPORATIONS: CASES AND MATERIALS, 405–35 (6th ed. 1988).

71. *See* Liebeler, *supra* note 59, at 430 n.25. Resubmission required levels of 3%, 6%, and 10% on the first three submissions, respectively. *See id.* Prior to 1954, the resubmission level was 3%. *See id.*

72. *See* Virginia Harnisch, *Rule 14a-8 After Reagan: Does It Protect Social Responsibility Shareholder Proposals?*, 6 J.L. & POL'Y 415, 422 (1990) (commenting that "[d]uring the 1950's, generally a time of social and political contentment, shareholder proposals tended to focus on the proper form of corporate governance and not on the corporation's impact on society and public policy"); Ryan, *supra* note 17, at 116–17.

73. *See* Carolyn Mathiasen, *Changing Shareholder Rules Prompted IRRC's Start*, IRRC CORP. SOC. ISSUES REP., May 1997, at 10. Mathiasen explains:

> Some public interest lawyers formed a group called Campaign GM and filed a batch of shareholder proposals with social policy implications for General Motors' 1970 annual meeting. The group succeeded in getting enormous publicity for the proposals, and the SEC decided that GM would have to bring two of them to votes. The resolutions led to a highly unusual six and a half hour meeting attended by 3,000 people, during which there was lively discussion of the company's social responsibilities, including questions as to why it had no blacks or women on its board.

Id. For a detailed discussion of Campaign GM, the most widely cited social activist case, see Donald E. Schwartz, *The Public-Interest Proxy Contest: Reflections on Campaign GM*,

other social activists to use the Rule to advocate social reform.[74] Social activists also received support from *Medical Committee for Human Rights v. SEC*.[75] The *Medical Committee for Human Rights* decision championed shareholders' rights to exercise their voice in all matters of company policy.[76] Accordingly, in response to the political climate of the 1960s and 1970s, the 1972 pro-proponent amendments changed the Rule's verbose language — which excluded proposals with a primary purpose of promoting "general economic, political, racial, religious, social, or similar causes" — to a narrower standard excluding matters "not significantly related to the business of the issuer or not within its control."[77]

On the heels of these amendments, the SEC considered amending the ordinary business exclusion, which was enacted in 1954.[78] The SEC opined that, because issues of substantial importance to shareholders were being excluded under the ordinary business exclusion, the current Rule was not functioning consistently with the original intent that spawned Section 14(a).[79] After considering and rejecting two proposals, the SEC opted to slightly modify the ordinary business exclusion.[80] Accordingly, the amendment changed the language to what the Rule reflects today: "registrant may omit a proposal . . . if the proposal deals with a matter relating to the con-

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69 MICH. L. REV. 419 (1971). Also, see *Medical Comm. for Human Rights*, 432 F.2d at 680, concerning the production of napalm. It is important to remember the political climate surrounding this era, namely the Vietnam War and the Civil Rights Movement.

74. *See* Mathiasen, *supra* note 73, at 10.

75. 432 F.2d 659.

76. *See id.* at 680–81. The court stated:

> [T]he clear import of the language, legislative history, and record of administration of [S]ection 14(a) is that its overriding purpose is to assure to corporate shareholders the ability to exercise their right — some would say their duty — to control the important decisions which affect them in their capacity as stockholders and owners of the corporation.

Id.

77. Exchange Act Release No. 9784, 37 Fed. Reg. 23,178, 23,180 (1972). "An explanatory note to the amended Rule states that `proposals not within [an] issuer's control are those which are beyond its power to effectuate.'" Ryan, *supra* note 17, at 114 n.67 (citation omitted).

78. *See* Waite, *supra* note 62, at 1262.

79. *See id.*; Proposed Amendments to Rule 14a-8, Exchange Act Release No. 12,598, 41 Fed. Reg. 29,982, 29,984 (1976) [hereinafter Proposed 1976 Amendments].

80. *See* Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, 41 Fed. Reg. 52,994, 52,997–98 (1976) [hereinafter Adoption of 1976 Amendments]; Waite, *supra* note 62, at 1262–64 (discussing the different proposals in detail).

duct of the ordinary business operations of the registrant."[81] The SEC issued the 1976 Interpretive Release stating that, although the language had not changed significantly, for a proposal to be excluded under the ordinary business exclusion the proposal must "involve business matters that are mundane in nature and do not involve any substantial policy or other considerations."[82] The SEC also announced that future no-action letters would reflect this interpretation.[83]

Moreover, as a result of proponents submitting proposals that were excessive in either length or number, the SEC also enacted some housekeeping provisions in 1976,[84] and again in 1983.[85] The 1983 amendments required, among other things, that: (1) a shareholder have at least (the lesser of) one percent or $1000 share ownership for a one year minimum, held continuously through the meeting date; (2) each proponent be limited to one proposal; and (3) a proposal pass the current economic test,[86] if it was not significantly related to company business.[87] Because these amendments were the

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81. 17 C.F.R. § 240.14a-8(c)(7) (1998).

82. Adoption of 1976 Amendments, *supra* note 80, at 52,997–98; *see* Waite, *supra* note 62, at 1264.

83. *See* Waite, *supra* note 62, at 1264. This policy was indeed followed until 1992. *See infra* Part II.

84. *See* Adoption of 1976 Amendments, *supra* note 80, at 52,996. These amendments also restructured the exclusions into the format used today. *See id.* The 1976 amendments added the thirteenth exclusion — the current total of exclusions in the Rule — regarding the omission of proposals concerning dividends. *See id.* The amendments also limited proponents to two 300-word proposals each and advanced the date by which proposals had to be received by management to 90 days prior to the day the previous annual shareholders' meeting was held. *See* 17 C.F.R. § 240.14a-8.

85. *See* Liebeler, *supra* note 59, at 433–43 (discussing the climate surrounding the 1983 amendments in depth). Professor Liebeler notes that the SEC's unsuccessful alternatives proposed, on one hand, to allow issuers and shareholders to develop their own system for proposals and, on the other, to limit SEC involvement by essentially allowing all proposals except those not proper under state law and those related to director elections — thus, effectively passing the torch to state courts and legislatures. *See id.*

86. The current economic test requires that the proposal not "relate to operations which account for less than 5% of the registrant's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales for its most recent fiscal year." 17 C.F.R. § 240.14a-8(c)(5).

87. *See* Liebeler, *supra* note 59, at 435–36. Interestingly, Professor Ryan opined that these amendments were geared toward excluding the "`small stake' shareholder activists . . . [and] continue[d] a much older trend of trying to isolate and contain a particular type of shareholder proposal — calls for corporate action in light of social, political, or economic conditions." Ryan, *supra* note 17, at 116. Essentially, Professor Ryan

SEC's first attempt at establishing eligibility requirements for making a shareholder proposal, they caused a considerable controversy.[88] Commissioner Bevis Longstreth strongly dissented from these amendments, expressing that they unduly restricted shareholder access to the proxy mechanism.[89]

In summation, the Rule currently includes thirteen grounds for omission.[90] If a proposal meets all the eligibility requirements and

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suggests that these amendments targeted the social activist. *See id.*

88. *See* Harnisch, *supra* note 72, at 415 (arguing that the amendments were contrary to the legislative intent of Section 14(a), that the Rule was operating successfully before the amendments, and that the pro-company amendments were a result of President Reagan's influence); *see also* Marilyn B. Cane, *The Revised SEC Shareholder Proxy System: Attitudes, Results, and Perspectives*, 1985 J. CORP. L. 57; Leila N. Sadat Keeling, *The 1983 Amendments to Shareholder Proposal Rule 14a-8: A Retreat from Corporate Democracy?*, 59 TUL. L. REV. 161 (1984); Sean P. O'Brien, Note, *The 1983 Amendments to SEC Rule 14a-8: Upsetting a Precarious Balance*, 19 VAL. U. L. REV. 221 (1984).

89. *See* Exchange Act Release No. 34-20,091, 47 Fed. Reg. 47,420 (1982). Commissioner Longstreth stated:

> My dissent from the adoption of the proposed amendments rests upon a belief that these amendments, in the aggregate tilt significantly and unnecessarily against shareholders seeking access to the proxy machinery. The tilt, in my opinion, goes well beyond that which is necessary to deal with recognized abuses. I do not believe the active use of the proxy machinery by shareholders, is of itself, an abuse; therefore, I do not favor changes the effect of which will be to reduce that usage by responsible shareholders.

Id.

90. The 13 grounds for exclusion, found in section (c) of Rule 14a-8, are as follows:

> (1) if the proposal is, under the laws of the registrant's domicile, not a proper subject for action by security holders; (2) if the proposal, if implemented, would require the registrant to violate any state or federal law . . . ; (3) if the proposal or supporting statement is contrary to any of the Commission's proxy rules and regulations, including Rule 14a-9, which prohibits false or misleading statements in proxy soliciting materials; (4) if the proposal relates to the redress of a personal claim or grievance against the registrant or any other person . . . ; (5) if the proposal relates to operations which account for less than 5% of the registrant's total assets at the end of its most recent fiscal year, and for less than 5% of its net earnings and gross sales . . . and is not otherwise significantly related to the issuer's business; (6) if the proposal deals with a matter beyond the registrant's power to effectuate; (7) if the proposal deals with a matter relating to the conduct of the ordinary business operations of the registrant; (8) if the proposal relates to an election to office; (9) if the proposal is counter to a proposal to be submitted by the registrant at the meeting; (10) the proposal has been rendered moot; (11) if the proposal is substantially duplicative of a proposal previously submitted which will be included in the issuer's proxy material for the meeting; (12) if the proposal deals with the substantially same subject matter as a previously submitted proposal . . . and within the preceding five calendar years . . . if the proposal was submitted at only one meeting . . . received less than 3% of the total number of votes cast in regard thereto . . . if the proposal was submitted at only two meetings . . .

does not fall under one of these thirteen grounds for exclusion, then the proponent may include one 500-word proposal in the proxy materials.[91] The Rule then allows management to have the last say by permitting the company to include an unlimited rebuttal to the proposal in the proxy materials.[92] Thus, a shareholder proposal must essentially jump through four hoops[93] — a proposal must: (1) be a proper subject under state law;[94] (2) be significantly related to the company's business;[95] (3) not "relate to ordinary business operations" or must raise a significant social issue;[96] and (4) meet the Rule's procedural/housekeeping requirements.[97] These requirements mean that the proposal can neither be too remote as to be irrelevant nor too detailed as to be within the realm of ordinary business operations.[98] Or, as the *Medical Committee for Human Rights* court quipped, the format enables the Rule to operate as a "vehicle for corporate democracy rather than an all purpose forum for malcontented shareholders to vent their spleen about irrelevant matters."[99]

In 1992, the SEC revised other proxy rules that dramatically impacted the Rule.[100] The amendments essentially were designed to facilitate shareholder communication, especially between institu-

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> it received at the time of its second submission less than 6% of the total number of votes . . . or if the proposal was submitted at three or more meetings . . . it received less than 10% of the total number of votes cast in regard thereto; (13) if the proposal relates to specific amounts of cash or stock dividends.

17 C.F.R. § 240.14a-8(c) (1998).

91. *See id.*

92. *See id.* § 240.14a-8(e).

93. These reflect the "four concerns" espoused by Professor Ryan. *See* Ryan, *supra* note 17, at 119–20.

94. Phrasing the proposal in precatory language is the established solution to avoid this obstacle. *See* Auer v. Dressel, 118 N.E.2d 590 (N.Y. 1954); Release, *supra* note 4, at **148–49 (proposed note to paragraph (i)(1)).

95. *See* 17 C.F.R. § 240.14a-8(c)(4)–(6).

96. At this time, the latter clause does not "save" employment-related proposals — which is the primary concern of this Comment and an area of reform proposed by the SEC. *See infra* Parts II, IV.

97. *See* 17 C.F.R. § 240.14a-8(a)(1)–(4).

98. *See Medical Comm. for Human Rights*, 432 F.2d at 679.

99. *Id.* at 678.

100. *See* CARY & EISENBERG, *supra* note 70, at 231–32 (referring to Exchange Act Release No. 34–31326, 57 Fed. Reg. 48276 (1992)); *see also* Michael J. Connell, *Shareholder Proposals*, *in* 970 PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1997, at 397, 400 (PLI Corporate Law and Practice Handbook Series No. B4-7173, 1997).

tional shareholders.[101] The most significant change was the addition of a "safe harbor" provision that excludes shareholder communications "that did not solicit proxy voting authority and that were sent by persons who had no material economic interest in the solicitation (other than their interest as shareholders)" from the definition of solicitation.[102] Before this enactment, such communication would have been included under the SEC's broad definition of solicitation.[103] Accordingly, this change provides a proponent shareholder with a significant advantage because, if a communication is deemed a solicitation, then the shareholder is required to comply with Rule 14a-3.[104] Rule 14a-3 requires that the soliciting shareholder provide the solicited individual with a "publicly filed preliminary or definitive proxy statement."[105] The cost of preparing such a statement serves as a deterrent to many shareholders.[106] According to Professor John Coffee, "This safe harbor was intended and expected to encourage and permit broad communication among shareholder activists and institutional investors."[107] Other 1992 amendments included relaxed proxy statement delivery and advertisement re-

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101. *See* CARY & EISENBERG, *supra* note 70, at 231 (citing John C. Coffee, *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837, 840–41 n.17 (1994)).

102. *Id.* This "safe harbor" is currently Rule 14a-2(b)(1). The rule states:

> Rules 14a-3 to 14a-6 (other than Rule 14a-6(g)), 14a-8, and 14a-10 to 14a-14 do not apply to the following: (1) Any solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization. *Provided, however,* that the exemption set forth in this paragraph shall not apply to . . . [ten listed exceptions to the safe harbor provision].

17 C.F.R. § 240.14a-2(b)(1) (1998) (emphasis added).

103. *See id.* Rule 14a-1(*l*)(iii) defines "the terms `solicit' and `solicitation' [to] include: . . . (iii) the furnishing of a form of proxy *or other communication* to security holders under circumstances *reasonably calculated* to result in the procurement, withholding or revocation of a proxy." *Id.* § 240.14a-1(*l*)(iii) (emphasis added).

104. *See id.* § 240.14a-3.

105. *Id*.

106. Reform of this Rule has decreased costs. *See* Coffee, *supra* note 101, at 840–41. United Shareholders Association reported that prior to the changes, corresponding with a company's top 1000 shareholders would cost $1 million to prepare and distribute a complete proxy statement. *See id.* After the amendment, targeting the same shareholders would only cost $5000 to $10,000. *See id.*

107. CARY & EISENBERG, *supra* note 70, at 231 (quoting Coffee, *supra* note 101, at 840–41 n.17).

quirements.[108]

The SEC administers these rules through the no-action process.[109] If management wishes to exclude a proposal from the proxy statement, they can request a no-action letter from the SEC.[110] A no-action letter is an SEC staff letter expressing that the SEC will not pursue action against the company if the proposal is omitted. The Rule requires that, eighty days prior to the filing of the proxy materials, management must provide: (1) the proposal; (2) the proponent's supporting statements; (3) a statement detailing why omission is proper; and (4) a supporting statement from an attorney if reasons are based on a point of law and notification of intended omission to the proponent.[111] Management carries the burden of proving that the proposal is not "proper" for inclusion in the proxy materials.[112]

A response from the SEC is not required before the company sends out proxy materials omitting the proposal; however, the SEC must be notified beforehand.[113] The Commission has discretion to review any staff decision.[114] However, neither proponents nor management have the right to Commission review,[115] and thus the Commission has discretion to decline review.[116] Further, not every request for a no-action letter receives a response from the SEC.[117]

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108. *See id.*

109. *See* 17 C.F.R. § 240.14a-8(d).

110. *See id.*

111. *See id.* This section is completely phrased in mandatory language. *See id.* Further, the requirements of this section must be complied with "not later than 20 days prior to the date the preliminary copies of the proxy statement are filed." *Id.* This provision was enacted "so that the Commission will have more time to consider the problems involved in such cases and the security holder will have an opportunity to consider the management's position and take such action as may be appropriate." Adoption of 1954 Amendments, *supra* note 69, at **3–5.

112. *See* Adoption of 1954 Amendments, *supra* note 69, at **3–5.

113. *See* Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholders Proposals, Exchange Act Release No. 12,599, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,635, at 86,602, 86,605 (July 7, 1976) [hereinafter Informal Procedures Release]; *see also* Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 883 (S.D.N.Y. 1993).

114. *See Medical Comm. for Human Rights*, 432 F.2d at 674.

115. *See id.*

116. *See Amalgamated Clothing & Textile Workers Union*, 821 F. Supp. at 885 n.8; Informal Procedures Release, *supra* note 113, at 86,605–06.

117. *See* New York City Employees' Retirement Sys. v. SEC, 843 F. Supp. 858, 863 n.4 (S.D.N.Y. 1994), *rev'd on other grounds*, 45 F.3d 7 (2d Cir. 1995). As explained by the SEC, the primary purpose for review and comment of shareholder proposals is to

C. Reasons for the Rule and Its Importance

Before discussing the Rule's merits and criticisms, it is important to understand the Rule's purpose as well as its reality. As reflected by the discussion of the Rule's intent and legislative history, "its overriding purpose is to assure to corporate shareholders the ability to exercise their right — or some would say their duty — to control the important decisions which affect them in their capacity as stockholders and owners of the corporation."[118] It is state law that confers this right to shareholders, but it is the Rule that ensures this right "in the face of the practical impediments of proxy voting in public corporations."[119]

In the 1996 proxy season, only 108 social policy proposals were put to a vote.[120] In fact, only a few companies receive these proposals each year.[121] Frequently, shareholder proposals receive only minimal support.[122] Moreover, shareholder proposals are usually phrased in advisory language; therefore, even on the rare occasion when a proposal is successful, it is not always binding. So, why the big debate? As explained by Professor Patrick Ryan,[123] the Rule facilitates

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mitigate the likelihood of needless litigation between companies and the SEC, and to foster compliance with the proxy rules. *See id.* (quoting Informal Procedures Release, *supra* note 113, at 86,602–03). No-action letters issued by the SEC have dramatically shaped the conduct of all parties involved in the process. Years of the SEC expressing its enforcement position, through no-action letters, has resulted in parties conforming their actions to the understanding of the securities laws as espoused by the SEC. *See id.* Cracker Barrel has adversely affected the confidence in this procedure. *See infra* Part II.

118. *Medical Comm. for Human Rights*, 432 F.2d at 680–81; *see also* SEC v. Transamerica Corp., 163 F.2d 511, 517 (3d Cir. 1947) (stating that "[a] corporation is run for the benefit of its stockholders and not for that of its managers").

119. Palmiter, *supra* note 53, at 894 (commenting that "[s]tate corporate law uniformly permits shareholders to offer resolutions at shareholder's meetings and to amend the corporate bylaws").

120. *See* Carolyn Mathiasen, IRRC CORP. SOC. ISSUES REP., June–July 1996, at 10, 11.

121. *See* Nell Minow, *Comment Letter to the Commissioners and Staff* (visited Dec. 3, 1997) <http://www.sec.gov/rules/proposed/s72597/minor1.txt>. Admittedly, "household name companies" receive more, but only a few companies receive more than one or two. *Id.*

122. In the 1996 proxy season, board diversity proposals averaged 11.3% supporting vote, equal employment proposals 10%, workplace issues proposals 7.5%, and Northern Ireland (MacBride principles) proposals 13.2%. *See* Mathiasen, *supra* note 120, at 11. Social issue proposals overall received a 7.6% vote. *See id*. The aforementioned numbers do not include proposals that were management supported. *See id.*

123. Professor Patrick J. Ryan is an Associate Professor at Rutgers Law School,

disagreement because the very essence of the Rule is to allow shareholders to voice their opinions, which may be contrary to management's policies.[124] Thus, this airing of divergent views is not well-received by management and is generally considered threatening.[125] Many corporate governance proposals accent more accountability to shareholders and less insulation for company executives and directors.[126] Also, discussion of the Rule generally transcends into more controversial topics, such as the corporation's role in society, social activism, and deregulation.[127] These issues generate debate on their own accord, and the Rule often serves as the fulcrum.

Those who favor shareholder proposals argue that the Rule: (1) abates the collective action and freerider problems; (2) achieves social policy accomplishments; (3) improves management decision-making by utilizing shareholder consultation; and (4) enhances "corporate democracy"[128] and disclosure. Professor Alan Palmiter espouses that the Rule's benefit flows from its allowance of collective

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Camden, New Jersey. He received his B.A. in 1976 from Loyola Marymount University, his M.A. in 1977 and J.D. in 1980 from Loyola Law School, Los Angeles, and his LL.M. in 1987 from Columbia University. He was a Wien Fellow and Associate in Law during 1984–86.

124. *See* Ryan, *supra* note 17, at 99. The California Public Employees' Retirement System (CalPERS) has a well publicized strategy of annually naming "a `dirty dozen' corporate managements with the worst governance records." John C. Coffee, Jr., *The Folklore of Investor Capitalism*, 95 MICH. L. REV. 1970, 1977 (1997) (reviewing MICHAEL USEEM, INVESTOR CAPITALISM: HOW MONEY MANAGERS ARE CHANGING THE FACE OF CORPORATE AMERICA (1996)). Coffee explained that "such a strategy works to a degree; a corporate management no more wants to be on Cal[PERS]' list (thereby grouped with Archer Daniels Midland and the other poster boys of corporate governance) than it wishes to be subject to a Mike Wallace-style expose on *Sixty Minutes*." *Id.*

125. *See* Ryan, *supra* note 17, at 99 n.9 (stating that "[m]ost corporate control groups attempt to manage by achieving consensus without discord"); Rachel Witmer, *Shareholder Proposals: Jesse Jackson Joins Shareholders' Groups Spurning SEC's Shareholder Proposal Plan*, BNA CORP. COUNSEL DAILY, Oct. 30, 1997, at 4, 5 (noting that "Nell Minow of LENS . . . explained that even though it is in a company's financial interest to deal with diversity, environmental, child labor and other issues through the shareholder proposal process, `[c]orporations try to cut off questions, try to cut off embarrassment'").

126. *See* Witmer, *supra* note 125, at 5 (explaining that "[m]any corporate leaders . . . choose to maintain their `personal comfort' by trying to block out controversial shareholder proposals, rather than to place the interests of the company first by giving such proposals a forum").

127. *See* Ryan, *supra* note 17, at 103.

128. See *infra* notes 150–60 and accompanying text for definitions and discussion of this nebulous term.

action to prevent freerider problems.[129] These problems are inherent in the company-controlled proxy system because state law requires a majority vote for most corporate action.[130] Therefore, shareholders must act collectively through the proxy machinery to effectuate most change. If an individual shareholder "identifies a value-producing corporate change [she] must initially bear all of the costs of developing the idea, communicating it to other shareholders, and soliciting their proxies for the change."[131] However, the shareholder will only receive benefits in proportion to her ownership. This is the freerider problem — one shareholder does all the work and pays all the expenses, while the other shareholders receive the same proportional benefit at no cost.[132] Moreover, if the shareholder is unsuccessful, she alone bears the costs.[133]

Professor Palmiter stated that this situation is further aggravated by "[t]he natural tendency . . . to assume that the proponent, a self-appointed representative of shareholder interests, has a personal agenda and that if the proposed reform were in the corporation's best interests management would already have initiated it."[134] Therefore, most shareholders automatically vote with management, without giving the issues much thought. Even the most meritorious proposal has little chance of passing without management support.[135] Rule 14a-8 alleviates some of these constraints by making meaningful reform practical for both institutional and individual investors.[136]

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129. *See* Palmiter, *supra* note 53, at 895–96.

130. *See id.; see also, e.g.*, FLA. STAT. ch. 607.0725 (1998).

131. Palmiter, *supra* note 53, at 895–96.

132. *See id.* at 896.

133. *See id.* Reimbursement of expenses usually occurs only if the reformer obtains control of the board of directors. *See generally* Rosenfeld v. Fairchild Engine & Airplane Corp., 128 N.E.2d 291, 292–93 (N.Y. 1955) (holding that, in policy contests, corporate funds may be used to pay reasonable expenses incurred in a proxy fight by incumbent directors acting in good faith, as well as by successful insurgents where — after gaining power — such groups receive ratification by stockholders for reimbursement of such expenses).

134. Palmiter, *supra* note 53, at 896. Most shareholders are not very interested in reforming the companies in which they own shares; thus, they make little effort to determine if non-management proposals are meritorious. *See id.*

135. *See id.*

136. Some argue that institutional investors do not have the freerider impediments; however, this analysis is flawed. *See* Dent, *supra* note 39, at 822; Palmiter, *supra* note 53, at 896. Institutional holdings are fairly widely dispersed and fund managers have a fiduciary duty to maximize the value of these holdings. *See* Coffee, *supra* note 101, at

Rule proponents also argue the Rule's accomplishments provide further support.[137] Early shareholder activism by pioneer reformer Lewis D. Gilbert resulted in companies implementing more uniform financial accounting and more liberal dividend policies.[138] Although Gilbert's ideas were unheard of in his time, they are now espoused by modern economists.[139] More recently, as explained by Professor Palmiter:

> [P]roponents urged a number of reforms, such as the spinoff by AT&T (well before Judge Green did AT&T shareholders the favor), the composition of the board compensation and nominating committees to include outside directors (well before the practice became commonplace), and clearer and more complete disclosure of executive compensation (well before the SEC took up the issue).[140]

Proposals also helped lead to disinvestment in South Africa and broader representation on the board of directors at GM.[141] Further, proponents have negotiated a significant amount of concessions with management in exchange for withdrawing proposals. For instance, Professor Marleen O'Connor explains that "General Motors recently reacted to shareholder criticism of low wages paid to employees in Mexico by building homes for those workers."[142] These concessions are often reached in the hope of alleviating political pressures before they result in increased regulation.[143] In fact, "[t]he extent to which

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843–44. Therefore, the freerider problem is very much a reality and a deterrent to even the largest of investors. *See id.*

137. This support is usually given in response to the criticism that the Rule is wasted by "gadflies" and their social causes. *See supra* note 53 and accompanying text.

138. *See* Palmiter, *supra* note 53, at 897; *see also* Liebeler, *supra* note 59, at 459–60; Ryan, *supra* note 17, at 117 n.77 (detailing Gilbert's history in shareholder activism). Ryan attributes modern day activism tactics to Gilbert: "His tactics — small holdings in a large number of corporations and dogged persistence in confronting management over matters of corporate policy — established much of the pattern for activism." *Id*.

139. *See* Palmiter, *supra* note 53, at 897.

140. *Id.* at 897–98 (citing Sonitrol, Inc. v. AT&T, 629 F. Supp. 1089 (D.D.C. 1986); Chevron Corp., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 141 (Jan. 23, 1988); Spencer Co., SEC No-Action Letter, 1981 SEC No-Act. LEXIS 4020 (Sept. 3, 1981)).

141. *See* Donald E. Schwartz & Elliot J. Weiss, *An Assessment of the SEC Shareholder Proposal Rule*, 65 GEO. L.J. 635, 643 (1977) (stating that minority shareholders aided the disinvestment of South Africa). For a discussion of Campaign GM, see Schwartz, *supra* note 73 and accompanying text.

142. O'Connor, *supra* note 16, at 15.

143. *See id.*

[social activists'] demands addressed to the corporation anticipate the substance of subsequent government regulations is indeed striking."[144]

Professor Ryan advances yet another reason for supporting the Rule by urging that the Rule's importance lies in its use as "shareholder consultation."[145] Various benefits flow from this shareholder consultation theory. First, shareholder proposals not only alert management to shareholder expectations, but are also more easily interpreted and harder to miss than stock price fluctuations.[146] If management fails to heed these warnings and follow a different path, then shareholders can respond by refusing to elect directors chosen by management.[147] Second, the process may improve decision-making because responding to a shareholder proposal forces management to articulate a response to the issues raised.[148] This may, in turn, improve management decisions overall by making the company think in the long-term — aware that it may later be required to explain the reasons for pursuing a certain course of action. Lastly, shareholder consultation legitimizes management decisions.[149]

Further, some supporters argue that the Rule fosters "corporate democracy."[150] This is a debatable term in itself with a myriad of

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144. *Id.* at n.65 (quoting DAVID VOGEL, LOBBYING THE CORPORATION (1978)).

145. *See* Ryan, *supra* note 17, at 111–12.

146. *See id.* at 112.

147. *See id.* Professor Ryan cites the famous case of *Auer v. Dressel*, 118 N.E.2d 590, 593–94 (N.Y. 1954), to support this view of "shareholder advice." *See* Ryan, *supra* note 17, at 112 n.54.

148. *See id.* Professor Liebeler argues that the same results of this theory are currently accomplished through other market forces, such as job and market competition. *See* Liebeler, *supra* note 59, at 447. Further, she argues that if information provided through proposals was so valuable, management would encourage proposals. *See id.* at 449. However, this logic is flawed because most proposals express views contrary to management and many governance proposals aim to reduce management's insulation. Therefore, it is not likely that management will encourage these proposals even if the proposal is valuable and profit-maximizing.

149. *See* Ryan, *supra* note 17, at 112. Professor Ryan views this as the most controversial benefit under this theory. *See id*.

150. *See Medical Comm. for Human Rights*, 432 F.2d at 678–79; Address by SEC Commissioner Bevis Longstreth before the National Association of Manufacturers, *reprinted in* [1980–1983 Transfer Binder] Mut. Funds Guide (CCH) ¶ 11,348 (Dec. 11, 1981); Schwartz & Weiss, *supra* note 141, at 635; Wallman, *supra* note 15, at 420. *But see* Liebeler, *supra* note 59, at 447. Professor Liebeler argues:

> Stockholder participatory democracy is a myth; investors do not buy stock in public companies with any serious expectation of influencing management. The Wall Street Rule is the only practical Rule by which sensible investors are gov-

meanings attributed to it.[151] A few critics argue that use of such a term impedes rather than facilitates meaningful discussion of the Rule.[152] Despite the fact that the term is nebulous, it is still used today to discuss the ideals behind the Rule.[153]

Inevitably, any discussion of corporate democracy begins with Berle and Means, who championed the notion of increased shareholder participation.[154] Berle and Means advocated that, without shareholder involvement, an unwatched management will not act in the best interests of the shareholders or economic efficiency.[155] Accordingly, supporters under this theory claim that by enabling shareholders to communicate with each other without incurring significant expenses, the Rule encourages increased shareholder participation.[156]

The corporate democracy concept has also been argued as the response to society's concern over "Big Business."[157] Shareholder

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> erned. Small investors who do not like management sell their shares. This response does not mean that management is undisciplined or uncontrolled. Market forces — such as competition for capital, products, jobs, and corporate control — discipline the management of widely held firms.

Id. (citation omitted).

151. The meaning of this term depends on its user. In some instances, corporate democracy is equated to an increased shareholder voice and accountability to shareholders. *See* Palmiter, *supra* note 53, at 900. In others, it may mean increased social responsibility by the company. *See id.* For even more possible definitions of the term, see Ryan, *supra* note 17, at 102, mentioning that "[t]he term could be a metaphorical description of shareholder activity uncritically applied to the corporate form because both citizens and shareholders exercise voting rights."

152. *See* Dent, *supra* note 39, at 818.

153. Although Professor Palmiter argues that the "corporate democracy" rationale was a phase that has long since passed, this rationale is still commonly used today. *See, e.g.*, *Medical Comm. for Human Rights*, 432 F.2d at 676 (stating that Section 14 gives "true vitality to the concept of corporate democracy"); New York City Employees' Retirement Sys. v. American Brands, Inc., 634 F. Supp. 1382, 1386 (S.D.N.Y. 1986) (stating that the shareholder proposal Rule "is imposed to encourage shareholder democracy"); Lazaroff, *supra* note 19, at 2 (Professor Lazaroff uses this term throughout his article); Wallman, *supra* note 15, at 420 (Former Commissioner Wallman used this term frequently throughout his speech).

154. The corporate democracy concept is usually accredited to the work of Berle and Means. *See* Ryan, *supra* note 17, at 102 n.17 (citing ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1933)).

155. *See* George W. Dent, Jr., *Toward Unifying Ownership and Control in the Public Corporation*, 1989 WIS. L. REV. 881, 882; Liebeler, *supra* note 59, at 444.

156. *See* Liebeler, *supra* note 59, at 444. This is particularly significant considering that most ownership of large publicly held companies is so widely dispersed that other methods of communication are impracticable.

157. *See* Ryan, *supra* note 17, at 168–69 (elucidating that "'[c]orporate democracy'

proposals provide individuals with a more secure feeling regarding the role that ever-growing corporations play in society because they know that, by knowingly owning shares, they are entitled to a voice in the company and a share of the profits.[158] Thus, the term "corporate democracy" emerged in an attempt to "describe and legitimate corporations by reference to self-understandings fundamental to United States culture."[159] Supporters argue that the Rule is further legitimated because it fosters debate over social and economic issues — thereby strengthening shareholder voice in the company.[160]

Still others, including Professor Ryan, feel that institutional use of the Rule justifies its existence.[161] As argued by Professor Ryan, "the Rule has been vindicated by recent institutional investor use of the shareholder proposal process to exert influence over internal corporate affairs,"[162] to combat the frequent argument that the Rule is a waste of time because the proposals are advisory and are rarely successful even as advisory opinions.[163] Professor George Dent[164] also agreed with this use of the Rule because, "[u]nlike most traditional proposals, institutional proposals deal with matters of unquestioned importance to shareholders and attract very substantial shareholder support."[165]

Finally, the Rule's enhanced disclosure requirements further

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also was offered as an ideological answer to Soviet criticisms of the capitalist democracies during the Cold War").

158. *See id.* at 169–70.

159. *Id.* at 170. No argument for the proposal Rule better highlights how debate over the Rule can be eclipsed by broader issues than the "corporate democracy" debate. This debate shows how discussion of the Rule can turn to controversial concepts of the corporation's role in society and the shareholders' role in the corporation. See Ryan, *supra* note 17, at 164–84, for a lucid discussion of the various corporate models and shareholder roles.

160. *See* Lazaroff, *supra* note 19, at 78–85.

161. *See* Ryan, *supra* note 17, at 103–04.

162. *Id*. "An institutional investor is a mutual fund, pension fund, or an insurance company." *Id.* at 103 n.24. Professor Ryan's reference to recent use focuses primarily on the institutional shareholder proposals concerning anti-takeover measures. *See id.*

163. *See infra* note 171 and accompanying text. In this context, "successful" means that the proposals received enough shareholder votes to pass. However, because this rarely occurs, proponents have changed "success" to mean that the proposal received enough support to qualify for resubmission. *See infra* notes 171, 284 and accompanying text.

164. Professor George W. Dent, Jr. is a Professor of Law at New York Law School. He received his B.A. in 1969, his J.D. in 1973 from Columbia University, and his LL.M. in 1981 from New York University.

165. Dent, *supra* note 39, at 821.

justify its existence.[166] The SEC originally proffered this as a basis for the Rule's enactment.[167] The SEC believed that a proxy solicitation was inherently misleading if it failed to disclose a shareholder proposal that management knew was going to be offered at the annual meeting.[168] However, Professor Dent argued that this justification for the Rule is flawed.[169] He reasoned that since Rule 14a-9 only prohibits statements in the proxy statement that are "false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading,"[170] and since most shareholder proposals receive only a small percentage of votes, shareholder proposals are immaterial.[171] Thus, according to Professor Dent, excluding shareholder proposals is not excluding a material fact.[172]

Even if this standard is applied, the SEC felt simply that the act of soliciting proxies, without informing shareholders that other proposals would be presented, was inherently misleading — regardless of the support these proposals would muster.[173] Further, if only one proposal out of many receives enough votes to pass, this should be enough under the Rule 14a-9 standard to require disclosure of all potentially "material" proposals. Moreover, Professor Dent contradicted himself when he justified the Rule's use under this very same rationale for proposals by institutional shareholders.[174] Professor Dent proposed limiting access to the proxy machinery to only institutional investors.[175]

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166. *See* Lazaroff, *supra* note 19, at 85 (stating that the Rule provides "shareholders an economically realistic method by which to inform other shareholders of their concerns regarding the manner in which a corporation conducts its business activities").

167. *See id.*; Dent, *supra* note 39, at 819.

168. *See supra* note 39 and accompanying text.

169. *See* Dent, *supra* note 39, at 819 (rebutting the argument that disclosure serves as justification for the Rule).

170. *Id.; see* 17 C.F.R. § 240.14a-9 (1998).

171. *See* Dent, *supra* note 39, at 819.

172. *See id.*

173. *See supra* note 39 and accompanying text.

174. *See* Dent, *supra* note 39, at 821. Professor Dent felt that the disclosure rationale here would be appropriate because many institutional shareholder proposals are supported. *See id*. He based this explanation on the support received for proposals to repeal anti-takeover devices (known as shark repellants). *See id.*

175. *See id.* at 822–24. Professor Dent proposed eliminating many bases for exclusion and implementing a bond requirement. *See id*. at 823. The bond would have to cover expenses incurred in the proposal's submission. *See id*. If the proposal receives enough support, possibly 20%, then the bond would be returned. *See id.*

D. Reasons Against the Rule and Other Criticisms

Many concede that corporate governance proposals, or proposals that directly maximize shareholder value, are worthwhile endeavors.[176] But, once discussion crosses to the realm of social proposals, critics argue that the Rule should not jettison the proxy machinery into a bully-pit for political debate. These critics argue that, since these proposals rarely receive enough votes to pass, the Rule must either "be an illegal extension of the SEC's Rulemaking power, a stupid imposition of regulatory costs for the benefit of habitual self-publicists, or both."[177] Thus, criticism of the Rule generally includes arguments that: (1) the Rule exceeds the SEC's rulemaking authority; (2) the Rule's costs outweigh its benefits; or (3) the Rule offers no benefits.[178]

Professor Susan Liebeler[179] argues that the Rule is an illegal extension of the SEC's authority granted by Congress under Section 14(a).[180] This argument posits that state law controls the relationship between shareholders and directors, including voting rights and the right to have proxy expenses reimbursed.[181] Shareholder proposals are simply proxy solicitations included in the company's proxy materials.[182] Therefore, for the SEC to usurp this state power, Congress must have explicitly provided for it. Professor Liebeler argues that this authority must be explicitly granted due to the Supreme Court's historic unwillingness to preempt state law without express authority from Congress.[183] However, Professor Ryan argues that

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176. *See* Release, *supra* note 4, at **135–37.

177. *See* Liebeler, *supra* note 59, at 443; Palmiter, *supra* note 53, at 901.

178. *See* Liebeler, *supra* note 59, at 466. Professor Liebeler chided that "the benefits of the Rule are grounded in rhetoric, not in reason, and are, in all probability nonexistent." *Id.*

179. Professor Susan W. Liebeler is a Professor of Law at Loyola Law School. She received her B.A. in 1963 from University of Michigan and her LL.B. in 1966 from UCLA. She served as Special Counsel to the SEC during the 1981–82 academic year.

180. *See* Liebeler, *supra* note 59, at 457–59.

181. *See id.* This argument is based in part on *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 128 N.E.2d 291 (N.Y. 1955). In this bellwether case on the right to have proxy expenses reimbursed, the court held that reasonable expenses could be reimbursed if approved by both the shareholders and directors, as long as a policy issue was in dispute. *See* Liebeler, *supra* note 59, at 458.

182. *See* Liebeler, *supra* note 59, at 458.

183. *See id.* Further support comes from Professor Loss, who stated: "[S]o revolutionary a federal intervention would presumably have been more clearly expressed." *Id.*

since Congress has had over fifty years to rectify this overreaching by the SEC and has chosen not to do so, the authority under Section 14(a) should be implicitly ratified.[184]

Criticism of the Rule also inevitably includes a discussion of the costs involved.[185] However, the costs have never truly been assessed.[186] The recent proposed amendments to the Rule published by the SEC included a cost analysis section.[187] In response to an SEC questionnaire inquiring into the cost of including a shareholder proposal in a proxy statement (for printing, additional postage, tabulation, and any other directly related expenses), companies reported costs varying dramatically from $200 to $900,000, with a median of $10,000.[188] In this same questionnaire, companies were also asked the amount spent on considering proposals and applying the procedures to exclude proposals (including legal expenses and other directly related expenses).[189] Companies reported costs from $10 to $1,200,000, again with a median of $10,000.[190] The 1997 Release publishing the proposed amendments to Rule 14a-8 (the Release) added that companies can save money by not seeking to exclude proposals because the SEC does not require a filing unless a proposal is going to be omitted.[191] However, considering that over 5412 Section 12 companies currently exist, these numbers cannot be considered true and accurate representations of the costs involved in the shareholder proposal process.[192] Therefore, a true cost analysis

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at 458–59 n.169 (citing 2 LOUIS LOSS, SECURITIES REGULATION 908 (2d ed. 1961)).

184. *See* Ryan, *supra* note 17, at 123 n.96. For a thorough analysis rebutting this argument by delving deep into the legislative history of Section 14(a), see *id.* at 122–46 (concluding that "the history shows that both proponents and opponents of the bill seemed to understand that the proposed proxy regulation power . . . would work significant changes in shareholder-management relationship in those public corporations made subject to the Exchange Act by their voluntary decision to seek public funds").

185. *See* Liebeler, *supra* note 59, at 454; Henry G. Manne, *Shareholder Social Proposals Viewed by an Opponent*, 24 STAN. L. REV. 481, 490–93 (1972).

186. *See* Liebeler, *supra* note 59, at 466 (admitting that "[t]he costs are unknown").

187. *See* Release, *supra* note 4, at **100–03.

188. *See id*. at *100 n.123. The questionnaire did not specify whether this figure represented one proposal or more. *See id.*

189. *See id*. at *100. Consideration of a proposal means determining whether to omit the proposal. *See id.*

190. *See id*. at *101 n.124. These figures represent only companies that reported an amount exceeding zero. *See id.*

191. *See id.* at *100.

192. *See NASDAQ Statistics* (visited June 16, 1998) <http://www.academic.nasdaq.com/mr3a.html>. This number represents only the current number of NASDAQ listed

of the Rule cannot be based on sixty-seven self-appointed companies.

Professor Liebeler took her argument even further, stating that the more damaging costs are those stemming from "the unrealistic concepts of corporate social responsibility and corporate governance which the Rule fosters."[193] Accordingly, these concepts will then misdirect management to pursue loftier social goals — resulting in bankruptcy, price-fixing, or a change in management.[194] However, this argument mistakenly assumes that all proposals are social proposals, and that all social proposals are contrary to profit maximization. First, many proposals are corporate governance proposals and have proven profit-maximizing effects.[195] Second, many social proposals have a positive effect on long-term profitability. For instance, board diversification and equal employment programs help bring a broader pool of knowledge to the company and may avoid costly future litigation. Moreover, this argument fails to consider that, in today's society, many individuals are more socially conscious and choose to invest and purchase based on social values. For example, "green funds" provide an opportunity for individuals to invest in environmentally conscious companies.[196]

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companies. *See id*. There are significantly more Section 12 companies considering that this number does not account for any of the other listed exchanges or those companies not listed but still subject to Section 12. Only companies registered under Section 12 are governed by Section 14 of the Exchange Act. Section 12 provides:

> An issuer shall be exempt from the requirement to register any class of equity securities pursuant to section 12(g)(1) if on the last day of its most recent fiscal year the issuer had total assets not exceeding $10 million and, with respect to a foreign private issuer, such securities were not quoted in an automated inter-dealer quotation system.

17 C.F.R. § 240.12g-1 (1998).

193. Liebeler, *supra* note 59, at 454. Professor Liebeler moved to this argument after acknowledging that empirical cost data on the Rule is lacking. *See id.*

194. *See id.* at 455 (citing Judge Richard Posner for the results of pursuing social goals over profit).

195. *See supra* Part I.C.

196. "Green funds" are mutual funds that invest in primarily environmentally conscious companies. *See Green Funds Offer Way to Invest While Being Socially Responsible*, TAMPA TRIB., Jan. 16, 1996, at 7 (Bus. & Fin.), *available in* LEXIS, Nexis Library, Curnws File; Ricardo Sandoval, *Just How "Green" Are the Green Funds?*, CHI. TRIB., Jan. 22, 1996, at 3C, *available in* 1996 WL 2636330. One publication reports that over $1 trillion in assets managed in the U.S. are in "socially and environmentally responsible" portfolios. *See Business and the Economy Investing: Green Funds Cross $1 Trillion Mark*, AM. POL. NETWORK GREENWIRE, Nov. 17, 1997, *available in* WL ALLNEWS Database. Further, approximately $1.19 trillion is currently invested in "green" assets by 710 institutional investors. *See id.* From 1995 to 1997, total assets invested in socially-

E. The Ordinary Business Operations Exclusion

As discussed above, the ordinary business operations exclusion was first enacted in the 1954 amendments, which clarified the general notion that state law determined whether a proposal is a proper subject for state action.[197] The Rule as originally promulgated read that a company could omit a proposal "which is a recommendation or request with respect to the conduct of the ordinary business operations of the issuer."[198] The Rule's history clearly shows that Congress intended to relieve management from including proposals concerning matters that should be properly left to management.[199] However, in 1976, the SEC became concerned that the Rule was not functioning "completely in accord with the purposes for which Section 14(a) of the Exchange Act was enacted," and thus the SEC proposed changes to this exclusion.[200] The SEC considered two alternatives,[201] but chose not to use either of them.[202] Instead, the SEC

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screened portfolios has increased by 227%. *See id.*

197. *See Medical Comm. for Human Rights,* 432 F.2d at 678 (quoting *Hearings on SEC Enforcement Problems Before a Subcomm. of the Senate Comm. on Banking and Currency,* 85th Cong. 118 (1957) (stating that "[w]hile Rule X-14A-8 does not require that the ordinary business operations be determined on the basis of state law, the premise of Rule X-14A-8 is that the propriety of . . . proposals for the inclusion in the proxy statement is to be determined in general by the law of the State of incorporation . . . . Consistency with this premise requires that the phrase `ordinary business operations' in Rule X-14A-8 have the meaning attributed to it under applicable state law. To hold otherwise would be to introduce into the Rule the possibility of endless and narrow interpretations based on no ascertainable standards.")); *supra* notes 69–71.

198. Waite, *supra* note 62, at 1262 (citing Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4979, [1952–1956 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,267 (1954)).

199. *See id.* (citing Notice of Proposed Amendments to Proxy Rules, Exchange Act Release No. 4950, 18 Fed. Reg. 6646 (Oct. 9, 1953) (commenting that "[i]n order to relieve management of the necessity of including in its proxy material security holder proposals which relate to matters falling within the province of the management")).

200. *Id.* at 1262–63 & n.59; Proposed 1976 Amendments, *supra* note 79, at 29,984.

201. *See* Proposed 1976 Amendments, *supra* note 79, at 29,984. The SEC proposed two different changes to the ordinary business operations exclusion. For a complete discussion of these two alternatives, see Waite, *supra* note 62, at 1262–63.

202. *See* Waite, *supra* note 62, at 1263–64 (explaining that "[t]he reasons the Commission gave for not adopting the First 1976 Proposal or the Second 1976 Proposal were that (i) the difficulties caused by the proposed standards would outweigh any benefits either would provide, (ii) the standard in effect already was workable if interpreted in a more flexible manner, and (iii) no reasonable means were apparent to distinguish between routine and important business matters").

slightly modified the language of the Rule and announced a change in the way the Rule would be applied.[203] The 1976 Release redefined the business operations exclusion to embody a two-part test.[204] After this change in interpretation,[205] for a company to exclude a proposal under this Rule, the proposal must (1) "involve business matters that are mundane in nature," and (2) must "not involve any substantial policy or other considerations."[206] This began a highly criticized era of line-drawing for the SEC.[207] The line had to be drawn between what qualified as a substantial policy issue and what did not.

The SEC identified these distinctions primarily through the use of no-action letters.[208] However, this system has caused uncertainty for both shareholders and companies.[209] To compound the situation, throughout the years the SEC frequently reversed itself on what it considered a substantial policy issue. For example, SEC staff previously determined that proposals relating to plant closings,[210] execu-

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203. *See id.* at 1264 (citing Adoption of 1976 Amendments, *supra* note 80, at 52,998). The language was changed to read that a company may exclude a proposal if it "deals with a matter relating to the conduct of the ordinary business operations of the issuer." *Id.* This is the language used today in Rule 14a-8(c)(7). *See* 17 C.F.R. § 240.14a-8(c)(7) (1998).

204. *See* Waite*, supra* note 62, at 1264. The SEC felt that this change would "produce results that were more in accord with the concept of shareholder democracy underlying Section 14(a) of the Exchange Act." *Id.* (citing Adoption of 1976 Amendments, *supra* note 80, at 52,998). The results anticipated were the inclusion of more proposals that implicated significant policy issues. *See id.*

205. I use the term "interpretation" because the release did not amend the text of the Rule to reflect the change, but merely explained how the SEC would interpret this exclusion in the future.

206. Adoption of 1976 Amendments, *supra* note 80, at 52,997–98; *see also supra* note 82 and accompanying text.

207. *See* Wallman, *supra* note 15, at 423 (explaining that "[t]he distinctions recognized by the staff are characterized by many as tenuous, without substance, and effectively nullifying the application of the ordinary business exclusion to employment-related proposals").

208. For a discussion of the no-action process, see *supra* notes 109–17 and accompanying text.

209. See Lazaroff, *supra* note 19, for an in-depth discussion including an analysis of the case law concerning the vagueness and unpredictability surrounding this exception.

210. *See* Pacific Telesis Group, SEC No-Action Letter, 1989 SEC No-Act. LEXIS 104 (Feb. 2, 1989). In the Pacific Telesis no-action letter, the SEC noted:

> In light of recent developments, including heightened state and federal interest in the social and economic implications of plant closings and relocation decisions, the staff has reconsidered its position with respect to the applicability of 14a-8(c)(7) to proposals dealing generally with the broad social and economic impact of plant closings or relocations. It is the Division's view that such proposals . . . involve substantial corporate policy considerations that go beyond

tive compensation,[211] golden parachutes,[212] and tobacco products[213] were excludable. Now, these are considered to raise substantial policy issues.[214] Arguably, these changes are necessary because, as time passes, the public's perception of what is a substantial policy issue changes. Therefore, the SEC's determination of what is a substantial policy issue must also change. This clearly illustrates the inherent subjectivity in the "substantial policy" standard.[215] The difficulty lies in determining at what point a policy issue becomes substantial, and who should properly make that determination.[216] The SEC generally explains that these decisions are based on both federal and state legislative interest in a particular area.[217]

> the conduct of the Company's ordinary business operations.

Id.

211. *See* Reebok Int'l Ltd., SEC No-Action Letter, 1992 SEC No-Act. LEXIS 376 (Mar. 16, 1992). In the Reebok no-action letter, the SEC expounded:

> In view of the widespread public debate concerning executive and director compensation policies and practices, and the increasing recognition that these issues raise significant policy issues, it is the Division's view that proposals relating to senior executive compensation no longer can be considered matters relating to the registrant's ordinary business.

Id.; *see also* Baltimore Gas & Elec. Co., SEC No-Action Letter, [1991–1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,101, 79,213 (Feb. 13, 1992). There is some speculation that the SEC's decision in Cracker Barrel was in a sense giving something to the companies in exchange for this reversal on executive compensation. *See* O'Connor, *supra* note 16, at 17 (stating that "[i]n addition, the Commission was moving toward a decision, announced in February 1992, that executive compensation would no longer be classed as ordinary business; Commissioners may have been a bit anxious to provide corporations with a bit of quid pro quo on shareholder resolutions").

212. *See* Transamerica Corp., SEC No-Action Letter, [1989–1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,338 (Jan. 10, 1990), *available in* 1990 SEC No-Act. LEXIS 46.

213. *See* Kimberly-Clark Corp., SEC No-Action Letter, 1990 SEC No-Act. LEXIS 330 (Feb. 22, 1990). The SEC Divisional Director stated that new legislation concerning smoking on airplanes prompted the change. *See* Waite, *supra* note 62, at 1268.

214. *See supra* notes 204–07.

215. Wallman colorfully described this process:

> [L]awyers are paid to read tea leaves and argue points as to which matters have risen to the level of important issues of national policy based on a speech here or a newspaper article there. And a Commission and its staff, expert in the administration of securities laws, attempts to divine what labor or workplace issues, what foreign policy issues, what economic or social theory is now sufficiently important to warrant access to the proxy machinery.

Wallman, *supra* note 15, at 423.

216. This question becomes even more difficult if the company's business itself is controversial — for instance, an abortion clinic or arms manufacturer. *See* Waite, *supra* note 62, at 1255.

217. *See supra* notes 210–14 (explaining the reasons for staff reversals on plant

Moreover, even after the determination is made, it is still difficult to identify when a company can exclude a proposal and when it cannot. The following two "high performance" workplace proposals demonstrate this point. One proposal recommended that "the board of directors . . . adopt executive compensation policies that emphasize and reward executives for creating a `high performance workplace' that places a priority on achieving continuous improvement in productivity, quality, and service through employee involvement in decision-making, employee compensation linked to performance, and a strong commitment to training."[218] The second proposal recommended that "the Board of Directors commit our Company to the goal of creating a high performance workplace based on policies of workplace democracy and meaningful worker participation, and prepare a report . . . identifying the extent to which the Company is implementing a high-performance workplace based on those policies . . . ."[219] The SEC determined that the first proposal could not be omitted, but the second one could. The difference is subtle.[220] Both proposals recommend the implementation of a high performance workplace — but, because the first proposal tied this concern to executive compensation, it may not be omitted under the ordinary business operations exclusion.[221] This form over substance philosophy forces shareholder proposal proponents to meticulously sculpt their proposals in an attempt to shape them into a form that involves a substantial policy.

In 1992, the SEC eliminated this subjective line-drawing for employment-related proposals with the Cracker Barrel no-action letter.[222] The SEC implemented a bright line test excluding all em-

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closings, executive compensation, and tobacco products). For criticism of this method, see Waite, *supra* note 62, at 1265–70 (arguing that "[t]he problem with equating `legislative interest' with `substantial policy issue' is that even if we accept that legislative interest is evidence of a substantial policy issue, the question remains: When does it become a substantial policy issue? When a bill is introduced? When it is passed by the House? By the Senate? When it is signed into law?").

218. Louisiana-Pacific Corp., SEC No-Action Letter, [1996–1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,217 (Feb. 29, 1996), *available in* 1996 SEC No-Act. LEXIS 274.

219. W.R. Grace & Co., SEC No-Action Letter, [1996–1997 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 77,216 (Feb. 29, 1996), *available in* 1996 SEC No-Act. LEXIS 275.

220. In fact, note that the no-action letters were issued on the same day. *See supra* notes 218–19.

221. *See supra* notes 218–19.

222. *See infra* Part II.

ployment-related proposals regardless of the policy implications.[223] Although decreased subjectivity is beneficial, in this instance the costs far outweighed any perceived benefits of certainty in the Rule.

II. THE CRACKER BARREL CONTROVERSY AND EMPLOYMENT-RELATED PROPOSALS

A. The Cracker Barrel Controversy

In 1991, Cracker Barrel Old Country Store, Inc., a restaurant chain, issued a press release announcing its policy of excluding homosexuals from employment.[224] Following this release, Cracker Barrel fired at least eleven employees based solely on sexual orientation.[225] The release led to many protests and negative publicity.[226] Cracker Barrel responded to the negativity by announcing that its previous policy "may have been a well-intentioned over-reaction to the perceived values of our customers and their comfort levels with these individuals."[227] However, Cracker Barrel did not rehire the discharged employees, nor did it expressly rescind the policy, leaving the decision to be made on a case-by-case basis.[228]

Spurned by these discriminatory actions, a Cracker Barrel shareholder, New York City Employees' Retirement System (NYCERS), submitted a proposal pursuant to Rule 14a-8 for inclusion in the company's proxy statement for the 1992 annual shareholder meeting.[229] This proposal requested that Cracker Barrel add "sexual orientation" to its non-discriminatory hiring policy state-

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223. *See infra* Part II.

224. *See* New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 9 (2d Cir. 1995). The press release stated:

> Cracker Barrel is founded upon a concept of traditional American values, quality in all we do, and a philosophy of 100% guest satisfaction. It is inconsistent with our concept of values, and is perceived to be inconsistent with those of our customer base, to continue to employ individuals . . . whose sexual preferences fail to demonstrate normal heterosexual values which have been the foundation of families in our society.

Id.

225. *See* Cracker Barrel No-Act, *supra* note 10, at *15.

226. *See id.* at **5–6. Negative responses included: a *20/20* news story, a national boycott, sit-ins, and many newspaper and magazine articles. *See id.*

227. *Id.* at *16.

228. *See id.*

229. *See id.* at 19.

ment and implement policies related to this statement.[230] Cracker Barrel sought a no-action letter from the SEC concurring with the decision to omit the proposal because it related to "ordinary business matters."[231] As discussed above, the ordinary business exclusion allowed the omission of proposals regarding "routine, day to day matters relating to the conduct of the ordinary business operations," unless the proposal implicated a significant social policy.[232] In the no-action letter issued to Cracker Barrel, the SEC reversed this long-standing position.[233] The SEC announced that "[i]n recent years . . . the line between includable and excludable employment-related proposals based on social policy considerations has become increasingly difficult to draw."[234] The letter distinguished proposals relating to executives as still being unique, and thus not excludable.[235] Consequently, a proposal regarding rank-and-file employees will no longer escape the ordinary business exclusion because the proposal involves a social policy issue.

NYCERS petitioned the Commission for the reversal of the Cracker Barrel no-action letter.[236] The SEC reviewed the letter and

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230. The proposal in its entirety stated:

> Whereas, in February, 1991 the management of Cracker Barrel Old Country Stores restaurants announced a policy of discrimination in employment against gay men and lesbians; and,
>
> Whereas, although Cracker Barrel management asserts that this discrimination policy has been rescinded, the company has refused to rehire fired workers and media reports have indicated that gay and lesbian workers continue to be dismissed on the basis of their sexual orientation; and,
>
> Whereas, employment discrimination on the basis of sexual preference may deprive corporations of the services of productive employees, leading to less efficient corporate operations which in turn can have a negative impact on shareholder value; and,
>
> Whereas, public demonstrations, boycott campaigns and negative editorial and news coverage concerning discriminatory practices by the company can undermine consumer confidence and lead to a loss of business revenue;
>
> Resolved, Shareholders request the Board of Directors to implement non-discriminatory policies relating to sexual orientation and to add explicit prohibitions against such discrimination to their corporate employment policy statement.

Id. at **43–44.

231. *See* Cracker Barrel No-Act, *supra* note 10, at **44–49.

232. *New York City Employees' Retirement Sys.*, 45 F.3d at 10; *see supra* Part I.E.

233. *See* New York City Employees' Retirement Sys. v. SEC, 843 F. Supp. 858, 862 (S.D.N.Y. 1994), *rev'd*, 45 F.3d 7 (2d Cir. 1995).

234. Cracker Barrel No-Act, *supra* note 10, at *2.

235. *See id.* at *3.

236. *See New York City Employees' Retirement Sys.*, 45 F.3d at 10.

affirmed the decision.[237] Undaunted, NYCERS filed suit against the SEC in the Southern District of New York, asserting that the no-action letter was invalid because: (1) the SEC failed to comply with the notice and comment procedures of the Administrative Procedure Act (APA),[238] and (2) the decision was arbitrary and capricious.[239] Judge Kimba Wood first held that the position stated in the Cracker Barrel no-action letter was a rule as defined by the APA.[240] Judge Wood then held that the 1976 interpretation was legislative action and, as such, any amendment would be subject to APA notice and comment requirements.[241] Further, the court found that the Cracker Barrel letter was such an amendment, and therefore, the SEC had violated the APA.[242] Thus, the court held the no-action letter was invalid, without ever reaching the arbitrary and capricious argument. Accordingly, the court granted an injunction prohibiting the SEC from issuing any no-action letters inconsistent with the 1976 Release.[243]

The SEC appealed,[244] and, while the appeal was pending, the SEC did not issue any no-action letters permitting exclusion under the ordinary business operations exception. On appeal, the SEC

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237. *See id.*

238. *See* 5 U.S.C. §§ 551–559 (1994). Specifically, § 553 provides:

> (b) [g]eneral notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
>
> (1) a statement of the time, place, and nature of public rule making proceedings;
>
> (2) reference to the legal authority under which the rule is proposed; and
>
> (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved. Except when notice or hearing is required by statute, this subsection does not apply—
>
> (A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice . . . .
>
> (c) After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. . . .

Id. § 553(b), (c).

239. *See New York City Employees' Retirement Sys.*, 843 F. Supp. at 863.

240. *See id.* at 867.

241. *See id.* at 880.

242. *See id.* at 880–81.

243. *See id.* at 882.

244. *See New York City Employees' Retirement Sys.*, 45 F.3d at 11.

argued that the no-action letter was not subject to the APA's notice and comment requirements because the letter merely announced a legislative interpretation.[245] Moreover, since adequate alternative remedies were available, NYCERS could not impugn the letter as arbitrary and capricious.[246] Relying on the non-binding nature of no-action letters, the court held that the SEC had not violated the APA by not allowing the letter to go through the notice and comment period, or by refusing to follow the 1976 Release's two-prong test for the ordinary business operations exclusion.[247] Furthermore, since the Cracker Barrel letter was an informal non-binding interpretation, it did not technically amend the 1976 Release.[248] Moreover, the court stated that "[a]gency rules that have not undergone notice and comment receive much closer scrutiny from the courts than do those that have cleared the procedural hurdles. And, since no-action letters are informal, they receive even less deference than other interpretive rules."[249] Therefore, the non-binding nature of a no-action letter encourages the proponent shareholder to sue a company directly when the SEC issues a no-action letter permitting the proposal's omission under the ordinary business exclusion. In fact, the court opined that suing Cracker Barrel directly to compel the proposal's inclusion was a viable and effective alternative.[250]

B. Other Cases

Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc.[251] provided further encouragement to sue an offending company directly. In this case, Amalgamated Clothing and Textile Workers Union (ACTWU) submitted a proposal under Rule 14a-8 requesting disclosure and formation of specific policies regarding Wal-Mart's affirmative action and equal employment opportunity

245. *See id*.

246. *See id.*

247. *See id.* at 12–13.

248. *See id.* at 13.

249. *Id*. at 14 (citation omitted).

250. *See New York City Employees' Retirement Sys.*, 45 F.3d at 14. The court then mentioned that any arguments regarding arbitrary or capricious conduct by the SEC could be raised in a suit directly against Cracker Barrel to defend against the company's reliance on the SEC no-action letter. *See id.*

251. 821 F. Supp. 877 (S.D.N.Y. 1993), *aff'd*, 54 F.3d 69 (2d Cir. 1995).

policies.[252] Wal-Mart relied on a no-action letter received from the SEC and the Cracker Barrel no-action letter in omitting the proposal.[253] ACTWU brought suit in the Southern District of New York to enjoin the omission.[254] Judge Wood refused to defer to the Cracker Barrel position or the Wal-Mart no-action letter because the reasoning contradicted the standard espoused in the 1976 Release.[255] Instead, the court subjected the proposal to the two-prong test articu-

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252. *See id.* at 880. The proposal in its entirety reads:

> W[hereas], Wal-Mart is one of the nation's largest employers in what is rapidly becoming a service oriented job market for many Americans;
>
> We believe the vast majority of Wal-Mart's customers are either women or members of a racial minority group.
>
> By the beginning of the next century, the majority of new entrants to our nation's workforce will be women and/or minority group members.
>
> We believe it makes good business sense for Wal-Mart to describe and publicize its employment standards which relate to its core customer groups and potential employees. By publicizing its standards, Wal-Mart will be an example to companies with whom it does business.
>
> We share the concern stated by U.S. Labor Department Secretary Lynn Martin who has declared a new goal of challenging the "glass ceiling investigation to remedy this situation."
>
> We believe a report containing basic information requested in this resolution keeps the issue high on management's agenda. It will also reaffirm our public commitment to non-discriminatory employment practices and equal economic opportunity and be responsive to the concerns of women and minorities. The format of the report requested is not important. Different companies use different styles and levels of detail in telling their story to shareholders. Bristol-Myers, Squibb and Travellers produced a magazine style report. Campbell Soup produced a four page document. GM discloses in its Public Interest Report.

Id. at 880 & n.4. This preamble is followed by the resolution requesting:

> 1. A chart identifying employees according to their sex and race in each of the nine major EEOC defined job categories for 1990, 1991, 1992 listing either numbers or percentages in each category.
>
> 2. A summary description of Affirmative Action Programs to improve performance especially in job categories where women and minorities are under utilized and a description of major problems in meeting the company's goals and objectives in this area.
>
> 3. A description of steps taken to increase the number of managers who are qualified females and ethnic minorities.
>
> 4. A description of ways in which Wal-Mart publicizes our company's policies to merchandise suppliers and service providers to encourage forward action on their part as well.
>
> 5. A description of Wal-Mart's efforts to purchase goods and services from minority and female owned business enterprises.

Id.

253. *See id.* at 888.

254. *See id*. at 879.

255. *See id.* at 890.

lated in the 1976 Release.[256] Ultimately, the court slightly amended the proposal and enjoined Wal-Mart from excluding the proposal because equal employment opportunity and affirmative action policies involve substantial policy issues.[257]

Wal-Mart appealed Judge Wood's decision solely on the issue of attorneys' fees awarded to the plaintiffs.[258] In the trial court, Judge Wood granted attorneys' fees of $54,740, although Wal-Mart relied on three apposite SEC no-action letters opposing the inclusion of the proposal.[259] The court found the proposal's inclusion "conferred a common benefit" upon Wal-Mart's shareholders by vindicating their voting and communication rights.[260] The Second Circuit affirmed the decision.[261]

Thus, in summation, the Cracker Barrel decision and its progeny "have raised questions regarding the SEC's authority to promulgate new rules exempting certain shareholder proposals from mandatory inclusion in proxy materials, and have undercut the ability of registrants to rely on SEC no-action letters as authority in omitting proposals."[262] Fortunately, the SEC, recognizing the importance of employment-related proposals, reversed its Cracker Barrel decision.[263] However, this may not restore certainty in the no-action process — the SEC has simply decided to return to a case-by-case analysis.[264] Thus, proponents may still choose to pursue litigation if the SEC concurs with a proposal's omission.

III. INSTITUTIONAL SHAREHOLDERS AND THE IMPORTANCE OF EMPLOYMENT-RELATED PROPOSALS

A. Institutional Shareholders

The growth of institutional investors has breathed new life into the debate on the proxy rules, shareholder activism, and corporate

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256. *See id.* at 890–91.

257. *See Amalgamated Clothing & Textile Workers Union*, 821 F. Supp. at 892.

258. *See Amalgamated Clothing & Textile Workers Union*, 54 F.3d at 70.

259. *See id.* at 70–71.

260. *Id.* at 70.

261. *See id*. at 73.

262. Connell, *supra* note 100, at 400.

263. *See* Amendments, *supra* note 9, at 29,108 (stating "the relative importance of certain social issues relating to employment matters has reemerged as a consistent topic of widespread debate"); *infra* Part IV.A.2.

264. *See* Amendments, *supra* note 9, at 29,108.

governance. Public and private funds have increased from approximately \$2 trillion in 1986 to currently over \$5 trillion.[265] This growth developed in large part from aging baby boomers and the increasing use of mutual funds by individual investors.[266] In this decade, institutional shareholders own over 50% of U.S. corporate shares, as compared to 10% ownership forty years ago.[267] In fact, the number of mutual funds currently exceeds that of publicly held companies.[268] Because of their size and financial expertise, institutional shareholders are potentially threatening to management.[269]

Prior to the 1980s, institutional investors rarely submitted their own proposals and almost always sided with management.[270] However, the takeover era woke these slumbering giants. The possibility of takeovers is beneficial to institutional investors for several reasons.[271] First, a company is generally ripe for a takeover when the company is capable of performing better than it is currently.[272] Therefore, if an insurgent group comes in and improves the company's performance, the company's value will increase and investors will enjoy a higher stock price.[273] Second, the mere threat of a takeover may increase current management's performance.[274] Consequently, this market discipline for complacent managers will result in long-term gains.[275] Finally, institutional investors have the financial acumen to assess a tender offer and take advantage of short term gains.[276]

Thus, it is easy to see that the giants took notice when management implemented anti-takeover devices to firmly entrench them-

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265. *See* Richard H. Koppes, *Institutional Investors*, *Now in Control of More than Half the Shares of U.S. Corporations*, *Demand More Accountability*, NAT'L L.J., Apr. 14, 1997, at B5.

266. *See id.*

267. *See id.*

268. *See* USEEM, *supra* note 124, at 1983.

269. *See* Ryan, *supra* note 17, at 149. Professor Ryan states that this is true despite the ability of management to self-perpetuate. *See id.*

270. *See* Jayne W. Barnard, *Institutional Investors and the New Corporate Governance*, 69 N.C. L. REV. 1135, 1153 (1991).

271. *See* Ryan, *supra* note 17, at 150–58.

272. *See id.* at 155.

273. *See id.*

274. *See id.* at 150.

275. *See id*. at 155.

276. *See id*.

selves.[277] These anti-takeover devices not only preclude any of the advantages discussed above, but also have negative impacts as well. First, these devices adversely affect share value.[278] Second, the shareholders are essentially stuck with this firmly entrenched management; this prevents new and possibly better management from coming in, and likely lessens current management's motivation and accountability.[279]

In the early 1980s, anti-takeover proposals initiated by management generally prevailed.[280] However, in 1987, three institutional investors, organized through the Council of Institutional Investors (CII), submitted proposals to redeem "poison pills" at forty companies.[281] One highly publicized proposal submitted to International Paper Company received 27.7% supporting vote.[282] Both management and the shareholders touted success.[283] Management claimed success because the shareholder proposal failed, while shareholders claimed success due to the high vote the proposal received compared to other management-opposed proposals and because the percentage received easily qualified for resubmission.[284] Overall, greater than fifty anti-takeover proposals were submitted, with an average supporting vote of 27.4%.[285] In 1988 and 1990, the average support-

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277. *See* Ryan, *supra* note 17, at 150. "Anti-takeover provisions are modifications to a corporation's financial structure designed to make the target less attractive to anyone considering a takeover." *Id.* Examples include: classified boards, "green mail," blank checks, and poison pills. *See id.* at 153–54. "A `poison pill' provision is a mechanism that will `kill' (or harm financially) an acquiring company after it has `swallowed' the target of an unfriendly takeover." *Id.* at 153 n.217.

278. *See* Barnard, *supra* note 270, at 1153 (referring specifically to poison pills).

279. *See* Ryan, *supra* note 17, at 150.

280. *See* Barnard, *supra* note 270, at 1153. Also in this time period, shareholder proposals still received only feeble support and institutional investors rarely instigated proposals. *See id.*

281. *See id.* The College Retirement Equities Fund, the State of Wisconsin Investment Board, and the California State Teachers' Retirement System comprised the three investors. *See id.* The CII was founded in 1985 to serve mainly as an information center and to "give shareholders a greater voice on shareholder rights questions." Ryan, *supra* note 17, at 157.

282. *See* Ryan, *supra* note 17, at 158–59. Over 60% institutional ownership of shares made this company a target. *See id.*

283. *See id.* at 159.

284. *See id.* at 160; *see also supra* note 163 and accompanying text (defining success).

285. *See* Barnard, *supra* note 270, at 1153; Ryan, *supra* note 17, at 159. The IRRC surveyed 32 companies and reported an average supporting vote of 29.4% for anti-takeover proposals. *See* Barnard, *supra* note 270, at 1152; Ryan, *supra* note 17, at 159.

ing vote increased to 38.7% and 42.7% respectively.[286]

This marked the beginning of institutional investors becoming actively involved in corporate governance through the shareholder proposal rule.[287] Since then, institutional investors have been influential in "organizing resistance to unacceptable managerial conduct, organizing affirmative campaigns to effectuate corporate reforms and seizing the moral high ground on such corporate governance issues as golden parachutes, greenmail, and confidential voting."[288]

With this growing role of the institutional investor in corporate governance, three differing views have emerged.[289] First, some view the institutional investor as the panacea to all current market woes.[290] As explained by Professor Coffee, this side "tends to see institutional investors essentially as Gulliver tied down by a host of Lilliputian regulations enforced by petty (or perverse) regulators who lack any coherent policy objective (other than a desire to maximize their bureaucratic authority and significance). Free Gulliver, they argue, and the market will work."[291] Obviously, proponents of this viewpoint favor deregulation by the SEC; they champion the 1992 amendments, but still want more. Safe harbor provisions under Rule 13(d) are also of particular concern.[292] Supporters of this perspective envision unbridled institutional investors as management watchdogs.[293] However, a second group of shareholders have a

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286. *See* Barnard, *supra* note 270, at 1153; Ryan, *supra* note 17, at 159. In 1990, four institutional-submitted proposals to redeem poison pills received enough votes to pass. *See* Barnard, *supra* note 270, at 1155. These proposals were submitted to Avon Products, Armco, Champion International, and K-Mart. *See id.*

287. Some active institutional investors include: Wisconsin Investment Board, CalPERS, New York State Common Retirement Fund (primarily limited to social issues), and The Florida Board of Administration. *See* USEEM, *supra* note 124, at 1977–78. However, these activists rarely combine efforts, preferring "to play `The Lone Ranger[]' with its own agenda and [displaying] little willingness to engage in common action." *Id.* at 1978.

288. Barnard, *supra* note 270, at 1154 (footnotes omitted). Institutional shareholders have accomplished these goals by acting collectively. *See id.*

289. *See* Coffee, *supra* note 101, at 842–43.

290. *See id.*

291. *Id*. at 842.

292. *See* Robert G. Vanecko, *Regulations 14A and 13D and the Role of Institutional Investors in Corporate Governance*, 87 NW. U. L. REV. 376 (1992) (addressing the arguments for and against changing the regulatory framework of 13D and 14A).

293. *See* Coffee, *supra* note 101, at 906 (arguing that "[f]ragmented by legislative restrictions, institutional investors are unable to assume their natural role as the efficient monitors of management, unless deregulation liberates them").

completely different perspective. They fear that concentration of financial control will fall into the hands of a few unaccountable institutions.[294] This conception "sees institutional investors as dangerous, short-term oriented, and inclined toward fads and `herd' behavior."[295] Thus, these shareholders would call for more regulations to control institutional investors. Finally, proponents of a third view would extend institutional investor control even further due to their belief that institutional investors are not only bridled by regulation, but also lack the incentive for activism.[296] Therefore, these shareholders would not only set Gulliver free, but would encourage him to stand up and take control.

This final perspective illuminates flaws in the other two viewpoints. First, institutional investors are still susceptible to the collective action and freerider problems.[297] Although the statistics show a high percentage of ownership by institutional shareholders, this percentage does not reflect the percentage of voting control each individual investor has per company.[298] In 1990, institutional investors owned 52.3% of all outstanding U.S. equity, but this percentage was widely dispersed between the various institutions.[299] For example, public pension funds, which are notorious activists,[300] could only claim 8.3% of all outstanding shares.[301] Most public funds index their holdings, thus this 8.3% was most likely distributed over many different companies.[302] Consequently, the fear that one institutional investor could impose a radical social agenda on a company is unfounded. For institutional investors to force change, they must act collectively.[303] However, current evi

294. *See id.*

295. *Id*.

296. *See id.* This is the view espoused by Professor Coffee throughout his article.

297. *See id.* at 843–44; *see also supra* notes 129–36 and accompanying text (discussing that one benefit of Rule 14a-8 is the assuagement of these problems).

298. *See* Coffee, *supra* note 101, at 852.

299. *See id.* at 848.

300. *See id.* at 857 (stating that "[w]hatever the reason, the bottom line is that pension funds have been . . . willing to undertake the role of catalyst and seek to form coalitions and make proxy proposals").

301. *See id.* at 848.

302. *See id*. at 860. Indexing means investing in a "broad market index that approximates the market as a whole, it precludes concentrated investments." *Id.*

303. *See id.* at 856; USEEM, *supra* note 124, at 1973 (alleging that "the role played by the public [pension] funds may resemble more that of Don Quixote than that of Paul Revere: when they are supported by allies, they can win, but otherwise, they are tilting

dence shows that institutional investors are reluctant to band together.[304] For instance, Robert Monks, a leading shareholder activist and co-founder of LENS, submitted a proposal to establish a shareholder advisory committee at Exxon.[305] This mandatory committee would monitor Exxon's board of directors.[306] In response, Exxon sought a no-action letter to omit the proposal, but the SEC declined.[307] Nevertheless, possibly due to lack of support from other institutions, the proposal received only an 8% vote.[308]

The low concentration of ownership also exacerbates the freerider problem.[309] The proponent shareholder will have to fund the change, but will still receive only benefits proportional to share ownership. Moreover, many institutions use outside fund managers whose performance is measured against other funds.[310] They may have to pay the costs incurred in proxy solicitation, and are paid on the short-term.[311] Therefore, these fund managers would probably only submit a proposal where gain is certain and preferably short-term.

There are other deterrents to institutional activism. First, diversification rules prevent institutions from commanding the majority vote of a company by concentrating their investments into a small number of companies.[312] Moreover, an institution may not have the staff to engage in any serious monitoring of management.[313] Rule 13(d) requires any shareholder or group owning more

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at windmills and destined to lose").

304. However, in 1990, 20 shareholder proposals, including seven by institutions, received enough votes to pass — more than in the entire history of the Rule. *See* Barnard, *supra* note 270, at 1156.

305. *See* Coffee, *supra* note 101, at 849. LENS, founded by Nell Minow and Robert Monks, specializes in targeting underperforming firms in an attempt to improve management through shareholder activism. *See* USEEM, *supra* note 124, at 1987.

306. *See* Coffee, *supra* note 101, at 849.

307. *See id.* This was a significant legal victory for shareholder activism. *See id.*

308. *See id.* at 850.

309. *See id.* at 866.

310. *See id.* at 868. The fund manager may be worried about losing both current and potential customers if his performance drops due to an unsuccessful proposal or if he gains a reputation as an activist. *See id.*

311. *See id*. at 863–64. This is usually true only of outside managers. *See id.* at 863.

312. *See* Coffee, *supra* note 101, at 850. ERISA imposes these rules on private funds, the "prudent man" common law standard imposes them on public funds, and the Investment Company Act of 1940 imposes them on mutual funds. *See id.*

313. *See* USEEM, *supra* note 124, at 1974–75. For instance, CalPERS "employs only two inside managers to oversee its $20 billion internally managed indexed funds." *Id.* at

than 5% of a company's shares to file a Schedule 13D.[314] This schedule requires the individual(s) to disclose a significant amount of information — including ownership, plans, and financing — within ten days of acquiring the 5% ownership.[315] Further, the SEC must be promptly notified of any material changes.[316]

Another deterrent to institutional activism is the SEC's extremely broad definition of a group, which reads "two or more persons agree to act together for the purpose of acquiring, holding, voting, or disposing of equity securities."[317] Practically, if a few institutional shareholders agree to vote on a proposal together, this rule would be triggered, and thus each additional supporter would be subject to the filing requirements. This makes the 1992 amendments to enhance shareholder communications a Catch-22 — "the SEC's approach today seems to say: you can communicate freely, but your audience must stay at a distance and not indicate that they agree."[318]

Furthermore, Section 16(b) may also deter some investors.[319] This rule limits "short-swing" profits in the company where share ownership exceeds 10%.[320] Institutions, particularly mutual funds, must preserve liquidity;[321] thus, too much concentration of stock in one company could jeopardize the institution by effectively eliminating any market for the shares.[322] It is important to remember that the goal of all institutions is to maximize the value of their holdings.

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314. *See* 17 C.F.R. § 240.13(d)(1), -101 (1998).

315. *See* 17 C.F.R. § 240.13(d)-101 (1998).

316. *See* 17 C.F.R. § 240.13(d)(1), -101 (1998).

317. 17 C.F.R. § 240.13d-5(b)(1) (1998).

318. Coffee, *supra* note 101, at 881.

319. *See* 17 C.F.R. § 240.16(b).

320. *See* Coffee, *supra* note 101, at 851. This rule, enacted to curb insider trading, is of dubious effect. Essentially, *Chiarella* insiders must automatically disgorge any profits made from buying or selling the subject company's stock within a six-month period. *See* Chiarella v. United States, 445 U.S. 222, 228 (1980) (contending "the duty to disclose arises when one party has information `that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them'" (citing Restatement (Second) of Torts § 551(2)(a) (1976))). This is essentially a rule for the unwary traditional insider.

321. *See* Coffee, *supra* note 101, at 851. This is a necessity for mutual funds. The number of mutual funds increased over 600% from 1984 to 1994. *See id.* at 855.

322. *See id.*

In light of the foregoing deterrents, it is difficult to see institutional investors as either free market saviors or scourges. However, as the institutions "find exit costly, they must turn to the alternative remedy of `voice' . . . and become more active shareholders."[323] To maximize the possibility of institutional investors effectuating major changes in both governance and social policy, institutions need to band together. If institutions coordinate their efforts through organizations, this will reduce costs and the risk of retaliation or business loss.[324] Some currently existing organizations are well-suited for this role, including LENS, the Council of Institutional Investors, and the Investor Responsibility Research Center.[325] Further, the SEC could aid this process by removing some of the current regulatory hindrances. However, even without deregulation, institutional investors will still play a major role in shaping corporations for many years to come.

B. The Importance of Employment-Related Proposals

Beginning in 1994, former DOL Secretary Robert Reich launched a campaign to rally institutional investor support for employment-related issues.[326] Mr. Reich advocated high performance workplace practices to enhance long-run competitiveness.[327] The DOL issued investment guidelines clarifying that, while ERISA obligated institutions to maximize the value of their holdings, institutional managers should still actively and critically vote their proxies.[328] Managers "may promote a company's `investment in training to develop its workforce, other workplace practices, and financial

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323. USEEM, *supra* note 124, at 1984. Coffee explains that institutions are currently caught in a "no man's land" where their holdings are "too large to assure them exit, but too small to give them effective voice." *Id.* at 1985.

324. *See id*. at 1982.

325. *See id.* at 1987 (positing that LENS' success will foretell the maturity of the institutional shareholder movement in the economic sense).

326. *See* O'Connor, *supra* note 16, at 3; *see also* Wallman, *supra* note 15, at 426.

327. *See* O'Connor, *supra* note 16, at 10. A high performance workplace involves "employee involvement in management decisions, team production methods, advanced training programs, and the integration of human resource policies in business strategies." *Id.*

328. *See id.* at 11 (explaining "ERISA applies to both corporate pension funds and industry-wide (Taft-Hartley) labor pension funds which are jointly trusteed by management and labor").

and non-financial measures of corporate performance.'"[329] The DOL also encouraged employment-related disclosures in the company financial statements that focus on training and workplace practices.[330]

Ironically, this increased emphasis by the DOL came at a time when the SEC fastidiously maintained its position in Cracker Barrel to exclude employment-related proposals.[331] CalPERS is one institutional investor that answered Reich's call to arms.[332] Since 1994, CalPERS has socially invested in companies that meet its specific labor standards.[333] Significantly, in 1997, CalPERS began a campaign against companies that overly compensate executives while engaging in downsizing.[334] CalPERS considers positive workplace practices as an indicator of long-term financial success, maintaining that companies with such policies do better than their less conscientious counterparts.[335]

Despite the Cracker Barrel decision, proponents submitted eighty-two employment-related proposals in 1997.[336] Due to man

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329. *Id.* (citing Patrick McGurn, *DOL Issues New Guidelines on Proxy Voting, Active Investing*, IRRC CORP. GOVERNANCE BULL., July–Aug. 1994, at 1).

330. *See id*. at 12 (noting "Reich emphasized that the balance sheet does not capture the quality and loyalty of the company's work force, the level of investment in training and retraining, or the capacity of the employees to continually innovate and adapt").

331. In 1994, the SEC's Cracker Barrel decision was pending appeal in the Second Circuit. Historically, legislative attention to a subject matter prompted the SEC to reverse their interpretive policies to align themselves with current trends. *See supra* notes 210–13 and accompanying text (discussing SEC reversals on plant closings, executive compensation, tobacco related production, and golden parachutes).

332. "One of the largest and most vocal of such funds is the California Public Employees' Retirement System (`CalPERS'), with assets totaling $108 billion. CalPERS and its outspoken executives have led the charge for the institutional investor community since the dawn of the current corporate governance era." Warren F. Grienenberger, *Institutional Investors and Corporate Governance*, *in* 1029 PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1998, at 63, 67 (PLI Corporate Law and Handbook Series No. B4–7230, 1998).

333. *See* O'Connor, *supra* note 16, at 13.

334. *See id.* (discussing the "reverse Robin Hood" program and other measures taken by CalPERS); *see also* Allan Sloan, *The Hit Men*, NEWSWEEK, Feb. 26, 1996, at 44.

335. *See* O'Connor, *supra* note 16, at 13 (quoting Lilli Gordon et al., *Report to the California Public Employees' Retirement System: High Performance Workplace: Implication for Investment Research and Active Investing Strategies*, The Gordon Group, Inc., May 30, 1994) (expressing that "firms with poor workplace practices have lower valuations than their peers with reputations for positive workplace practices")).

336. *See id*. at 18–19 (citing IRRC CORP. SOC. ISSUES. REP., 1997 and 1996 checklists of shareholder resolutions). The 82 included proposals concerning Mexican Maquiladora operations, equal employment, and global labor standards. *See id.* This was an increase

agement concessions, most of these proposals were withdrawn.[337] Proponents also discovered ways to get around Cracker Barrel by linking the proposal to executive compensation or by using Rule 14a-4.[338] For example, the SEC expressly limited the Cracker Barrel decision to rank-and-file employees, stating: "[P]roposals concerning senior executive and director compensation are viewed by the Commission as inherently outside the scope of normal or routine practices in the running of the company's operations."[339] Accordingly, proponents utilized this narrow exception — the IRRC reported that more than eighteen proposals of this type were submitted in 1997.[340]

The SEC's Cracker Barrel decision suggested that employment-related issues are insignificant. However, the importance of employment-related proposals is clearly evidenced by the exorbitant sums paid in recently settled cases, including: Texaco,[341] Shoney's,[342] and Publix.[343] Employment-related proposals include such issues as

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from 26 in 1996 and 14 in 1995. *See id.*

337. *See id.* at 19.

338. *See id*. at 19–21. Rule 14a-4 is beyond the scope of this Comment. Professor O'Connor noted that labor proponents also include language concerning labor policies in the supporting statements of proposals not employment-related. *See id.* at 20–21. This practice carries the risk of the extraneous language being omitted due to Rule 14a-9. *See id.*

339. Cracker Barrel No-Act, *supra* note 10, at *3.

340. *See* O'Connor, *supra* note 16, at 18–19. Proponents submitted only eight of these type proposals in 1996. *See* Mathiasen, *supra* note 120, at 11.

341. In 1996, Texaco agreed to a settlement in a class action racial discrimination case which required Texaco to: pay an astounding $176.1 million, appoint a task force that will revise the company's personnel policies by developing new hiring and promotion procedures, create diversity and sensitivity training programs for the company's managers, and establish a mentoring program. *See* Susan Williams, *Texaco Settles Record Race Discrimination Suit; Establishes Groundbreaking Task Force*, IRRC CORP. SOC. ISSUES REP., Dec. 1996, at 1, 4. The settlement specifically includes: $115 million and a one-time 11% salary increase (estimated at $26.1 million over the next 5 years) to the approximately 1400 members of the class, and $35 million for the establishment of an Equality and Tolerance Task Force. *See id.* Interestingly, the article notes that "[r]eligious investors have been filing diversity resolutions at the company since 1990." *Id.* at 6-7.

342. In 1994, Shoney's settled a class action EEO lawsuit for $134.5 million, including lawyers' and administrative fees. *See* Ken Bertsch, *Proponents Increase Social Policy Filings; Dispute on Employment Issues Comes to a Head*, IRRC CORP. SOC. ISSUES REP., Dec. 1997, at 1, 3. The Shoney's settlement "was proportionately much larger than Texaco's recent settlement, and, therefore, `far more devastating to the financial position of the company.'" *Id.* at 3 (quoting Paul Neuhauser, attorney for church proponents).

343. In 1977, Publix Super Markets, Inc. settled a class action gender discrimination lawsuit for $81.5 million, including $18 million for attorneys' fees. *See* C. Geoffrey Weirich et al., *Employer Strategies for Avoiding the Mega-Verdict: Learning from Recent*

eradicating sweatshops and child labor, increasing equal employment opportunity, withdrawing from South Africa, and adopting the MacBride principles.[344] While leaving subjective policy decisions to the SEC financial experts may not be the best solution, the SEC made the right decision in reversing Cracker Barrel.

There are sufficient safeguards in the current Rule to prevent much of the feared abuse. The personal grievance exception prevents employment-related proposals submitted solely for self-interest.[345] Also, the eligibility requirements provide sufficient deterrents to keep most frivolous would-be proponents at bay.[346] Moreover, "[p]aternalistic merit regulation such as the Cracker Barrel decision is unnecessary in the current environment of sophisticated institutional investors."[347] This decision only hindered the ability of institu-

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High-Profile Employment Discrimination Lawsuits, *in* 26th ANNUAL INSTITUTE ON EMPLOYMENT LAW, at 31, 36 (PLI Litigation and Administrative Practice Course Handbook Series No. H4-5272, May 1997). The class action, brought in 1995 by 12 women on behalf of more than 150,000 current and former female employees, alleged that Publix "had engaged in a pattern and practice of discrimination by failing to promote female employees to management positions in the Company's retail stores." *Id.* Publix also agreed to establish a system for registering individual promotion interests, use its best efforts to promote women according to their interest, and set up EEO training programs. *See id.*

Publix also announced a settlement to pay certain black full-time associates and female applicants an additional $3.5 million "to end a separate EEOC investigation into possible racial bias affecting the company's promotion practices, and alleged gender discrimination in hiring into craft jobs." *Id.*

344. In 1984, the Irish National Caucus established the MacBride Principles. *See* Elizabeth Glass Geltman & Andrew E. Skroback, *Environmental Activism and the Ethical Investor*, 22 J. CORP. L. 465, 477 n.80 (1997). "These Principles requested corporations to promote fair employment practices by United States firms doing business in Northern Ireland." *Id.* (citing Kevin A. Burke, *Fair Employment in Northern Ireland: The Role of Affirmative Action*, 28 COLUM. J.L. & SOC. PROBS. 1, n.80 (1994)). As explained by Barbara Frey:

> The MacBride Principles offer detailed non-discrimination standards to fit the context of the Northern Ireland situation. In addition to promoting hiring, training, and advancement on a non-sectarian basis, the principles call for a ban on "provocative, sectarian, or political emblems from the workplace," and adequate security to protect employees from sectarian violence.

Barbara A. Frey, *The Legal and Ethical Responsibilities of Transnational Corporations in the Protection of International Human Rights*, 6 MINN. J. GLOBAL TRADE 152, 175–76 (citing Dermot O'Callaghan, *From Belfast to Brixton: Could New Monitoring Measures Cross the Irish Sea?*, PERSONNEL MGMT., Aug. 1988, at 44, 45).

345. *See* 17 C.F.R. § 240.14a-8(c)(4) (1998). If the proposal is legitimate and neutral on its face, it should not matter whether it was submitted by a union or other labor affiliated organization.

346. *See id.* § 240.14a-8(a)(1).

347. O'Connor, *supra* note 16, at 28.

tional investors to promote successful employment policies. As CalPERS intimated, there is a link between positive employment policies and long-term financial success. If long-term financial success is not enough of an incentive, companies only have to look to Texaco, Shoney's, and Publix to see what other consequences could result.

IV. THE 1998 AMENDMENTS AND THEIR POTENTIAL IMPACT ON SOCIAL POLICY PROPOSALS

In response to a congressional mandate, the SEC began a comprehensive review of the shareholder proposal process.[348] The SEC conducted this study through a questionnaire, distributed in February 1997,[349] as well as through group discussions and internal review.[350] Incorporating the results of these efforts, the proposed changes attempted to balance the competing interests between shareholders and companies by proposing the reforms as a "package."[351] Accordingly, some proposals were pro-proponent and others pro-management.

On September 18, 1997, the SEC issued a release delineating the current rules, proposed changes, and reasons underlying the changes.[352] The Release caused an uproar among shareholder proponents and criticism from companies. Response to the proposed changes was overwhelmingly negative. Some critics pronounced that the proposed amendments "would greatly hinder, if not cripple, the process of shareholder dialogue and participation that has been of

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348. *See* Release, *supra* note 4, at *11 n.22 (citing National Securities Markets Improvements Act of 1996, § 510(b), Pub. L. No. 104-290, 110 Stat. 3416 (1996)). The Release explained:

> The Commission is required to study "(A) whether shareholder access to proxy statements pursuant to [S]ection 14 of the Securities Exchange Act of 1934 has been impaired by recent statutory, judicial, or regulatory changes; and (B) the ability of shareholders to have proposals relating to corporate practices and social issues included as part of proxy statements."

Id.

349. *See id.* at *11. Responses were received from 172 companies and from 149 individual and institutional investors. *See id*. at *12 n.23. Wallman expressed concern over the heavy reliance by the SEC on these questionnaires in drafting the proposed rules due to "the failure to use scientific sampling in both its design and its distribution." *Id.* at *162 n.6.

350. *See id*. at *11.

351. *See id.* at *17.

352. *See id*.

such a benefit to society."[353] Shareholders objected to increased resubmission thresholds, new administration of the personal grievance exclusion, the shift to a strict economic relevancy test, and elimination of Rule 14a-8(e). Companies, on the other hand, were displeased with Cracker Barrel's reversal,[354] the lower economic relevancy threshold, and the override provision.

In the Release, the SEC explained its understanding of the Rule's purpose: "We believe that the purpose of the rule is to ensure proper disclosure and enhance investor confidence in the securities markets by promoting proposals raising significant issues that are relevant to the company and its business."[355] The SEC undertook the arduous task of amending the Rule with this purpose in mind, and with the intent to balance the concerns of both companies and shareholders while still streamlining the Rule's operation.[356] Amending this Rule was an unenviable task; and, after receiving more than 2000 critical comment letters, the SEC retreated from its original expansive proposal.[357] In May 1998, the SEC released more modest changes, including most notably the reversal of its Cracker Barrel decision.[358]

Due to popular demand, the SEC will retain the role of "informal arbiter" of shareholder proposals.[359] This role requires the SEC to engage in difficult line-drawing regarding the proposal interpretation, social policy issues, and the proper exclusion of proposals.

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353. *Shareholder Proposals: Suggested Proposal Rule Would `Cripple' Dialogue, Coalition Warns*, BNA CORP. COUNSEL DAILY, Dec. 11, 1997, at D2 (quoting a comment letter from 340 corporations to SEC Chairman Arthur Levitt).

354. Bell Atlantic commented, "social proposals, including those related to employment, should not be aired in the proxy arena. Leaving all such proposals to the Commission's line-drawing is not a good solution since it will bring no certainty to this area." P. Alan Bulliner, *Comment Letter to Commissioners and Staff* (visited Dec. 3, 1997) <http://www.sec.gov/rules/proposed/s72647/bulline1.txt>. Nell Minow's letter advocated the opposing viewpoint: "Because it is so clear that employment practices relate to a company's economic viability, these resolutions are appropriate for shareholder consideration." Minow, *supra* note 121.

355. Release, *supra* note 4, at *92.

356. *See id.* at *93 (stating that "[t]he purpose of the amendments is to streamline the operation of the rule, and address concerns raised by both shareholder and corporate participants").

357. *See* Stone & Kewalramani, *supra* note 9, at B9.

358. *See id.*

359. Amendments, *supra* note 9, at 29,106 n.12; Release, *supra* note 4, at **15–16. Questionnaire results showed that the majority of both shareholders and companies preferred the SEC maintain this role. *See id*.

Other alternatives to the SEC assuming this role included: placing a numerical cap on proposals,[360] having state law control,[361] or allowing each company to adopt its own rule governing shareholder proposals.[362] SEC Commissioner Wallman originally advocated a numerical cap hybrid where the grounds for exclusion would be substantially decreased.[363] Wallman's alternative model proposed eliminating both the ordinary business exclusion and the relevancy exclusion — the two most subjective grounds for exclusion.[364] Each company, depending on its shareholder base, would be required to include at least three, but not more than six, shareholder proposals.[365] All corporate governance proposals would be included automatically and would count against the cap, but would not be limited by the cap.[366] All other proposals could be included by either obtaining 3% shareholder support[367] or by winning the lottery.[368] Throughout the decades, other alternatives have been proposed; however, each time the SEC determined that modification of the Rule was sufficient.[369]

A. Proposed Amendments Adopted

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360. *See* Release, *supra* note 4, at *16. This received support from 63% of companies, but only 9% of shareholders. *See id.* at *16 n.28. Professor Palmiter proposed a numerical cap of seven proposals per company. *See* Palmiter, *supra* note 53, at 919 (suggesting that if more than seven proposals were received, then the largest shareholders would take precedence).

361. *See* Release, *supra* note 4, at *15 n.28. This received support from only 8% of companies and 5% of shareholders. *See id.*

362. This received support from 47% of companies, but only 1% of shareholders. *See id*. at *15 n.28.

363. *See* Wallman, *supra* note 15, at 427–32.

364. *See id.*

365. *See id.* at 340.

366. *See id.* at 428. Corporate governance proposals would be defined as those seeking action that would require shareholder or board action to effectuate. *See id.* at 427–28.

367. *See id.* at 429. This suggestion mirrors the proposed addition of an "override" provision recommended in the Release and discussed below. *See infra* Part IV.B.4.

368. *See* Wallman, *supra* note 15, at 431. The complete details of this proposed model are beyond the scope of this Comment. However, the model also proposed increased eligibility requirements from $1000 to $5000 share ownership and increased resubmission levels from the current 3%, 6%, and 10% for the first three submissions to 5% or 10%, 15%, and 30%, respectively. *See id.* at 427. Further, the model also proposed an exclusion for truly frivolous proposals. *See id.* at 430.

369. *See supra* notes 85–89 and accompanying text (discussing the 1983 amendments).

1. *Question and Answer Format*

The first adopted change reformats the Rule's text into a question and answer format using plain English.[370] This change does not include any substantive changes, but includes (and essentially codifies) some interpretive language to enable a novice reader to more easily understand the Rule. For example, the provision for excluding proposals that are not proper for state action would include the language stating that, if the proposal is phrased in precatory language, the SEC will regard the proposal as proper.[371] Making the rules more understandable and easier to follow is clearly a beneficial change. Thus, this proposed change caused little controversy.[372] The SEC stated that "[m]ost commenters who addressed this proposal expressed favorable views, believing that it would make the rule easier for shareholders and companies to understand and follow."[373]

2. *The Ordinary Business Exclusion*

The most noteworthy change involves the highly controversial "ordinary business exclusion."[374] The original purpose of this exclusion was to "relieve the management of the necessity of including in its proxy material[s] security holder proposals which relate to matters falling within the province of management."[375] Two considerations underlie this purpose: (1) certain functions are so integral to a company's effective everyday management that shareholder involvement is impracticable; and (2) shareholders, as a whole, do not have the experience nor the knowledge to "micro-manage" the company.[376] As discussed above, the advent of social policy ac

370. *See* Amendments, *supra* note 9, at 29,106–07; Release, *supra* note 4, at **19–20.

371. *See* Amendments, *supra* note 9, at 29,120. This exclusion is currently 14a-8(c)(1). *See* 17 C.F.R. § 240.14a-8(c)(1) (1998).

372. To review all the changes involved in reformatting the Rule to question and answer, see Amendments, *supra* note 9, at 29,119–21 (demonstrating how the new Rule will appear).

373. *Id*. at 29,107.

374. *See* 17 CFR § 240.14a-8(c)(7).

375. Release, *supra* note 4, at *41 (citing Notice of Proposed Amendments to Proxy Rules, Exchange Act Release No. 4950, 18 Fed. Reg. 6646 (Oct. 9, 1953)); *see also infra* Part I.E and accompanying notes.

376. *See* Release, *supra* note 4, at **49–50 (noting that "[t]his [second] consideration may come into play in a number of circumstances, such as where the proposal seeks intricate detail, or seeks to impose specific time-frames or methods for implementing

tivism prompted the SEC in 1976 to change the Rule's operation to preclude the exclusion of proposals that raise significant policy issues.[377]

a. Cracker Barrel

The Cracker Barrel decision changed this application for employment-related proposals.[378] Subsequent to this decision, all employment-related proposals could be omitted under this exclusion — even if the proposal raised significant policy issues.[379] Criticism of the SEC's administration of the Rule prompted this change.[380] The SEC received numerous requests to reverse this decision.[381] In the 1996 proxy season, the SEC declined to review this decision due to these pending reforms.[382]

b. The Reversal of Cracker Barrel

The SEC has now decided to reverse Cracker Barrel and return to a case-by-case analysis.[383] However, this decision does not mean that all employment-related proposals will automatically be included, only that the Rule will not operate to allow exclusion solely be-

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complex policies").

377. *See id.* at **42–43; *see also supra* notes 78–83 and accompanying text.

378. *See* Cracker Barrel No-Act, *supra* note 10. According to Wallman, "Cracker Barrel has had little practical effect." Release, *supra* note 4, at *163 (Wallman, Comm'r, concurring) (observing that this is due to the fact that proponents of proposals implicating Cracker Barrel have either had their interests addressed, voluntarily withdrawn their proposals, or had their proposals included despite the Cracker Barrel decision). But, Wallman felt that Cracker Barrel should have been reversed immediately because it negatively reflected on SEC priorities and amounted to "bad public policy." *Id.* at *164.

379. *See supra* Part II; Release, *supra* note 4, at **42–44.

380. *See* Release, *supra* note 4, at *44. "The distinctions recognized by the staff are characterized by many as tenuous, without substance and effectively nullifying the application of the ordinary business exclusion to employment-related proposals." *Id*.

381. For example, in 1995, the Interfaith Center on Corporate Responsibility (ICCR) and the Comptroller of the City of New York filed a rulemaking petition calling for the reversal of Cracker Barrel. *See* Wallman, *supra* note 15, at 425. This is a drastic dividing area between companies and shareholders. In the questionnaire, 86% of shareholders favored reversing Cracker Barrel as opposed to 91% of companies against reversing the decision. *See* Release, *supra* note 4, at *45 n.72.

382. *See* Release, *supra* note 4, at *47 n.74.

383. *See id.* at *46. The reversal was effective May 21, 1998. *See* Amendments, *supra* note 9, at 29,108 n.33. In the 1996 proxy season, the SEC received about 30 requests for no-action letters involving the Cracker Barrel position. *See* Release, *supra* note 4, at *112.

cause the proposal concerns employment-related issues.[384] Nevertheless, with this change, the SEC may determine that employment-related proposals raising significant policy issues must be included in the company's proxy materials. Discussing the reversal, the SEC stated:

> Since 1992, the relative importance of certain social issues relating to employment matters has reemerged as a consistent topic of widespread public debate. In addition, . . . we have gained a better understanding of the depth of interest among shareholders in having an opportunity to express their views to company management on employment-related proposals that raise sufficiently significant social policy issues.[385]

The SEC reiterated that the determination of whether an employment-related proposal is excludable will be made according to the Commission's 1976 Release.[386] As such, the employment-based nature of the proposal will no longer be the issue; rather, the issue will be only whether the subject matter raises a significant social policy issue.[387] Now that the SEC has decided to return to line-drawing, only time will tell the reversal's true effect.[388] In fact, the Release stated that some issues — such as Maquiladora operations and "workplace practices" may continue to raise onerous interpretive questions.[389]

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384. *See* Amendments, *supra* note 9, at 29,108.

385. *Id.*

386. *See id.*

387. *See id.*

388. Proponents expressed concern over a footnote referenced in the Release. *See* Carolyn Mathiasen, *SEC Publishes Final Shareholder Proposal Rule*, IRRC CORP. SOC. ISSUES REP., June–July 1998, at 11. This footnote, number 79, used Capital Cities/ABC as an example of a proposal that would still be excludable under the new interpretation. *See id.* In Capital Cities/ABC, proponents asked for certain EEO-1 data; however, the SEC allowed the company to omit the proposal because it was too detailed. *See id.* Proponents were concerned that this footnote meant that all proposals seeking similar data would be excludable. *See id.* at 11–12. The SEC clarified this reference in the Amendments, indicating that "we cited Capital Cities/ABC, Inc. only to support the general proposition that some proposals may intrude unduly on a company's `ordinary business' operations by virtue of the level of detail that they seek." *Id.* at 12 (quoting Amendments, *supra* note 9, at 29,109). The SEC did not intend this citation to imply that all similar proposals would be automatically excludable. *See id.*

389. *See* Release, *supra* note 4, at **47–48.

3. Definition of a "Proposal"

The SEC also adopted the Release's recommended addition of a definition of a "proposal" to Rule 14a-8.[390] According to this definition, a proposal is "a request that the company or its board of directors take an action."[391] Rule 14a-8's underlying rationale is that a proposal seeking only to express the proponent's point of view is not within the Rule's purpose.[392] Thus, such a proposal should be properly excludable under the Rule. In adopting this amendment, the SEC clarified that proposals seeking information only will not necessarily be excluded for that reason alone.[393]

This definition should not be a significant roadblock to proponents. Similar to couching a proposal in precatory language to thwart the operation of the "proper under state law" exclusion, a proponent should be able to phrase the proposal in proper language to avoid being excluded under this new definition.[394] Therefore, future proponents will merely need to phrase their proposals in such a way that requests action by the company.

4. Eligibility Requirements

Due to inflation, the Release advocated changing the ownership requirements from $1000 of continuous share ownership to $2000.[395] Some companies proposed increasing these eligibility requirements to reduce the number of proposals that must be included annually.[396] However, as recognized by the SEC, these interests must be balanced with smaller shareholders' interest in equal access to proxy

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390. *See id.* at **82–83.

391. *Id*.

392. *See id.* at *83. The SEC cites its Pacific Gas & Electric Co. (Pacific Gas) decision to demonstrate the definition's effect. *See id.* at *83 n.105. In Pacific Gas, the proponents sought to air their disapproval of Pacific Gas's backing of a certain legislative action. *See id*. at *83. The SEC declined to support the company in omitting the proposal. *See id*. However, the Release stated that now such a proposal would be found properly excludable by the SEC. *See id.* (citing Pacific Gas & Elec. Co., SEC No-Action Letter (Jan. 21, 1997)).

393. *See* Amendments, *supra* note 9, at 29,111.

394. The "proper under state law" exclusion is found in 14a-8(c)(1). 17 C.F.R. § 240.14a-8(c)(1) (1998).

395. However, since the Rule's adoption inflation has only accounted for $600. *See* Release, *supra* note 4, at *84. The SEC proposes the $1000 increase "to account for future inflation, and because it will be easier to use for calculations." *Id.*

396. *See id.* at *9.

materials — "a more significant increase could restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders."[397] In keeping with this purpose, the SEC chose to adopt the $2000 requirement despite comments that the increase is not enough to be meaningful.[398]

B. Proposed Amendments Not Adopted

1. Personal Claim or Grievance Exclusion

The SEC did not adopt its proposal to change the administration of the personal claim or grievance exclusion.[399] The current Rule is designed to ferret out proposals intended to advance a personal claim or grievance.[400] Administration of this Rule becomes arduous when the proposal is "neutral on its face," meaning that the words of the proposal itself do not convey the personal grievance or claim.[401] In 1982, the SEC stated that this exclusion is "perhaps the most subjective provision and definitely the most difficult for the staff to administer [because it] requires the staff to make determinations essentially involving the motivation of the proponent in submitting the proposal."[402] Currently, when a company seeks to exclude a facially neutral proposal on personal grievance or claim grounds, the SEC reviews circumstantial evidence presented by both parties.[403] However, in the past, the SEC has rarely found facially neutral proposals excludable.[404]

The SEC proposed that facially neutral proposals reviewed by

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397. *Id.* at *84. This statement recognizes the Rule's true purpose as a communication tool for shareholders.

398. *See* Amendments, *supra* note 9, at 29,111–12.

399. *See* Release, *supra* note 4, at *28.

400. *See id.* The policy behind this exclusion is that such proposals probably will not benefit all shareholders. *See id.*

401. *See id.* at *29.

402. *Id.* at *28 (quoting Exchange Act Release No. 19,135, 47 Fed. Reg. 47,420 (1982)).

403. *See id.* at *29.

404. *See id.* (citing Service Corp. Int'l, SEC No-Action Letter (Feb. 28, 1997); Nortek Inc., SEC No-Action Letter (Aug. 13, 1996)).

the staff would receive "no view" responses.[405] These no view responses would have allowed companies to exclude the proposal "if they believe they possess adequate factual records to demonstrate the personal grievance or interest."[406] Thus, the SEC would no longer have made these factual determinations.[407] Essentially, this would have meant that companies receiving no view responses to their requests for no-action letters could have excluded neutral proposals.[408] However, proponents were concerned that such a change could have forced them to seek relief in the courts to have their neutral proposals included in proxy materials.[409]

In declining to adopt this proposal, the SEC noted the concerns expressed by proponents,[410] stating: "We agree that the proposal might increase the likelihood of disputes between shareholders and companies."[411] The SEC announced that it will continue to administer the Rule by "making case-by-case determinations on whether the rule permits exclusion of particular proposals."[412]

2. *The Relevance Exclusion*

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405. *See* Release, *supra* note 4, at **29–30.

406. *Id.* at *30.

407. *See id.*

408. Nell Minow, a respected authority on corporate governance and co-founder of LENS, stated in her comment letter:

> [W]hat I consider the most dangerous part of the current proposal, the proposed amendments to the "personal claim or grievance exclusion." . . . Under the proposed change, a company could simply assert that our [LENS] proposal was based on a "grievance" with the company, leaving us no recourse but expensive litigation. If the proposal is, in terms of the Release "neutral on its face," it deserves to be included on the company's proxy and voted on by shareholders.

Minow, *supra* note 121.

409. *See* Mathiasen, *supra* note 388, at 12 (noting that this was particularly true of labor union activists).

410. *See* Amendments, *supra* note 9, at 29,112 (stating that "[s]ome shareholders, for instance, were concerned that companies might rely on the rule to exclude proposals focusing on social policy matters").

411. *Id.*

412. *Id.*

The SEC also did not adopt the proposed change involving a narrowing of what is commonly called the relevance exclusion.[413] The Rule currently allows a company to exclude a proposal relating to operations that account for less than five percent of its net earnings, gross sales, and total assets for the most recent fiscal year, as long as the proposal is not "otherwise significantly related" to the company's business.[414] This exclusion has a rocky history. In 1976, the SEC rejected a pure economic standard due to concerns that some issues, such as cumulative voting rights, may not have a quantifiable economic value.[415] Then, in 1982, the SEC changed the Rule to reflect the current five percent economic test combined with the not "otherwise significantly related" language.[416] This latter language has caused the most recent controversy due to its subjective character, which tends to eclipse the economic portion of the Rule.[417] According to the SEC, only two companies successfully omitted proposals under this exclusion between September 30, 1996, and September 18, 1997.[418]

The proposed narrowing of the relevance exclusion would have removed the "otherwise significantly related" language, thus leaving a strict economic test.[419] However, to appease shareholders, the SEC would have lowered the economic threshold.[420] The new standard would have been "the lesser of either $10 million in gross revenue or total costs (whichever is appropriate), or 3% of gross revenues or total assets (whichever is higher)."[421] The SEC felt that this proposal

413. *See id.* at 29,113; Release, *supra* note 4, at *31.

414. *See* Release, *supra* note 4, at *31; 17 C.F.R. § 240.14a-8(c)(5) (1998).

415. *See* Release, *supra* note 4, at **31–32 (citing Adoption of 1976 Amendments, *supra* note 80).

416. *See id*. at *32 (citing Exchange Release Act Release No. 19,135, 41 Fed. Reg. 52,994 (1982)); *supra* notes 86–87 and accompanying text.

417. The proponent bears the burden of proving that "the proposal is otherwise significantly related" to the company's business. Release, *supra* note 4, at *31 (quoting Exchange Act Release No. 19,135, 41 Fed. Reg. 52,994 (1982)).

418. *See id.* at *33.

419. *See id.* According to Wallman, this shift may have been "even more restrictive than Cracker Barrel" because, by only focusing on historical financial data, "shareholder proposals motivated by far more important possible material liabilities or prospective costs, such as boycotts, negative publicity or lawsuits" would have been excluded. *Id.* at *160 n.2. For example, a proposal concerning slave labor employed by a company in Asia could be excluded according to this test, although such conduct may result in significant costs to both the company and its shareholders. *See id.*

420. *See id.* at *33.

421. *Id.* at *36. The SEC discusses what "appropriate" means in this context by way

answered the concern expressed by companies in the questionnaire that the current Rule requires the inclusion of too many irrelevant proposals.[422]

The SEC claimed that four precautions would have been in place to preclude the Rule from operating to exclude significant proposals with a low economic value.[423] First, responding to the 1976 argument, the Rule would not have applied to unquantifiable proposals that include proposals concerning cumulative voting.[424] Second, the lower economic threshold would have offset the removal of the "otherwise significantly related" language.[425] Third, only proposals concerning the purchase or sale of products and services would have been governed by the exclusion,[426] thus ensuring that the exclusion would not have been applied to internal governance issues.[427] Lastly, the override provision would have alleviated any evils of a strict economic test.[428]

Thus, as discussed below, the proposed override provision would have allowed a proponent to "override" the relevance exclusion by garnering the support of at least three percent of the outstanding

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of example. *See id.* at *40. For supply contracts, cost would be appropriate. *See id.* For retail operations, revenue would be more appropriate. *See id.* Further, the proposal states that the company will not be able to choose; however, it is not clear who does make the decision. *See id.* "The alternative 3% test would operate only to reduce the $10 million threshold, not to increase the threshold." *Id.* at *39.

422. *See id.* at *35. This is not the first time companies have advocated changing the Rule to a strict economic test. During the 1976 amendments, company advocates proposed codifying no-action letters addressing proposals concerning the Arab boycott of Israel. *See* STAFF OF SEC DIVISION OF CORPORATE FINANCE, 96TH CONG., 2D SESS., REPORT ON CORPORATE ACCOUNTABILITY B12, B56 (Comm. Print 1980) (citing International Business Machine Corp., SEC No-Action Letter (May 4, 1975)). A large number of proposals submitted by the American Jewish Congress requested information on each company's compliance with the boycott. *See id.* The SEC issued no-action letters supporting the omission of these proposals if the company did less than 1% business with any of the involved nations. *See id.* However, the SEC refused to codify this strict test because "the Commission does not believe that subparagraph (c)(5) should be hinged solely on the economic relativity of a proposal, since there are many instances in which the matter involved in the proposal is significant to the issuer's business, even though the significance is not apparent from an economic viewpoint." Adoption of 1976 Amendments, *supra* note 80, at 52,997.

423. *See* Release, *supra* note 4, at **35–36.

424. *See id.* at *36.

425. *See id.*

426. *See id.* at *37.

427. *See id.*

428. *See id*.

shares entitled to vote.[429] However, these precautions did little to allay proponents' fears that a strict economic test would preclude many social proposals.[430] While many company proponents favored the concept of a strict relevance test, they expressed concern that the proposed economic threshold was too low.[431] Thus, due to the lack of strong support from either side, the SEC chose to abandon the proposal.[432]

3. Resubmission Levels

The SEC would have dealt a severe blow to proponent shareholders if it adopted the Release's proposal to increase the resubmission levels.[433] Resubmission levels determine the percentage of support a same or substantially similar proposal must receive in order to be eligible for resubmission in a following year.[434] Currently, the Rule sets the resubmission levels at three percent for the first submission, six percent for the second, and ten percent for the third.[435] These levels apply if a proponent seeks to submit a proposal with the same or substantially the same subject matter within a five year period.[436] Thus, considering that most non-management supported proposals receive a minimal vote, the Rule serves as a powerful gatekeeper.

The proposed change alteration would have increased the resubmission levels to six percent, fifteen percent, and thirty percent for the first, second, and third submissions, respectively.[437] This would have given most social proponents only one shot at effecting a change in a company.[438] Hence, if this change "had been insti

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429. *See* Release, *supra* note 4, at *56; *see also infra* Part IV.B.4.

430. *See* Amendments, *supra* note 9, at 29,113.

431. *See id.*

432. *See id.*

433. *See* Release, *supra* note 4, at *51.

434. *See* 17 C.F.R. § 240.14a-8(c)(12) (1998). The standard for determining the percentage is a proponent-friendly "votes cast standard." *See* Release, *supra* note 4, at *54. Non-votes by brokers and abstentions are not included in calculating the percentages. *See id.*

435. *See* Release, *supra* note 4, at *51; 17 C.F.R. § 240.14a-8(c)(12).

436. *See* 17 C.F.R. § 240.14a-8(c)(12).

437. *See* Release, *supra* note 4, at *51.

438. Social Investment Forum (SIF) conducted a "study-back" test to examine the effect of the proposed resubmission levels. *See Shareholder Proposals: Suggested Proposal Rule Would `Cripple' Dialogue, Coalition Warns*, BNA CORP. COUNSEL DAILY, Dec. 11,

tuted previously, shareholder advocacy campaigns on apartheid in South Africa, tobacco sales to American youths, and other issues would have been virtually impossible."[439] One of the most powerful weapons social proponents wield is their persistence. Under the current regime, management knows that the social proponent will not go away and will continue to submit the proposals year after year. This relentless barrage frequently results in negative publicity,[440] which generally makes management more willing to come to the table to negotiate a change to avoid the spotlight.

Therefore, due to the potential impact that increased resubmission levels could have on social proposals, proponents were up in arms over the proposed increases.[441] Companies, on the other hand, generally supported the increased thresholds.[442] Ultimately, however, the SEC decided against raising the resubmission levels.[443] In making this decision, the SEC stated, "[m]any commenters from the shareholder community expressed serious concerns about this proposal. We have decided not to adopt the proposal, and to leave the thresholds at their current levels."[444] Considering that resubmission levels have not increased since 1970, when social issues first began

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1997, at D3. The tests showed that only 20% of all proposals would be eligible for resubmission after the third year, as compared to 79% currently. *See id*. "Significantly, the SIF study concluded corporate social responsibility resolutions — addressing race, gender, environmental, or tobacco issues — would have been `destroyed.'" *Id.* Only 1% of these proposals would be eligible for resubmission after the third year, as compared to 69% currently. *See id.; see also Shareholder Proposals: Coalition Concern with Investor Rights Fights Proposed Shareholder Proposal Rule*, BNA CORP. COUNSEL DAILY, Oct. 24, 1997, at D2 (maintaining that "[i]n practical terms, the pernicious effect of this SEC-proposed change would be to kill most shareholder resolution campaigns in the cradle after their first year, before the process has had time to germinate").

439. Witmer, *supra* note 125, at D2. This sentiment was argued by the members of the Rainbow/PUSH Coalition, including CalPERS, LENS, and Rev. Jesse Jackson. *See id.*

440. For discussion of CalPERS' very publicized "dirty dozen" strategy, see Coffee, *supra* note 124 and accompanying text. Newspapers also pick up on the stories. The best example of publicity aiding the cause is Campaign GM. *See supra* note 73 and accompanying text.

441. *See* Bulliner, *supra* note 354; William Apfel, *Comment Letter to Commissioners and Staff* (visited Dec. 3, 1997) <http://www.sec.gov/rules/proposed/s72597/apfel1.htm>. The SEC website (<http://www.sec.gov>), posted all comment letters submitted electronically.

442. *See* Amendments, *supra* note 9, at 29,112.

443. *See id.*

444. *Id.* at 29,112–13. "[C]omment letters showed that institutions were worried that higher percentages would quickly kill off new proposals for which support takes time to build." Mathiasen, *supra* note 8, at 15.

appearing in proxy statements, Commissioner Laura Unger voiced surprise at this decision.[445]

4. Override Provision

The SEC also did not adopt the Release's proposed addition of an "override" provision, which would have allowed a proponent to bypass the ordinary business and relevance exclusions.[446] This override would have been triggered by a proponent who established that a minimum of three percent of the company's outstanding shares entitled to vote favored the proposal's submission for a vote at the meeting.[447] The proponent's own shares could have been included in arriving at the three percent figure.[448] In setting this percentage, the SEC attempted to balance two interests: (1) that the proposal is relevant and important enough to warrant inclusion in the proxy materials; and (2) that the override is attainable.[449] Thus, the percentage could neither be so high as to make the override unattainable nor so low that the exception abrogates the Rule.

By endorsing a proposal, a shareholder would neither have obtained proxy rights nor been guaranteed an affirmative vote for the proposal.[450] Furthermore, supporting a proposal would not have prevented a shareholder from submitting his own proposal.[451] However, only one proposal could be supported per meeting[452] — just as only one proposal may be submitted per meeting.[453] Moreover, the SEC also suggested "safe harbors" from other securities rules, such

445. *See* Mathiasen, *supra* note 8, at 15.

446. *See* Release, *supra* note 4, at *56. The relevance and ordinary business exclusions are contained in 17 C.F.R. § 240.14a-8(c)(5) and (c)(7), respectively. In the 1996 proxy season, the SEC agreed with the omission of almost 100 proposals under these two exclusions. *See* Release, *supra* note 4, at *112.

447. *See id*. at *56. Shareholder support would have to be shown at least "120 calendar days before the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting." *Id.* at *60. Additionally, each supporter must satisfy individual filing requirements. *See id.* at **60–62.

448. *See id.* at **57–58. Therefore, 3% ownership of a company's stock would guarantee overriding the operation of the ordinary business and relevance exclusions. *See id.* at *58.

449. *See id.* at *57.

450. *See id.* at *61.

451. *See id*. at *67.

452. *See* Release, *supra* note 4, at *67.

453. *See* 17 C.F.R. § 240.14a-8(a)(4) (1998).

as 13d-5 and 14a-1(*l*)(1);[454] but, since the SEC decided not to adopt this proposal, all ancillary proposed amendments also were not adopted.[455]

Although most proponents welcomed the override provision, many felt that the three percent threshold would have been unattainable for all but the largest investors.[456] Conversely, companies feared that the override provision would have led "to the erosion of the `ordinary business' and `relevance' exclusions . . . ."[457] In fact, companies were more willing to tolerate the current resubmission levels then risk the potential impact of the override provision.[458] Moreover, as noted above, these amendments were proposed as a "package"; thus, when the SEC rejected the strict economic test, the override provision also fell.[459]

5. Elimination of Rule 14-8(e)

Finally, the SEC decided not to adopt the Release's proposed elimination of Rule 14a-8(e).[460] This Rule provides an opportunity for staff review of a company's opposing statement included in the proxy statement upon request by a proponent.[461] Rule 14a-8(e)'s purpose is primarily to allow a proponent to take issue with any statements that may violate Rule 14a-9.[462] However, the Release stated that this Rule is infrequently used and, when used, rarely results in any changes.[463] Nevertheless, proponents opposed the elimination of this provision "because they believed that the potential for propo-

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454. *See* Release, *supra* note 4, at *68.

455. *See* Amendments, *supra* note 9, at 29,113.

456. "The new rules provide an automatic qualification for any resolution sponsored by the owners of 3% of a company's shares of stock. For most Fortune 500 companies, 3% of the shares means more than $1 billion worth of stock, which means only the biggest investors could wield this kind of clout. This is grossly discriminatory." Dj Bear, *Comment Letter to the Commissioner* (visited Dec. 3, 1997) <http://www.sec.gov/rules/proposed/s72597/bear1.txt>.

457. Amendments, *supra* note 9, at 29,113.

458. *See* Mathiasen, *supra* note 8, at 15.

459. *See supra* notes 351, 423–32 (discussing both the package approach as well as how the SEC intended the override provision to serve as one of the precautions to protect shareholders from the strict economic test).

460. *See* Release, *supra* note 4, at *89.

461. *See id*.

462. *See id.*

463. *See* Release, *supra* note 4, at *89. In fact, the proponent usually objects to statements that do not violate Rule 14a-9. *See id.*

nent objections deters companies from making materially false or misleading statements, and encourages negotiation between the company and proponent."[464] Taking this into consideration, the SEC declined to adopt the proposed amendment.[465]

C. Reactions to the Amendments

SEC Chairman Arthur Levitt, Jr. remarked that "no issue has generated more passion or been the subject of lengthier debate than the shareholder proposal rule."[466] Levitt also acknowledged that, compared to the original proposal, the final amendments may appear "modest in scope, but constitute what I believe are significant steps in redressing existing imperfections in the rule."[467] The SEC itself appears to be the biggest "loser."[468] The SEC noted that the unadopted proposals shared the common theme of reducing "the Commission's and its staff's role in the process."[469] Thus, the SEC has reluctantly left its role as referee intact. Overall, response from the SEC intimates that the Commission would have preferred enacting more comprehensive changes.[470]

Despite the SEC's apparent disappointment, both shareholder proponents and companies appear satisfied with the final changes. However, shareholder proponents have claimed victory with the final amendments.[471] Companies originally opposed Cracker Barrel's reversal but were willing to accept that reversal as part of a larger

464. Amendments, *supra* note 9, at 29,113.

465. *See id.*

466. *SEC/Shareholder Proposals -2: Cracker Barrel View Reversed*, DOW JONES NEWS SERVICE, May 20, 1998, at 1, *available in* WL, ALLNEWS Database.

467. *Id*.

468. *See* Matthew Greco, *Cracker Barrel Reversed*, INVESTOR REL. BUS., June 8, 1998, at 1 (citing Patrick McGurn, director of corporate programs at Institutional Shareholder Services).

469. Amendments, *supra* note 9, at 29,106.

470. *See* Mathiasen, *supra* note 8, at 15 (noting that Commissioner Laura Unger applauded the SEC staff for their efforts, but was disappointed that she was not "voting on a more comprehensive package that would have gotten the SEC out of the process of refereeing shareholder proposals").

471. *See* Marcy Gordon, *Companies Must Mull Social Policy Proposals*, PITTSBURGH POST-GAZETTE, May 24, 1998, at E4 (reporting that "[a] coalition of 340 social activist, religious and labor groups that had protested an earlier proposal by the Securities and Exchange Commission declared victory after the agency voted to adopt a revised set of rules").

reform package.[472] Therefore, companies cannot be too pleased with the results. SEC Commissioner Norman Johnson summed up the results most aptly, commenting that "[i]f all the participants are somewhat satisfied with these proposals then maybe the [C]ommission is doing something correctly."[473]

CONCLUSION

The SEC's laudable attempts at amending the shareholder proposal rule fell short due to the excessive criticism from both proponents and companies. By reigning in its more expansive proposal for changing the Rule, the SEC managed to appease both sides with the final amendments. Although the SEC may have stumbled off the path of protecting investors with the Cracker Barrel decision, it has recovered by reversing itself with the amendments to the Rule. However, the extent of that recovery will only become evident over time as the SEC returns to subjective case-by-case analysis. In today's employee-intensive society, employment-related proposals are a proper subject for shareholder action not only for social reasons, but also because positive employment policies enhance long-run profitability. Moreover, at the very least, such policies avoid the costly litigation that is so prevalent today.

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472. *See* Stone & Kewalramani, *supra* note 9, at B9.

473. *SEC/Shareholder Proposals -2: Cracker Barrel View Reversed*, *supra* note 466, at 1.