THE SHAREHOLDER PROPOSAL RULE: A FAILED EXPERIMENT IN MERIT REGULATION

Alan R. Palmiter*

A system of prior restraint is in many ways more inhibiting than a system of subsequent punishment. It is likely to bring under government scrutiny a far wider range of expression; . . . the system allows less opportunity for public appraisal and criticism; the dynamics of the system drive toward excesses, as the history of all censorship shows.¹

For more than half a century, the SEC’s shareholder proposal rule has been a corporate curiosity. A glaring inroad into management’s control over the process and content of the solicitation of shareholder proxies, Rule 14a-8 mandates that public companies subsidize access to the company’s proxy mechanism for shareholders who offer “proper” proposals.² If a shareholder proposal satisfies the rule’s daunting agency-made conditions, management must include it in the company-funded proxy statement and give the body of shareholders a chance to vote on it.³ If the proposal does not, management can effectively block shareholder access to the proxy machinery for initiating corporate reforms.

The history of Rule 14a-8 offers, in microcosm, a study of federal involvement in the shareholder-management relationship of the American public corporation. Emerging from the Great Depression, the SEC promulgated the rule in 1942 to catalyze what many hoped would be a functional “corporate democracy.”⁴ During the 1950s, sensing that “what is good for GM is good for America,” the agency added layers of conditions to the rule and

---

¹ Professor, Wake Forest University School of Law. I wish to thank Dale Oesterle, Michael Curtis, and Ron Wright for their helpful comments, and Scott Davis for his research assistance.

⁵ REPORT OF THE SEC, PROPOSAL TO SAFEGUARD INVESTORS IN UNREGISTERED SECURITIES, H.R. DOC. NO. 672, 79th Cong., 2d Sess. 18 (1946).

879
gutted meaningful shareholder access. Later, as Vietnam and Watergate led Americans to question their political institutions, federal courts and the SEC opened the 14a-8 door for shareholders to join in the questioning of America's corporate institutions. In the 1980s, as America turned inward, the Reagan-inspired SEC sought to squelch access by social/political activists and enlarge the role of shareholders seeking governance changes. Today, with the rise of shareholder activism, the rule—and with it the public corporation—faces a defining moment.

This Comment looks at the operation of the current shareholder proposal rule and criticizes the SEC's self-appointed role to define the proper subjects of the dialogue between public shareholders and management. I argue that Rule 14a-8's regulation of the merits of shareholder communications—nonexistent under other SEC rules that compel management to act as a conduit of information for shareholders—disserves the rule's valuable purposes and is at odds with the spirit of the agency's recent moves to facilitate shareholder communications.

The responsibility for regulatory reform lies with the SEC. From the beginning, Rule 14a-8 jurisprudence—both in quality and quantity—has rested almost exclusively with the agency, not the courts or Congress. At the heart of the rule is its mandatory no-action procedure, which assigns to the staff of the SEC's Division of Corporate Finance the task of mediating all Rule 14a-8 interpretive disputes. Since 1947 the rule has re-


Legislative supervision has been cursory. See Security and Exchange Commission Proxy Rules: Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce, 78th Cong., 1st Sess. (1943) (hearings considering bills that would give shareholders power to nominate directors); STAFF OF SENATE COMM. ON BANKING, HOUSING, AND URBAN AFFAIRS, 96TH CONG., 2D SESS., STAFF REPORT ON CORP. ACCOUNTABILITY (Comm. Print 1980) [hereinafter STAFF REPORT] (examining rules relating to shareholder communications, shareholder's participation, and corporate governance).

Shareholder Proposal Rule

Required management to submit for SEC no-action review every shareholder proposal it intends to omit from the company’s proxy materials. Rarely do disappointed proponents seek judicial review. In fact, until 1990, only thirteen reported court cases (about one every four years) arose out of the hundreds of annual 14a-8 exclusions. When courts do hear disputes under the rule, their review is often case-specific and generally deferential.

One would think that such a well-ensconced tradition of administrative litigation must have something going for it—not so. The history of the SEC as arbiter of a proper dialogue between shareholders and management under the rule has been

7. Proposals of Security Holders, 17 C.F.R. § 240.14a-8(d) (1983). Under the current rule, management must submit to the SEC Division of Corporate Finance a statement of its objections, along with a copy of the proposal, at least 80 days before filing its proxy materials. If management objects to a proposal “based on matters of law,” it must submit a supporting opinion of counsel. § 240.14a-8(d). There is no penalty for frivolous or groundless objections.

A no-action letter typically states that, on the basis of the facts presented in management’s letter, the staff will not recommend that the Commission institute any enforcement action against the registrant if it omits the proposal from its proxy statement. Herbert A. Gocha, Jr., Comment, The 1980’s Amendments to Shareholder Proposal Rule 14a-8: A Final Damper on Dissent?., 17 U. Tol. L. Rev. 411, 429-30 (1986).

8. Since 1990, in a relative explosion in 14a-8 litigation, there have been eight reported court cases, an average of two per year. This is eight times as many as in the pre-1990 period, even though the total number of proposals has not increased proportionally. See, e.g., New York City Employees’ Retirement Sys. v. Dole Food Co., 795 F. Supp. 95 (S.D.N.Y.) (shareholders sought preliminary injunction after Dole attempted to omit their proposal regarding national health care), appeal dismissed, 969 F.2d 1430 (2d Cir. 1992).


tumultuous. Since its promulgation five decades ago, the rule itself has undergone no less than fourteen revisions.\textsuperscript{10} Lately, the agency's interpretive flip-flops in no-action letters have become legion.\textsuperscript{11} Over the last decade, with the most minimal of explanations and without any formal rulemaking, the agency has openly reversed itself on the propriety of proposals raising such matters as executive compensation, tobacco production, board composition, and employment policies.\textsuperscript{12} And, without acknowledging the shift, the SEC staff is now thirty percent more likely to permit the exclusion of proposals urging greater corporate social responsibility than was the case ten years ago. Adding to the confusion, the federal judiciary has joined the ruckus, in recent cases chastising (and mirroring) the agency's aimless vacillation.\textsuperscript{13} In short, the rule is today in chaos.


\textsuperscript{12} See infra notes 115-69 and accompanying text. Some of the SEC's positions are contrary to previous court interpretations. See Dole, 795 F. Supp. at 100 (requiring inclusion of proposal on national health care plan because it constitutes a "significant strategic decision as to . . . daily business matters"); Cracker Barrel Old Country Store, Inc., SEC No-Action Letter, 1993 SEC No-Act LEXIS 51 (Jan. 15, 1993) (permitting exclusion of proposal barring discrimination on ground related to "ordinary" employment matters).

Other court cases are contrary to long-held agency interpretations. See Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 892 (S.D.N.Y. 1993) (rejecting the SEC's reinterpretation of 14a-8's "ordinary business" exclusion that affirmative action and equal employment opportunity policies are excludable); see also Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 5599, 41 Fed. Reg. 52,994, 52,998 (Nov. 22, 1976) (proposals having "significant policy, economic or other [major] implications" are "beyond the realm of an issuer's ordinary business operations").

\textsuperscript{13} For example, in Amalgamated Clothing, the court enjoined Wal-Mart's exclusion of a proposal that requested the board to prepare a report on the company's equal opportunity and affirmative action policies, since it raised "substantial policy considerations . . . in light of, among other things, the continual interest of Congress in employment discrimination since 1964." 821 F. Supp. at 891. The court never
Until recently, the stakes presented by Rule 14a-8 and the consequences of the SEC's erratic and desultory performance have been low. During its first four decades, shareholder proposals faced near certain defeat by wide margins at the ballot box. As of 1981, only two contested shareholder proposals of the thousands submitted had ever won.\(^{14}\) The rule's subsidized access to the company's proxy materials amounted to little more than a nuisance for corporate management and a slight burden on the SEC staff. Based on management's statement of costs, I estimate that annual compliance costs total about $15 million.\(^{15}\) The SEC has estimated its regulatory costs to be equivalent to one staff year.\(^{16}\)

In the late 1980s institutional shareholders brought Rule 14a-8 out of its quaint and curious shell, employing the rule as a potent tool for corporate governance reform. They proposed such changes as limits on golden parachutes and executive pay, repeal of staggered boards, redemption of poison pills, reduction of supermajority voting requirements, opting out of antitakeover


\(^{15}\) In 1992, shareholders submitted a total of about 900 proposals, half of which were included in companies' proxy statements. Assuming costs of $30,000 per included proposal and $4000 per excluded, total compliance costs amounted to $15.3 million.

My estimates of costs are based on company estimates from the early 1980s. In response to an SEC inquiry, companies estimated the administrative and legal costs of excluding a proposal to be between $2000 to $4600, and the printing, mailing, and administrative costs of including a proposal to be between $18,760 to $44,000. See \textit{Proposed Amendments to Rule 14a-8}, Exchange Act Release No. 19,135, 47 Fed. Reg. 47,420, 47,424 n.17 (Oct. 14, 1982); \textit{see also} Liebeler, \textit{supra} note 14, at 454 n.156 (using reported costs of shareholder proposals in 1976 and 1981 to estimate that shareholder proposals, both included and excluded, during 1975-1976 proxy season cost U.S. companies a total of $7 million).

statutes, establishment of confidential voting, and greater roles for outside directors. 17 Some recent proposals have won outright; others have led managers to negotiate settlements rather than face the embarrassment of a shareholder rebuff. 18 Over the last couple of years, the rule has served as the springboard for direct shareholder access to directors and management. 19

The rule’s mandate of subsidized access gives meaning to the right of shareholders under state law to initiate corporate reforms through resolutions and bylaw amendments. Rule 14a-8, like the rest of the federal proxy rules, breathes life into state voting rights otherwise blunted by the practical impediments presented by proxy voting. The power of shareholders to remold the corporation to changing environments—whether through revised governance structures or by refocusing corporate responsibility—takes on special importance with the increasing institutionalization of American equity ownership. As wider groups of people become beneficial owners of the American public corporation, equity ownership increasingly mirrors political citizenship. The rule offers a singular mechanism for investors to shape particular firms and the body politic to define the American


During the 1993 proxy season, institutional investors and organized shareholder groups (such as unions and the United Shareholders Association) “sponsored a total of 70 corporate governance proposals, up from 54 in 1992.” Institutions, Activist Groups Sponsored More Governance Proposals in 1993 Season, BNA'S CORP. COUNS. WKLY., June 9, 1993, at 3.

18. In 1991, for example, shareholder proposals against poison pill plans received, on average, 44.8% support, and proposals to reduce supermajority voting requirements received 47.2% support. Proponents withdrew a record 46 proposals following negotiated settlements. Robert Walters, Study Documents Rising Institutional Ownership, CORP. GOVERNANCE BULL. Sept./Oct. 1991, at 15 (summarizing study by Carolyn Kay Brancato, executive director of Institutional Investor Project of Columbia University Law School’s Center for Law and Economic Studies).

19. See revised SEC Proxy Rules, 20 Pens. & Benefits Rep. (BNA) 1572 (July 26, 1993) (reporting that institutional investors are using the Council of Institutional Investors as clearinghouse to communicate with management); Use of Proposals as Negotiation Tool Seen Growing under Communication Rules, BNA'S CORP. COUNS. WKLY., Mar. 3, 1993, at 3 (reporting view of John Wilcox, chairman of the proxy solicitation firm Georgeson & Co., that institutional proponents will use the rule to reach negotiated agreements with management without formally submitting proposals).
corporation.

Standing in the way of the rule’s purposes is the SEC’s attempt to channel the shareholder-management dialogue through a regime of administrative licensing of corporate speech. The time has come to jettison 14a-8 merit regulation, a vestige of another time and regulatory attitude. The decision whether a proposal is “substantially related” to the company’s business or an “ordinary business” matter—two exclusionary grounds that test the merits of a proposal—should be left to the shareholder voting process or, in the unusual case, to dispute resolution under state corporate law. As the last few traumatic proxy seasons demonstrate, the agency’s attempts to pass on the merits of the shareholder-management dialogue offer a sad picture of an officious, though well-meaning, bureaucracy.

Eliminating 14a-8 merit regulation does not necessarily call for the SEC to abandon its traditional oversight of subsidized access to the proxy machinery. The agency and its no-action procedure serve a valuable function to prevent shareholder proposals from clogging management’s use of the proxy mechanism and to filter out vexatious, frivolous, fraudulent, or unintelligible proposals. Without merit regulation, however, further adjustments to the system of procedural oversight are in order. Unlike the political system’s mechanisms of voter petitions and primary elections, Rule 14a-8 lacks a method to condense the number of initiatives. A merit-free rule should limit the number of subsidized proposals; I propose a limit of seven per company. If there are more than seven qualifying proposals, the rule should provide access only to those proponents (or groups of proponents) with the largest shareholdings—in effect, a variable minimum ownership requirement.

This Comment proceeds as follows. Part I outlines the current rule and the agency’s stated reasons for limiting shareholder access in public corporations. Part II summarizes the purposes of subsidized access to the proxy mechanism and the evolution of the policy debate on the subsidy. Part III reviews the justifications for the current rule’s exclusionary structure and criticizes the SEC’s attempts to define the “proper subjects” of the shareholder-management dialogue. Part IV presents and critiques my proposal to amend the rule to excise the most troubling (and troubled) aspects of 14a-8 merit regulation and to
impose instead numerical limitations on shareholder access to the corporate reform mechanism.

I. THE CURRENT RULE

Rule 14a-8, in its current form, compels reporting companies that solicit proxies to print and mail with management’s proxy statement, and to place on management’s proxy ballot, any “proper” proposal submitted by a qualifying shareholder.\(^\text{20}\) By shifting the proposing shareholder’s solicitation costs to the company, the rule compels the body of shareholders to subsidize self-appointed corporate reformers.

The SEC-mandated subsidy does not, however, create an open forum for shareholder communications. Rule 14a-8 imposes on shareholders strict procedural rules of access and gives management a daunting array of reasons, many content-based, to exclude a shareholder proposal.\(^\text{21}\)

A. Anticongestion Conditions

Many of the rule’s access conditions seek to ensure an orderly solicitation process so that shareholder proposals do not choke the company-funded proxy mechanism or interfere with management’s solicitation efforts.\(^\text{22}\) Some protect the solicitation process without regard to a proposal’s content: the proponent’s submission must be submitted four months before the annual meeting so that management has time to include the proposal or seek SEC review;\(^\text{23}\) the proponent can submit only one resolution per meeting;\(^\text{24}\) and the proposal and accompany-


\(^{21}\) Id.


\(^{23}\) Proposals of Security Holders, 17 C.F.R. § 240.14a-8(a)(3) (1993). For an annual meeting, the proposal must be received at the company’s principal executive offices at least 120 calendar days before the date that last year’s proxy materials were sent out, if the current year’s meeting is scheduled to fall within 30 days of the date of last year’s meeting. § 240.14a-8(a)(3). To avoid any controversy, the SEC advises proposing shareholders to send their proposals by certified mail, return receipt requested. § 240.14a-8(a)(3) (see “Note” subsequent to § 240.14a-8(a)(3)).

\(^{24}\) Proposals of Security Holders, 17 C.F.R. § 240.14a-8(a)(4) (1993). Originally,
Shareholder Proposal Rule 887

ing statement cannot exceed 500 words—approximately two double-spaced typewritten pages.\textsuperscript{25}

Other requirements seek to avoid shareholders converting management's proxy solicitation into an open forum in which shareholder proposals could swamp or confound management's solicitation: the proposal may not substantially duplicate another shareholder proposal that management already plans to include;\textsuperscript{26} the proposal may not be counter to a proposal that management plans to submit at the meeting;\textsuperscript{27} the proposal may not nominate directors or officers;\textsuperscript{28} and the proposal may


28. Proposals of Security Holders, 17 C.F.R. § 240.14a-8(c)(8) (1993). This exclusion is directly at odds with shareholder initiation rights, which include nominating and electing directors at the shareholders' meeting. It is an anomaly that the rule excludes the most significant shareholder function in corporate governance—the election of directors. Without the exclusion, however, "firms might be forced to list as candidates innumerable small investors with no significant support." George W. Dent, Jr., Response, Proxy Regulation in Search of a Purpose: A Reply to Professor Ryan, 23 GA. L. REV. 815, 824 (1989). Recently, Congress has conducted hearings into mandating greater shareholder access in the nomination process. See Sheldon Yett, Markey to Introduce Shareholder Empowerment Measure, CORP. FINANCING WK. (Nov. 8, 1993) (describing Rep. Markey's plans to introduce legislation that would permit large shareholders or groups to nominate board candidates who would appear on company's proxy materials).

Moreover, the leading case on the proper scope of shareholder resolutions, Auer v. Dressler, 118 N.E.2d 590, 593-94 (N.Y. 1954), upheld the right of shareholders to propose a precatory resolution seeking the reinstatement of the company's former president.
not relate to specific amounts of cash or stock dividends.\textsuperscript{29} Consistent with management's control of the proxy solicitation process, the rule permits management to state in the proxy statement and on the proxy card its opposition to a shareholder proposal, thus giving management the last word.\textsuperscript{30}

\textbf{B. Anticrackpot Conditions}

Other provisions of Rule 14a-8 filter out vexatious, illegal, deceptive, and unintelligible proposals. As one court explained, the rule's structure prevents "an all-purpose forum for malcontented shareholders to vent their spleen about irrelevant matters."\textsuperscript{31}

Some of the anticrackpot exclusions are content-neutral: the proponent must have owned (beneficially or of record) at least one percent or $1000 worth of the company's voting securities for at least one year;\textsuperscript{32} the proposal may not substantially be the same as a prior unsuccessful proposal submitted in the last five years that failed to garner a vote of at least three percent on its first try, or six percent on its second try, or ten percent after three tries;\textsuperscript{33} and the proponent must appear at the

\textsuperscript{29} Proposals of Security Holders, 17 C.F.R. § 240.14a-8(c)(13) (1993). In adopting this exclusion, the SEC stated its concern that "several proponents might independently submit to an issuer proposals asking that differing amounts of dividends be paid." Adoption of Amendments, Investment Act Release No. 9559, 41 Fed. Reg. 52,994, 52,999 (Nov. 22, 1976). Nonetheless, shareholders can present proposals concerning dividends "to the extent such proposals are advisory in nature." Id.


shareholders’ meeting and continue to own a qualifying number of shares. 34

Other exclusions, based on the proposal’s content, carry out the state law mandate that shareholder communications relate to the shareholder’s interest as such: the proposal may not relate to the redress of the proponent’s personal claim or grievance; 35 the proposal may not be beyond the company’s power to effectuate; 36 the proposal may not be moot; 37 the proposal may not seek to have the company violate any law, 38 and the proposal may not violate the federal proxy rules, 39 including the antifraud provisions of Rule 14a-9 which prohibit false or misleading solicitations. 40 The SEC staff has also used the antifraud provision to justify exclusion of proposals that are “vague and indefinite.” 41 The “crackpot” exclusions have not created significant controversy.

33. The SEC has increased the “resubmission” percentages over time. 1948: less than 3% (if submitted at last annual meeting or a subsequent special meeting). Solicitation of Proxies, Exchange Act Release No. 4185, 13 Fed. Reg. 6678, 6679 (Nov. 5, 1948).

1954: less than 3% (if defeated in prior three to five years); less than 6% (if defeated in prior two years); less than 10% (if defeated in prior year). Solicitation of Proxies, Exchange Act Release No. 4979, 19 Fed. Reg. 246, 246 (Jan. 6, 1954); 1983: less than 5% (if defeated in prior three to five years); less than 8% (if defeated in prior two years); less than 10% (if defeated in prior year). Amendments to Rule 14a-8, Exchange Act Release No. 20091, 48 Fed. Reg. 38,218, 38,223 (Aug. 16, 1983).


C. Merit-Based Exclusions

The most frequently used (and most litigated) of the grounds for exclusion purport to test the content of the proposal against the state law scheme of centralized corporate governance: the (c)(1) "proper subjects" exclusion; the (c)(5) "substantially related" exclusion; and the (c)(7) "ordinary business" exclusion. 42

The first draft of the rule released for comment in 1942 did not include any "limitation whatsoever upon the shareholder as to what was proper for proposal at the annual meeting." 43 To address the stated concern of management that an open-ended rule would allow "libelous" or "scurrilous" materials to be placed in the proxy statement, 44 the new rule mandated inclusion of any shareholder proposal that was "a proper subject for action by the security holders." 45

In 1954, following the Commission’s successful challenge of the exclusion of a shareholder proposal seeking greater shareholder supervisory powers in SEC v. Transamerica Corp., 46 the Commission codified in the rule its view that "the laws of the issuer's domicile" determine the "proper subject[s]" for action by shareholders. 47 Among the agency's most established assumptions is that state law permits only precatory shareholder resolutions that request, but do not demand, board

42. For example, during the 1981 and 1982 proxy seasons, 124 of the 489 (25.4%) proposals that SEC staff found to be excludable were excluded on (c)(7) grounds. Proposed Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 19,135, 47 Fed. Reg. 47,420, 47,424 (Oct. 14, 1982).


44. Id. at 591-92.


46. 163 F.2d 511 (3d Cir. 1947) (only case in which SEC has sought to enjoin management solicitation for excluding shareholder proposals), cert. denied, 332 U.S. 847 (1948). The court upheld as "proper subjects" proposals (1) to require future shareholder ratification of management's choice of independent public auditor, (2) to change procedures to amend the company's bylaws, and (3) to require that a report of the annual meeting be sent to shareholders. Id. at 516-18.

action.\footnote{48}

The two other "merit" exclusions purport to define the scope of shareholders’ state-based rights to initiate corporate reforms under a regime of centralized corporate decision-making.\footnote{49} Under subsection (c)(5), the proposal must relate to operations that account for at least five percent of the firm’s total assets, gross annual sales or net annual earnings, or be "otherwise significantly related" to the firm’s business.\footnote{50} The exclusion is the culmination of a four-decade debate on the propriety of proposals dealing with social/political causes.\footnote{51} The SEC added it in 1972 to provide a more "objective standard" than the prior exclusion of proposals submitted primarily for the purpose of promoting "general economic, political, racial, religious, social, or similar causes."\footnote{52} According to the SEC, matters relating to ethical issues, such as political contributions and carrying on business in South Africa, may be significant even though not from a purely financial standpoint.\footnote{53}


49. Some of the anticongestion exclusions—those dealing with proposals counter to management proposals, proposals that relate to board elections, and proposals on specific dividends—might be seen as merit regulation. Their animating purpose, however, is not to solidify management decision-making, but rather to avoid a confused, unwieldy proxy solicitation.


51. See infra notes 147-68 and accompanying text.


53. One court has interpreted the (c)(5) exclusion broadly. Lovenheim v. Iroquois Brands, Ltd., 618 F. Supp. 554 (D.D.C. 1985) (holding a proposal calling for report to shareholders on forced geese feeding to be "significantly related to issuer's business," even though goose pate sales lost money and accounted for less than .05% of
Under subsection (c)(7), the proposal may not relate to the firm’s “ordinary business operations.” The SEC adopted the exclusion “to relieve the management of the necessity of including in its proxy material security holder proposals which relate to matters falling within the province of management.” Judicial interpretation of the “ordinary business” exclusion has been mixed, sometimes contradicting SEC interpretation but more often deferring to the staff’s views.

The “significantly related” and “ordinary business” exclusions create a near-perfect bureaucratic Catch-22. A proposal can be neither so general that it is unrelated to the firm’s business or so specific that it is a matter of ordinary business. The merit exclusions thus supply the SEC with sufficient textual ambiguity to construct a regime of censorship in which the agency has virtually complete administrative freedom.

56. For cases that refuse to adopt SEC interpretations see Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 661 (D.C. Cir. 1970) (holding that the precatory proposal that Dow Chemical not sell napalm for use against people was includable if management’s decision to continue napalm manufacture was motivated by political or moral preferences, not business considerations), vacated, 404 U.S. 403 (1972); Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 892 (S.D.N.Y. 1993) (holding that proposal for report on company’s affirmative action and equal opportunity employment practices raises “significant policy considerations” and is includable).


57. For example, in Roosevelt v. E.I. Du Pont de Nemours & Co., No. CIV.A. 91-556, 1991 WL 332260 (D.D.C. 1991), aff’d, 958 F.2d 416 (D.C. Cir. 1992), the court upheld management’s exclusion of a proposal requesting accelerated phase-out of chloro-fluorocarbons since the company already had adopted a policy to phase out CFCs “as soon as possible” and stated that “only management has the specialized skills necessary to make such daily business decisions about when a complete phase out of CFC production will be responsible and appropriate.” Id. at *2. See also Medical Comm., 432 F.2d at 679 (noting problem of rule’s under-inclusion and over-inclusion).
II. JUSTIFICATIONS FOR THE RULE

In this part, I consider the reasons for subsidized access to the proxy machinery before turning to a critique, in the next part, of the SEC's current limits on access.

A. Mandated Access and Informed Voting

The SEC originally justified subsidized access as a means to carry out the congressional directive that the SEC regulate deceptive practices in management's solicitation of proxies.\textsuperscript{58} On the theory that a management proxy statement would be misleading if it failed to state the subject and supporting justifications for shareholder proposals that management anticipated at the upcoming shareholders’ meeting, the rule requires management to include such proposals, along with the proponent's supporting statement.\textsuperscript{59} Some federal courts have recently accepted this justification for the rule.\textsuperscript{60} Further, if management fails to include a proper proposal, the proponent may bring a private cause of action to enjoin management's incomplete and misleading solicitation.\textsuperscript{61}


\textsuperscript{59} Amalgamated Clothing, 821 F. Supp. at 884.


Federal courts, however, have been less willing to infer a private cause of action to challenge SEC no-action positions taken under the rule. Section 25(a) of the 1934 Act limits judicial review to "orders issued by the Commission," and some
Under this view, the extent of management's 14a-8 obligations, like the rest of federal proxy regulation, hinges on state law voting rights. As the SEC's former Assistant Solicitor Milton V. Freeman pointed out, "[Rule 14a-8] in its fundamental aspects is not an invention of the SEC. It is an almost necessary consequence of the status of the individual shareholder under the laws of the various states of incorporation . . . . [Rule 14a-8] is merely a recognition of rights granted by state law."62

The legislative history of the 1934 Act, moreover, refers to the importance that shareholders be "enlightened not only as to the financial condition of the corporation, but also as to the major questions of policy which are decided at stockholders' meeting."63 State corporate law uniformly permits shareholders to offer resolutions at shareholders' meetings64 and to amend the corporate bylaws.65 Like voting, these are mandatory rights, courts have refused to review no-action positions by SEC staff. Amalgamated Clothing and Textile Workers Union v. SEC, 16 F.3d 254 (2d Cir. 1994) (dismissing petition to review SEC affirmance of staff no-action position on management exclusion of health care reform proposal); Kixmiller v. SEC, 492 F.2d 641, 645-46 (D.C. Cir. 1974) (holding that "[t]he Commission is the only effective vehicle through which all of the shareholders can have an opportunity to express themselves.") (quoting 116 Cong. Rec. E-2147 (Mar. 17, 1970)), vacated, 404 U.S. 403 (1972).

63. S. REP. NO. 1455, 73d Cong., 2d Sess. 74 (1934). See also Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 672 n.12 (D.C. Cir. 1970) ("Management's proxy statement is the only effective vehicle through which all of the shareholders can have an opportunity to express themselves.") (quoting 116 Cong. Rec. E-2147 (Mar. 17, 1970)), vacated, 404 U.S. 403 (1972).
64. See DEL. CODE ANN. tit. 8, § 211(b) (1991) (in addition to election of directors, "[a]ny other proper business may be transacted at the annual meeting"). See also David C. Bayne et al., Proxy Regulation and the Rule-Making Process: The 1954 Amendments, 40 Va. L. Rev. 387, 390-91 (1954) (idea of shareholders' meeting as "forum for free communication" is fundamental to Anglo-American jurisprudence").
66. See DEL. CODE ANN. tit. 8, § 109(a) (1991) ("the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote" unless the articles confer this power on the directors); see also REVISED MODEL BUSINESS CORP. ACT § 10.20(a) (1991) (board may amend or repeal bylaws unless the articles or the state corporate statute "reserve this power exclusively to the shareholders" or the shareholders
not subject to opt-out or amendment.\textsuperscript{66}

The point is important. Rule 14a-8, like federal proxy regulation in general, mandates subsidized access to ensure the effectiveness of shareholder state-based control rights in the face of the practical impediments of proxy voting in public corporations.\textsuperscript{67}

\textbf{B. The 14a-8 Subsidy and Suboptimal Shareholder Participation}

Subsidized access alleviates the collective action and free-rider problems that the management-dominated proxy mechanism creates for public shareholders who would initiate corporate reforms. Faced with the costs of moving fellow shareholders to collective action and a state law system that makes reimbursement by free-riding shareholders both voluntary and dubious, shareholder reform initiatives would be suboptimally produced unless subsidized.\textsuperscript{68}

Why is this so? The corporate governance structure requires a specified majority of shares approve any shareholder initiative. Unlike the pricing of corporate shares where a few informed investors can move the market, shareholder voting in public corporations requires collective action through the proxy mechanism. A shareholder who identifies a value-producing (or

\textsuperscript{66} DEL. CODE ANN. tit. 8, § 109(b) (1991) ("bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees"); REVISED MODEL BUSINESS CORP. ACT § 2.06(b) (1991) (essentially same).

\textsuperscript{67} DEL. CODE ANN. tit. 8, § 109(a) (1991) (if the articles confer power on the board over the bylaws, this "shall not divest the stockholders ... of the power, nor limit their power to adopt, amend or repeal bylaws"); REVISED MODEL BUSINESS CORP. ACT § 10.20(b) (1991) ("shareholders may amend or repeal the corporation's bylaws even though the bylaws may also be amended or repealed by its board of directors"). See SEC v. Transamerica Corp., 163 F.2d 511, 513 (3d Cir. 1947) (enunciating this principle as a matter of Delaware corporate law), cert. denied, 332 U.S. 847 (1948).

externality-reducing) corporate change must initially bear all the costs of developing the idea, communicating it to other shareholders, and soliciting their proxies for the change.69

If the proposal is unsuccessful, state law provides no mechanism for the dissident to demand reimbursement from the corporation. Even the proponent of a value-enhancing proposal can expect to gain only in proportion to his or her shareholdings. Corporate reimbursement of solicitation costs is discretionary and available, as a practical matter, only if the dissident gains control of the board of directors.70 And if the proposal reduces the uncompensated costs that the firm imposes on others, there is no state law mechanism for reimbursement (voluntary or otherwise) from other free-riding beneficiaries.

Exacerbating these problems is the phenomenon in public corporations of rational shareholder apathy. Public shareholders have little incentive to determine whether initiatives not supported by management have merit. The natural tendency is 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. That is, the chance of an outright voting victory is slim even in the case of value-producing proposals.

Some critics of Rule 14a-8 argue the collective action and free rider impediments that may have justified the rule for individual proponents no longer justify the rule in the wake of its use by institutional shareholders. The problems of suboptimal production, however, still exist even for larger shareholders.71


70. Cf. Rosenfeld v. Fairchild Engine and Airplane Corp., 128 N.E.2d 291, 293 (N.Y. 1955) ("stockholders . . . have the right to reimburse successful contestants for the reasonable and bona fide expenses").

71. See Dent, supra note 28, at 822 ("Rule 14a-8 can properly be used to overcome this collective action problem" for institutional shareholders).

Consider the numbers. A contested proxy solicitation for a large public company costs about $5 million. Even if we assume in this age of institutional activism that a highly desirable proposal (and request for reimbursement) would stand a 60-40 chance of succeeding, a rational institutional proponent would not undertake the effort unless it promised an expected increase in share value that offset the expected costs of the contest. In our example, with a 60% chance of reimbursement, the expected value to the shareholder of the reform would have to be greater than $2
The SEC recognized this when it amended the rule in 1987 to permit its use even by well-heeled shareholders who are independently conducting a proxy contest.\(^72\)

The SEC and commentators have defended the Rule 14a-8 subsidy as producing "significant revisions of corporate policy, even where the proponent shareholder has owned few shares."\(^73\) Lewis D. Gilbert, a pioneer and lifetime advocate of shareholder activism, used Rule 14a-8 to urge public companies to adopt more liberal dividend policies and consistent financial accounting\(^74\)—visionary ideas with which modern finance economists now agree.\(^76\) Other less notable, but equally prophetic, propo-

---

\(^72\) In 1987, the Commission revisited its 1982 amendments to permit use of the rule even if a qualifying shareholder was already independently conducting a proxy solicitation of 25% or more of the shareholders. Amendments with Regard to Rule 14a-8, Exchange Act Release No. 25,217, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,211, at 88,949 (Dec. 21, 1987). "Such independent solicitations may increase shareholder participation and broaden the opportunities for shareholders to receive information on corporate governance issues, as well as foster debate on these issues." Id. at 88,954.


\(^74\) Professor Loss calls Lewis Gilbert the "most celebrated minority stockholder." 2 Louis Loss, Securities Regulation 903 n.182 (2d ed. 1961). Professor Ryan recounts Gilbert's story:

Lewis D. Gilbert, a small shareholder (by virtue of a bequest) in the Consolidated Gas Company of New York, was a pioneer of shareholder activism. Angered by the ritualistic lack of meaningful content at the company's annual meeting in 1932, his response was to broaden his holdings in order to change both the nature of the shareholder meeting itself and the ways in which directors were allowed to run the corporation. He was chiefly concerned with undeclared dividends and with installing accounting and other monitoring devices to make directors more answerable to the shareholders. Ryan, supra note 17, at 117 n.77. With his brother John, the Gilberts became ardent users of the new Rule 14a-8. Their share of 14a-8 submissions increased from 47% during the period from 1948 to 1951 to 65% in 1955. Frank D. Emerson, Some Sociological and Legal Aspects of Institutional and Individual Participation Under the SEC's Shareholder Proposal Rule, 34 U. Det. L.J. 528, 542-43 (1957). Two decades later they were still going strong.

ponents urged a number of reforms, such as the spinoff by AT&T of its operating subsidiaries (well before Judge Green did AT&T shareholders the favor), the composition of board compensation and nominating committees to include only outside directors (before the practice became commonplace), and clearer and more complete disclosure of executive compensation (well before the SEC took up the issue). The significant number of proposals recently withdrawn because of negotiated management concessions illustrates the perspicacity of shareholder proponents.

To the extent the rule subsidizes shareholder discourse on externality-reducing proposals—whose value may not immediately or ever be reflected in share prices—the rule acts as a tax on public companies and their shareholders. The Rule 14a-8 tax, however, increasingly falls broadly on those who benefit from greater social utility. Rising institutional equity ownership has spread indirect corporate ownership to a wider range of Americans, so that today there is a significant identity between equity owners and beneficiaries of social-enhancing gains. To turn an old adage on its head: “What’s good for America is good for Wall Street.”

Professors Schwartz and Weiss argued that the rule led management to take actions, such as South African divestment and broader representation on GM’s board, “tied directly to or seemingly stimulated by shareholder proposals.”

79. Schwartz & Weiss, supra note 73, at 647-48. The phenomenon is not new. During the 1975-1976 proxy season, proponents withdrew 27 “social/political” resolutions and approximately 30 Arab boycott resolutions after negotiations with management. Schwartz & Weiss, supra note 73, at 647.
80. Schwartz & Weiss, supra note 73, at 646-47. See also Donald E. Schwartz, The Public-Interest Proxy Contest: Reflections on Campaign GM, 69 Mich. L. Rev. 419 (1971) (explaining the impact of Campaign GM). Campaign GM, a proxy solicitation effort, sought to create a shareholder committee on social responsibility and to enlarge the board to add women, Blacks, consumer advocates, community activists, and ecologists. Though the Campaign garnered less than 3% of the vote, GM management within three years added a black community leader, a woman, and a
religious-affiliated proponents have forged alliances with institutional investors.\textsuperscript{81} Even critics acknowledge that shareholders use the rule to "gain publicity for their pet causes and to embarrass management into changing its policies."\textsuperscript{82} Professor Liebeler brooded that the rule might lead management to be less inclined to pursue shareholder wealth maximization and might lead disgruntled shareholders to treat proposals as a substitute for selling their shares.\textsuperscript{83}

The tax imposed by Rule 14a-8 funds a dialogue with management that may well be less expensive and more effective than other government regulatory systems. Adopting a "shareholder consultation" explanation for the rule, Professor Ryan has argued that shareholder proposals "can put management on notice of shareholder expectations" and compared to such information as stock market performance are "harder to overlook or misinterpret."\textsuperscript{84} For example, the communicative value of corporate proposals and shareholder votes to adopt the Valdez Principles (as unlikely as such proposals are to succeed) would seem superior to an EPA mandated corporate attitude of environmental responsibility. Internalized values are better than those imposed externally. It is telling that management commentators generally disfavored the SEC's initiative in 1982 to permit companies to "opt out" of the rule,\textsuperscript{85} the Business Roundtable has

scientist to the board. GM also held annual conferences on "Progress in Areas of Public Concern" and sent lengthy reports of these conferences to its shareholders. \textit{Id.}


82. Dent, \textit{supra} note 28, at 820. \textit{See also} George W. Dent, Jr., \textit{SEC Rule 14a-8: A Study in Regulatory Failure}, 30 \textit{N.Y.L. Sch. L. Rev.} 1, 20-22 (1985) (stating that some evidence shows that publicity is the primary motive for most shareholder proposals).


84. Ryan, \textit{supra} note 17, at 112.

85. \textit{See} Liebeler, \textit{supra} note 14, at 442 n.102:

Xerox Corporation stated that "[t]he current 'system functions reasonably well'"
regarded the rule as “a viable and valuable part of corporate governance.”

C. The Current 14a-8 Debate

From the beginning Rule 14a-8 has generated unusually heavy academic attention. The debate on the rule has proceeded along a dialectic path.

In the first stage, reformers claimed the rule would foster “corporate democracy”—a value-laden term that meant different things for different people. For some it meant a greater role for equity investors in corporate governance and more management accountability to shareholders; for others it meant greater “corporate social responsibility”; and for others it simply offered supplemental information for shareholders. The phase lasted through the rule's 1983 amendments.

and does not have “any ‘reasonable substitute. ’” Owens-Illinois Inc. commented that “SEC regulation has to an extent introduced the elements of order, certainty and uniformity into the shareholder proposals process.” See also Richard L. Hudson, Firms Oppose Looser Rules on Meetings, WALL ST. J., Apr. 6, 1983, at 31 (explaining that corporations are rejecting SEC proposals to reduce government involvement in shareholder meetings).

86. STAFF OF SECURITIES EXCHANGE COMM’N DIV. OF CORPORATE FINANCE, 96TH CONG., 2D SESS., STAFF REPORT ON CORPORATE ACCOUNTABILITY 133 (Comm. Print 1980) (quoting statement of Business Roundtable, a group of CEOs from country’s largest 200 companies).

87. Through 1984, Professor Ryan included no less than 17 articles, seven student notes or comments, and one symposium in his “representative sample” of academic writings on the rule. Ryan, supra note 17, at 99 n.8.


89. In 1980 SEC staff prepared a 760-page report reviewing shareholder participation in the American public corporation. The staff concluded that shareholders had inadequate opportunities to take part in corporate governance and recommended (1) that the board of directors increase disclosure, (2) that the SEC continue to facilitate shareholder proposals, and (3) that shareholders be permitted to nominate directors. DIVISION OF CORPORATE FINANCE, SECURITIES AND EXCHANGE COMMISSION, 96TH CONG., 2D SESS., STAFF REPORT ON CORPORATE ACCOUNTABILITY 63 (Comm. Print 1980).

Some academic writers decried the SEC’s restrictive 1983 amendments. See Marilyn B. Cane, The Revised SEC Shareholder Proxy Proposal System: Attitudes, Results and Perspectives, 1985 J. CORP. L. 57 (1985); Sadat-Keeling, supra note 73,
In the second phase, revisionists attacked the rule as a misguided regulatory intrusion used chiefly by grandstanding social/political activists.\(^{90}\) Observing that shareholder proposals almost always lose, the revisionists claimed the rule to be either an illegal extension of the SEC's rulemaking power, a stupid imposition of regulatory costs for the benefit of habitual self-publicists, or both.\(^{91}\) They complained the rule was used "chiefly by time-worn gadflies or religious or political groups unable to achieve their ends through legitimate political mechanisms."\(^{92}\) Riding the rising tide of legal economics, Professor Liebeler concluded, "[T]he benefits of the rule are grounded in rhetoric, not in reason, and are, in all probability, nonexis-tent."\(^{93}\)

For the revisionists, the failure of 14a-8 proposals at the ballot box indicated the rule neither offered shareholders any material information\(^{94}\) nor affected management behavior. Writing at a time when hostile takeovers had real bite, they found more communication efficiency in shareholder exit than shareholder voice:

Stockholder participatory democracy is a myth; investors do not

\(^{90}\) "The real significance of these moves can only be understood in terms of a broadly-waged propaganda war that has been going on in the United States against large-scale corporate capitalism since at least the early part of this century." Manne, supra note 83, at 492.

\(^{91}\) Dent, supra note 82, at 20-22; Liebeler, supra note 14, at 442 n.102.

\(^{92}\) Dent, supra note 28, at 820 n.26 ("as of 1982, nearly half of all shareholder proposals were submitted by just five investors, two of whom were [the Gilbert] brothers acting as a team"); Ryan, supra note 17, at 147 (summarizing arguments of Liebeler and Dent). Liebeler stated that the rule was used by "very small number of professional proponents and religious groups." Liebeler, supra note 14, at 439.

Law school casebooks cultivate this reputation, as well, choosing court decisions on such social/political proposals as Dow's production of napalm during the Vietnam War. ROBERT W. HAMILTON, CASES AND MATERIALS ON CORPORATIONS - INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS (1976); LEWIS D. SOLOMON ET AL., CORPORATIONS (1982). See, e.g., Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 659 (D.C. Cir. 1970) (regarding the production of napalm), vacated, 404 U.S. 403 (1972).

\(^{93}\) Liebeler, supra note 14, at 466.

\(^{94}\) Liebeler, supra note 14, at 438 n.87. See also Dent, supra note 28, at 819 ("The problem with the disclosure explanation is that only material information must be disclosed, but the feeble support obtained by traditional proposals showed that shareholders did not consider them material.").
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 governed. 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.95

The views of the revisionists captured the imagination of the SEC and undergirded the 1983 amendments to the rule, which set into motion a still existing regulatory climate that squelches social/political proposals.96

Over the last several years, the fall of the hostile takeover and the rise of institutional activism cast the rule in a new light. A rising chorus of neo-reformers, beginning with Professor Ryan, rebutted the revisionists' pessimism by pointing to institutional use of the rule and claimed the rule's legitimacy as "a temporary remedy for market failure."97 Writing in 1988 before the SEC's recent interpretive flip-flops,98 Ryan urged that the rule be left intact for use by institutional investors against, principally, management antitakeover measures.99 Professor George Dent, an erstwhile revisionist, grudgingly accepted the rule's legitimacy, but only for proposals by investors willing to post a bond to cover the company's solicitation costs if the proposal failed to garner at least a twenty percent vote.100 Professor Coffee recently urged the rule be limited to shareholders (or groups) with

95. Liebeler, supra note 14, at 477 (footnote omitted).
96. Gocha, supra note 7, at 425-29.
97. Ryan, supra note 17, at 162. "Institutional resort to rule 14a-8 demonstrates that the rule has the potential to act as a temporary remedy for market failure." Ryan, supra note 17, at 162.
98. See discussion infra part III.B.1.
99. Ryan, supra note 17, at 184. "[N]o reasons exist at this time for further modifications of the rule, which can be expected to gain importance as institutional investors continue to increase their ownership of corporate equities." Ryan, supra note 17, at 184.
100. Dent, supra note 28, at 823. Professor Dent also considered the possibilities of limiting the rule to proposals "in opposition to anti-takeover devices" or increasing the minimum ownership level to $1 million. Dent, supra note 28, at 822-23. Curiously, Professor Dent does not deal with the possibility that social/political shareholders or organized groups—his so-called "traditional" proponents—might be willing to pay "to gain publicity for their pet causes and to embarrass management into changing its policies." Dent, supra note 28, at 818, 820.
a minimum level of share ownership—his suggestion is a one percent ownership threshold or $100,000. 101 Congress has considered bills that would delete exclusions based on a proposal’s content and impose minimum ownership requirements. 102

The neo-reformers and revisionists are agreed on one point: Rule 14a-8 should not be an open-ended tool for social/political activists. 103 For the neo-reformers, the debate has narrowed to whether and how the rule should be tailored to its new institutional shareholder clientele. 104

III. CRITIQUE OF THE SEC’S LIMITS ON THE RULE 14A-8 FORUM

Neither the generalized justifications for shareholder access to the company-funded proxy machinery nor the academic criticism of the rule provides a systematic account of the current rule’s convoluted exclusionary structure. In this part, I argue that although many of the conditions on shareholder access under the current rule (with minor adjustments) comport with the rule’s purposes, the SEC’s attempt to impose its view of the “proper subjects” on the shareholder-management dialogue has been, and will continue to be, a bureaucratic failure.

103. The social/political aspect of the rule is “a means by which only trivial or improper matters are foisted upon an unwilling majority of shareholders and their designated management.” Ryan, supra note 17, at 164; see also Welter, supra note 102, at 1981-82 (noting that complexity in the rule allows “offensive and irrelevant proposals in the proxy statement if they are cleverly drafted”).
104. Ryan, supra note 17, at 164.
A. An Appropriate SEC Role: Ensuring Shareholder Initiation Rights in the Context of Proxy Voting

The shareholder-management relationship, enabled and defined by state law, contemplates a significant role for the board in shareholder voting. To safeguard shareholders’ residual control rights, state law uniformly specifies that the board must conduct an annual meeting at which shareholders elect directors and vote on any shareholder-initiated resolutions.105 In public corporations, the shareholders delegate to management the task of administering the annual meeting, which includes setting the time and place of the meeting, nominating a slate of directors, specifying a record date, soliciting proxies, conducting the meeting, and counting and reporting the balloting.106 Not surprisingly, public shareholders, who when dissatisfied have a liquid market into which to sell their shares, traditionally vote with management.107

The Rule 14a-8 requirements allow management to use the proxy machinery and to exclude vexatious, illegal, and deceptive proposals.108 This is consistent with state law limits on the power of shareholders to initiate corporate reforms. For example, Delaware courts have denied access to shareholder lists if the requesting shareholder’s purpose is “vexatious . . . or . . . has no relation to the relator's interest, as a stockholder, in the corporation.”109

Further, the SEC’s mediative role through the 14a-8 no-action procedure facilitates and reinforces shareholder access rights. The procedure offers proponents and management, before

105. See, e.g., DEL. CODE ANN. tit. 8, § 211(b) (1991) (“An annual meeting of stockholders shall be held for the election of directors . . . . Any other proper business may be transacted at the annual meeting.”).
107. Ryan, supra note 17, at 178.
the shareholders’ meeting, an immediate and virtually costless administrative review of exclusion decisions.\textsuperscript{110} State law, even in Delaware, does not offer as efficient a system. SEC review under the anticongestion and anticrackpot exclusions requires significantly less judgment and for many purposes is largely ministerial.

\textbf{B. An Inappropriate SEC Role: The Case Against Merit Regulation}

The Rule 14a-8 “proper subject” exclusions stand on different ground.\textsuperscript{111} As applied by the SEC, they are beyond the agency’s institutional competence, they engage the agency in the vain exercise of evaluating the merits of social/political proposals, they are inconsistent with state law, they are at odds with the avowed federal disdain for merit regulation of corporate governance, and they mock the agency’s renewed faith in shareholder control. In short, the SEC’s attempts to pass on the propriety of shareholder proposals illustrate the intractable problems of administrative licensing of speech based on its merits.

1. \textit{The SEC is institutionally incapable of passing on the merits of shareholder initiatives.}—The SEC’s recent inconstancy paints a sad portrait of a bureaucracy aimlessly in search of purpose. SEC staff, moved by what the popular press considers newsworthy or by personal political views on recent corporate governance trends,\textsuperscript{112} seems quite unable to delineate which initiatives shareholders should be able to consider and which ones they should not. The conclusion is inescapable: the agency’s substantive views on a “proper” shareholder dialogue either have been mistaken in the past or are mistaken now, or perhaps both.\textsuperscript{113} Rule 14a-8’s “proper subject” jurisprudence flounders

\begin{footnotesize}
\begin{itemize}
\item[110.] Proposals of Security Holders, 17 C.F.R. § 240.14a-8(d) (1993).
\item[112.] See Mary L. Schapiro, Shareholders Should Have a Soapbox, WALL ST. J., Mar. 9, 1993, Letters to the Editor, at A19 (criticizing the operation of the rule and the agency’s “case-by-case decision making that shifts with the political and corporate governance views of the staff and individual commissioners”), Welter, supra note 102, at 2004.
\item[113.] In explaining its new position that proposals on charitable contributions are excludable matters of “ordinary business,” the SEC staff simply stated that its
\end{itemize}
\end{footnotesize}
without any hope of judicial or legislative correction.\textsuperscript{114}

The list of recent Rule 14a-8 policy shifts impresses even a
casual observer. Common law systems rarely see the paroxysms
of change that Rule 14a-8 has recently undergone.\textsuperscript{116} Matters
once treated as excludable “ordinary business” are now
includable as “significant issues of public policy”: senior execu-
tive compensation;\textsuperscript{116} director compensation;\textsuperscript{117} tobacco manu-
ufacturing and production;\textsuperscript{116} plant closings;\textsuperscript{119} and golden

earlier positions “were in error.” See Exxon Corp., SEC No-Action Letter, 24 Sec.

Thirty years ago Professor Clusserath concluded the agency’s administration of
the “proper subjects” and “ordinary business” exclusions was characterized by “incon-
sistent administration, poor substantive law, and failure fully to inform outsiders of
its informal decisions under these provisions.” Thomas M. Clusserath, The Amended
Today, the only change is that the SEC’s no-action positions are available on LEXIS
and WESTLAW.

114. As then-Commissioner Bevis Longstreth pointed out in 1981, “the Rule has
effectively invested our staff with the power to decide complex issues of law, fact
and policy without any real possibility of outside, objective appellate review.” Bevis
Longstreth, The SEC and Shareholder Proposals: Simplification in Regulation, [1981-

115. Before 1980, policy shifts on specific issues were relatively few and far
between. See, e.g., Adoption of Amendments Relating to Proposals by Security
Rep. (CCH) ¶ 80,812 (adopting amendments to Rule 14a-8).

Fed. Sec. L. Rep. (CCH) ¶ 76,131, at 79,337 (Mar. 16, 1992) (requiring inclusion of
proposals relating to senior executive compensation on the ground that such pro-
posals “no longer can be considered matters relating to a registrant’s business”); cf.,
31, 1990) (allowing exclusion of proposal regarding incentive compensation since it
deals with a matter of ordinary business, namely employee compensation) (letters
cited).

212 (Feb. 13, 1992) (requiring inclusion of proposal relating to retirement plan for
outside directors on ground that proposals relating to “director compensation no
longer can be considered matters relating to a registrant’s business”); cf., e.g., North
Fork Bancorporation, SEC No-Action Letter, 1991 SEC No-Act LEXIS 409 (Mar. 5,
1991) (allowing exclusion of proposal that directors waive their fees until stock price
reached specified level on the ground proposal relates to “ordinary business opera-
tions (i.e., the compensation of the Company’s directors)

118. See, e.g., Philip Morris Companies, Inc., SEC No-Action Letter, 1990 SEC
No-Act LEXIS 335 (Feb. 13, 1990) (requiring inclusion of proposal to amend charter
to provide company not conduct any business in tobacco products after December 31,
1999); cf., e.g., Philip Morris Companies, Inc., SEC No-Action Letter, 1990 SEC No-

119. See Pacific Telesis Group, SEC No-Action Letter, 1989 SEC No-Act LEXIS
parachutes. 120

At the same time, matters once considered "significantly related" and "extraordinary" are now excludable as "ordinary business matters" including: corporate charitable contributions; 121 the manufacture of tobacco-related products; 122 and affirmative action plans and equal employment policies. 123 In addition, proposals to create advisory committees that report to shareholders, once treated as "proper subjects" under state law, are no longer treated as such. 124

104 (Feb. 2, 1989) (requiring inclusion of proposal for study on impact of plant closings and announcing staff position to allow proposals that "deal generally with the broad social and economic impact of plant closings or relocations"); cf., e.g., General Electric Co., SEC No-Action Letter, 1988 SEC No-Act LEXIS 167 (Jan. 29, 1988) (allowing exclusion of proposal to reverse decision to close a particular plant on ground closing of facilities is a matter of "ordinary business operations").


121. See, e.g., Exxon Corp., SEC No-Action Letter, 1992 SEC No-Act LEXIS 209 (Feb. 19, 1992) (allowing exclusion of proposal that company refrain from giving money to pro-abortion groups); cf., e.g., American Telephone and Telegraph Co., SEC No-Action Letter, 1991 SEC No-Act LEXIS 76 (Jan. 16, 1991) (requiring inclusion of proposal that company contribute to teenage pregnancy prevention programs on the ground that management decisions on charitable expenditures involve issues "beyond matters of the Company's ordinary business operations").


123. See Cracker Barrel Old Country Store, Inc., SEC No-Action Letter, 1992 SEC No-Act LEXIS 984 (Oct. 13, 1992) (allowing exclusion of proposal that company implement nondiscriminatory employment policies related to sexual orientation on the ground day-to-day issues concerning hiring and other personnel matters are properly left to company management); cf., e.g., Dayton Hudson Corp., SEC No-Action Letter, 1991 SEC No-Act LEXIS 428 (Mar. 8, 1991) (requiring inclusion of proposal for report on progress of equal employment opportunity and affirmative action since such questions "involve policy decisions beyond those personnel matters that constitute the Company's ordinary business").

Adding to the disarray have been highly unusual Commission reversals of staff positions. Following a staff decision to require inclusion of a shareholder proposal that called for annual reports on the company's implementation of affirmative action programs, the Commission in an appeal from the staff decision said the proposal could be omitted since it "lies in the very heart of the Company's 'ordinary business operations.'"\(^{125}\)

Even more troubling than the number of policy shifts has been the agency's terse and desultory explanations for its new positions, often little more than a reference to an extant public debate on the question: \(^{126}\)

"In 1990 when SEC staff abandoned its position on excluding proposals related to a company's tobacco-related businesses, the staff explained that the prior position "failed to reflect adequately the growing significance of the social and public policy issues attendant to operations involving the manufacture and distribution of tobacco related products."\(^{127}\) Since when?

creating shareholder advisory committee); cf. Exxon Corp., SEC No-Action Letter, 1992 SEC No-Act LEXIS 281 (Feb. 28, 1992) (requiring inclusion of proposal to create advisory committee that would review and grade board performance, and prepare 2500-word report to be included in proxy statement; committee members would receive half ($20,000) the compensation of board members to be paid by the company); Baltimore Bancorp, SEC No-Action Letter, 1991 SEC No-Act LEXIS 447 (Mar. 11, 1991) (proposal to create a "Stockholder Advisory Committee").


Commenting on the Wal-Mart reversal, a SEC staff member "couldn't recall any major staff decision on shareholder proposal being reversed in more than 20 years." SEC Reverse Staff, Says Company May Exclude Affirmative Action Proposal, BNA'S CORP. COUNS. WKLY., Apr. 17, 1991, at 1.

126. See Welter, supra note 102, at 2007 (describing recent changes in SEC staff positions); Face-To-Face Meetings Between Shareholders, Directors Could Improve Understanding, Help Avoid Confrontations, BNA'S CORP. COUNS. WKLY., Nov. 4, 1992, at 7 (discussing recent changes regarding social responsibility proposals and corporate employment policies).

In reversing its position on proposals dealing generally with plant closings, the staff cited to “recent developments, including heightened state and federal interest in the social and economic implications of plant closing and relocation decisions.”¹²⁸ So what?

When it dramatically reversed an 18-year-old position that executive compensation is a matter of ordinary business, the agency cited to “the widespread public debate” on the subject and “the increasing recognition that these issues raise significant policy issues.”¹²⁹ Says who?

In reversing the long-standing view that shareholder proposals dealing with social or political issues that touch on employment are includable, the staff commented “the line between includable and excludable employment-related proposals based on social policy considerations has become increasingly difficult to draw.”¹³⁰ Amen.

Noticeably lacking has been even a hint that the agency is responding to changes in state corporate law, the supposed fountainhead for Rule 14a-8’s merit regulation. Why matters once improper for shareholder dialogue became proper overnight, or once proper became improper, the SEC and its staff have failed to explain.¹³¹ It is hard to imagine a more troubling example of

¹³¹. A noticeable exception was the agency’s active solicitude for proposals that seek director independence. The agency suggested, in response to arguments that such proposals would conflict with state law by disenfranchising certain shareholders in contested elections and conflict with the director removal and vacancy-filling provisions of state statutes, that such proposals could be drafted as amendments to the bylaws. See General Dynamics Corp., SEC No-Action Letter, 1993 SEC No-Act LEXIS 108 (Jan. 5, 1994) (allowing inclusion of proposal that would require a majority of independent directors).
"arbitrary and capricious" administrative action.\textsuperscript{132}

In all fairness to the SEC staff, the current rule's attempt at merit regulation lays on the staff the impossible task of deducing what should be of interest to investment-minded and public-minded shareholders and what should not be of interest. As SEC Commissioner Richard Roberts recently pointed out, "it is neither fair nor reasonable to expect securities experts to deduce the prevailing wind on public policy issues that have yet to be addressed by Congress in any decisive fashion."\textsuperscript{133}

2. The SEC has been unable to assess the merits of social/political proposals.—The most dramatic and prominent example of SEC inconstancy under the rule has been the agency's shifting approach to social/political proposals. The ebb and flow began in 1952 when the SEC codified an earlier staff position that management could exclude proposals made "primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes."\textsuperscript{134} In the words of the Commission staff: "It was not the intent of [the shareholder proposal rule] to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or economic nature."\textsuperscript{135} Why this was not the intent, the agency did not explain.

The SEC maintained this position until the 1970s when it performed a dramatic regulatory about-face. The turning point came in the D.C. Circuit's decision in \textit{Medical Committee for Human Rights v. SEC},\textsuperscript{136} the first shareholder victory in a Rule 14a-8 case since 1944.\textsuperscript{137} The court read the rule—if not

\textsuperscript{132} Courts correctly question agency decisions when they break from past policies. \textit{See}, e.g., \textit{Aitchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. of Trade}, 412 U.S. 800, 808 (1973); \textit{Sioux Valley Hosp. v. Bowen}, 792 F.2d 715, 719 (8th Cir. 1986).

\textsuperscript{133} \textit{See Commissioner Criticizes Subjectivity, Inconsistency in SEC Review of Proposals}, BNA'S CORP. COUNS. WKL., Mar. 31, 1993, at 2-3 (remarks to the Exchequer Club of Washington). Commissioner Roberts argued that shareholders "are interested predominantly in a reasonable return on their investment" and urged the rule should be abandoned "if the process cannot be improved." \textit{Id.} at 3.


\textsuperscript{137} \textit{See}, e.g., \textit{Dyer v. SEC}, 289 F.2d 242, 246-47 (8th Cir. 1961) (denying inclu-
section 14(a) of the 1984 Act—to assure shareholders at least co-equal governance powers over “moral and political decisions” of the firm, when management had acted for moral and political, rather than business, reasons.\textsuperscript{138} Asserting that shareholders could choose a firm “more socially responsible but possibly less profitable,” the court ordered the SEC to reconsider its no-action position on Dow Chemical’s exclusion of a proposal urging management to initiate a charter amendment to prohibit the sale of napalm for use on or against humans.\textsuperscript{139}

Soon after \textit{Medical Committee}, and on the heels of a congressional effort to end the exclusion,\textsuperscript{140} the SEC amended the rule to remove the “social/political cause” language, retaining it only as an example of “matter[s] . . . not significantly related to the business of the issuer or . . . not within the control of the issuer.”\textsuperscript{141} In 1976, the agency omitted the “social/political cause” language entirely,\textsuperscript{142} and the number of social/political proposals exploded.\textsuperscript{143} The Commission stated that some social/political proposals, such as “ethical issues” related to then-newsworthy corporate political contributions, “also may be significant to the issuer’s business,”\textsuperscript{144} and would not be excluded.

\begin{footnotesize}
\begin{itemize}
\item 138. \textit{Medical Committee}, 432 F.2d at 681.
\item 139. \textit{Id.} at 681, 682.
\item 140. The proposed Corporate Participation Act of 1970 would have amended § 14(a) to permit proposals involving economic, political, racial, religious, or similar issues unless the matter proposed was not within the control of the issuer. S. 4003, 91st Cong., 2d Sess. (1970).
\item 142. One court read this omission as a reversal of earlier SEC policy, opening the way for social/political proposals. New York City Employees’ Retirement System v. American Brands, Inc., 634 F. Supp. 1382, 1384 (S.D.N.Y. 1986) (preliminarily enjoining exclusion of proposal that management pursue fair employment practices in its Northern Ireland operations by hiring Catholics).
\item 143. Liebeler, \textit{supra} note 14, at 431.
\end{itemize}
\end{footnotesize}
as "ordinary business." Why this was so, the agency did not explain.

The experiment with Rule 14a-8 as a tool for far-flung social reform proved to be short-lived. In 1982, the Reagan-era SEC undertook a thorough review of the shareholder proposal rule, setting it on a course that would culminate in the recent agency reinterpretations. To curtail "abuse of the security holder proposal rule" by those without a measured economic stake or investment interest in the corporation, the 1983 amendments were aimed at small-stake "social/political" proponents in a number of ways. The amended rule for the first time imposed minimum ownership and holding period requirements, and established the five percent "substantiality" test, a daunting obstacle for social/political proponents seeking to have the company cut back on externality-creating behavior. The SEC,

Reg. 52,997 (Nov. 22, 1976).

145. Id.

146. See Proposed Amendments to Rule 14a-8, Exchange Act Release No. 19,135, 47 Fed. Reg. 47,420, 47,420-23 (Oct. 14, 1982). The agency floated three proposals: (1) keep existing rule with some modifications to clarify the rule; (2) permit companies to create their own qualifications and requirements as to proposals, subject to approval by the company's security holders; and (3) eliminate content exclusions, except for a proper-subject test and nomination of directors, subject to a numerical maximum per year determined by a formula.


148. The idea of minimum ownership and holding period requirements originated in a speech by former Commissioner Bevis Longstreth. See The SEC and Shareholder Proposals: Simplification in Regulation, [1981-1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,067, at 84,708 (Dec. 23, 1981) ("to assure that shareholders seeking to use the process are indeed investors—holder of shares—rather than activists of one kind or another using a share of stock as the passekey to the proxy bullhorn.").

149. See Proposals of Security Holders, 17 C.F.R. § 240.14a-8(a)(1) (1993). The 5% threshold of the amendments, Proposals of Security Holders, 17 C.F.R. § 240.14a-8(c)(5), stiffened an earlier staff no-action position developed in response to the 1976 campaign by the American Jewish Congress to obtain company reports concerning compliance with the Arab economic boycott of Israel. See Sadat-Keeling, supra note 73, at 184. SEC staff had allowed management to exclude these proposals if it could show the company did less than 1% of its business with Arab Countries or Israel. Sadat-Keeling, supra note 73, at 184. The 5% presumption not only proportionally immunized large companies from social/political proposals, but it also placed the burden on the proponent to show qualitative "otherwise significance." See Sadat-Keeling, supra note 73, at 186, n.144.

The SEC was quick to point out that the "substantially related" exclusion did not apply to governance proposals, such as cumulative voting. See Proposed Amendments to Rule 14a-8, Exchange Act Release No. 20,091, 48 Fed. Reg. 38,218, 38,220.
however, failed to address a number of issues: how social/political proposals abused shareholders' state law rights to initiate reforms, why shareholder governance rights should be limited to matters "substantially related" to the firm's business, and why the communications on ordinary business falls within the exclusive province of management. Certainly the agency made no attempt to justify its conclusory shifts on the basis of state law.

As former SEC Commissioner Longstreth commented about the 1983 amendments, "these amendments, in the aggregate, tilt significantly and unnecessarily against shareholders seeking access to the proxy machinery. The tilt . . . goes well beyond that which is necessary to deal with recognized abuses."\(^{150}\)

Recent SEC decisions expanding use of the rule in governance matters, while contracting it for social/political questions, suggest the agency has accepted the neo-reformer arguments. A sampling of SEC 14a-8 no-action practice a decade ago and during the last two proxy seasons provides powerful evidence of the regulatory shift.\(^{151}\)

---


\(^{151}\) I sampled no-action letters from the LEXIS SEC No-Action file for the calendar years 1981-1982 and 1991-1992. For 1981 and 1982, I looked at 281 14a-8 no-action positions—46.7% of the total 601 no-action letters under Rule 14a-8. For 1991 and 1992, I looked at 203 14a-8 no-action positions—27.1% of the total 749 no-action letters under Rule 14a-8. I categorized the proposals as follows:

- Governance proposals: dividend policies, board membership, confidential voting, changing bylaw amendment procedures, urging stock sales and splits, information about shareholders' meetings, director liability and pay, sale or merger of company.
- Operational proposals: business acquisitions, pension plans, golden parachutes, executive compensation, management retention, glossy annual reports, sales policies.
- Social/political proposals: anti-tobacco, women on board, no smoking, use of Chinese labor, Valdez Principles, military contracts, MacBride Principles, wildlife charity, overseas charity, universal health, baby formula.
Inclusion Rates—
SEC No-Action Letters

<table>
<thead>
<tr>
<th></th>
<th>1981-82</th>
<th>1991-92</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance proposals</td>
<td>33.3%</td>
<td>44.8%</td>
</tr>
<tr>
<td>Operational proposals</td>
<td>15.1%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Social/political proposals</td>
<td>49.5%</td>
<td>33.3%</td>
</tr>
</tbody>
</table>

The trend is unmistakable. Proposals on governance issues (such as board composition, sale or liquidation of the firm, and takeover defenses) are today the most likely to attract SEC favor,\textsuperscript{152} while proposals on social/political issues (such as Valdez Principles, charitable contributions, and antismoking) have fallen from favor.\textsuperscript{153} Proposals on operational matters (such as pension plans and management policies) continue to fare poorly.\textsuperscript{154} In fact, in 1992 the only operational proposals the SEC decided were includable were those that dealt with top executives’ compensation—a matter the agency came to regard as a governance issue.\textsuperscript{155}

3. The SEC’s merit-based restraint of shareholder initiatives is inconsistent with state law.—Shareholder control, a hallmark of the American corporation, ensures business adaptation in changing circumstances. Although shareholders exercise this power principally through the annual election of directors—a voting right that also animates takeovers and proxy fights—state law leaves shareholders a significant role to initiate corporate reforms. State corporate law does not specify any


\textsuperscript{155} See Breeden Announces SEC Initiative on Executive Compensation Issues, 24 SEC. REG. & L. REP. (BNA) 223, 223 (Feb. 21, 1992).
limits on the content of shareholder resolutions or bylaw changes except that they be consistent with the corporate statutes and the articles of incorporation. The few courts to face the issue have assumed wide shareholder latitude to make nonbinding, precatory recommendations on any subject related to maximizing shareholder value. In fact, under state law shareholders may vote selfishly or altruistically, as they choose.

In the related context of shareholder inspection rights, state courts have interpreted the "proper purpose" requirement for access to shareholder lists to encompass a broad definition of wealth maximization. For example, a recent Delaware case permitted a shareholder to request a list "for the purpose of communicating with fellow stockholders with respect to the alleged economic risks of Chevron's business activity in Angola," even though the requester's position was "only marginally related to the economic interests of the corporation" and might even be viewed by other shareholders as "useless" or "bizarre."

156. Delaware's statute specifies that in addition to election of directors, "[a]ny other proper business may be transacted at the annual meeting." Del. Code Ann. tit. 8, § 211(b) (1991). The statute is more explicit with respect to the content of the bylaws: "The bylaws may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its right or powers or the rights or powers of its stockholders, directors, officers or employees." Del. Code Ann. tit. 8, § 109(b) (1991). See also Revised Model Business Corp. Act § 2.06(b) (1991) ("bylaws of a corporation may contain any provision for managing the business and regulating the affairs of the corporation that is not inconsistent with law or the articles of incorporation").


Federal cases construing state law in the context of Rule 14a-8 have assumed, without support, that the SEC's exclusions properly declare state law. Brooks v. Standard Oil Co., 308 F. Supp. 810, 813-14 (S.D.N.Y. 1969) (assuming that statute giving board power to manage corporation's business precludes precatory shareholder proposal on oil exploration policies).

158. See DuPont v. DuPont, 251 F. 937, 944 (D. Del. 1918) (stating that shareholder is "free to exercise his own judgment, and to act with selfish rather than altruistic motives"), aff'd, 256 F. 129 (3d Cir.), cert. denied, 250 U.S. 642 (1919); Heil v. Standard Gas & Elec. Co., 151 A. 303 (Del. Ch. 1930) (stating that "stockholders have the right to exercise wide liberality of judgment in the matter of voting and may admit personal profit or even whims and caprice").

Nowhere do the inspection statutes or state courts mention a "substantiality" test or limit access when the topic of shareholder communications is related to "ordinary business." Not surprisingly, state courts have said it is irrelevant to a shareholder's state inspection right that the SEC has not cleared the shareholder's 14a-8 proposal.

4. The SEC's "proper subject" review is paternalistic merit regulation.—Since 1933 when Congress rejected merit regulation for public offerings of securities, federal securities regulation has cleaved to the policy of not passing on the worthiness of investment and voting opportunities. The recent debacle of the SEC's one-share/one-vote listing requirement, which sought to regulate the merits of dual-class recapitalizations, continues a long-standing tradition of federal acquiescence to incorporation-based private ordering.

Other SEC rules that compel management to facilitate communications to shareholders—nonsubsidized "common carrier" obligations—do not regulate the content of the communications, leaving such questions to the market, antifraud protections, and state law. Rule 14a-7, without imposing any content limits, requires management to share the proxy machinery and mail shareholder solicitations, provided the soliciting shareholder

__________________________________________________________________________

160. See, e.g., Del. Code Ann. tit. 8, § 220(b) (1991) (requiring purpose "reasonably related to such person's interest as a stockholder"); Hatlegh Corp. v. Lane Bryant, Inc., 428 A.2d 350, 352 (Del. Ch. 1981) (holding proper purpose was sufficient); Mite Corp. v. Heli-Coil Corp., 256 A.2d 855, 856 (Del. Ch. 1969) (holding proposal was reasonably related to Mite Corporation's interest as a shareholder).

161. Mite Corp., 256 A.2d at 856.


pays for the additional printing and mailing costs. Likewise, Rule 14d-5 requires management to distribute an outside bidder's tender offer materials, provided the bidder pays the expenses.

The underlying premise of the shareholder proposal rule's content-based exceptions—that shareholders cannot be trusted to abide by the corporate contract that delegates day-to-day decision-making to management or that shareholders will be unable to ascertain their own interest and vote accordingly—harkens back to an earlier, paternalistic era of SEC regulation.

If management is correct that a shareholder proposal interferes with management prerogatives or is otherwise nonmaximizing, management has at its disposal the means to say so and shareholders the means to agree. In fact, the rational tendency of shareholders to side with management is powerfully demonstrated by the rule's history. For four decades shareholders uniformly rejected shareholder proposals. The early concerns of the agency that shareholders would be duped were, to put it mildly, overblown. As shareholder demographics shift toward active institutional investors and organized individual shareholders, the paternalism is even less founded.

Moreover, the concerns that shareholders will approve proposals that revamp the regime of centralized corporate management are misplaced. In recent years, proposals that have mustered significant shareholder support—proposals on confidential voting, golden parachutes, poison pill plans, staggered boards, and supermajority voting—suggest that shareholders are fully capable of responsibly drawing the bounds of shareholder control rights. In fact, in many instances management has reacted to such proposals by negotiating to implement the very action proposed.

In the end, shareholders (not the SEC) will bear the costs

---

164. Mailing Communications for Security Holders, 17 C.F.R. § 240.14a-7 (1993). The rule also gives management the option to provide a shareholder list, leaving the mailing to the requesting shareholder. Id. § 240.14a-7(c). For strategic reasons, management rarely chooses this alternative.


166. See, e.g., Ryan, supra note 17, at 100 n.11.
when shareholders vote for (or management accedes to) a too intrusive governance model. Like prior restraints of speech forbidden under the First Amendment, the 14a-8 licensing scheme permits access to the proxy statement only for "proper" shareholder communications.\textsuperscript{167} The current rule doubts too much the "marketplace" of shareholder voting and, when necessary, state court litigation to deal with the dangers of shareholder confusion and opportunism. The First Amendment's prior restraint doctrine, which originated against administrative licensing of speech, offers a valuable lesson.\textsuperscript{168} The Rule 14a-8 "proper subject" exclusions accept the unfortunate philosophy that disseminating controversial shareholder initiatives is "a threat to, rather than an integral feature of, the [corporate] order."\textsuperscript{169}

IV. A PROPOSAL TO ABANDON
RULE 14A-8 MERIT REGULATION

A. Numerical Limitations on
"Proper Subject" Proposals

The time has come to return Rule 14a-8 to its fundamental, animating purpose of unlocking the proxy mechanism to give meaning to shareholders' state rights to initiate corporate reforms. I would retain much of the current rule, including the SEC no-action procedure, but revise it as follows:

1. Narrow merit regulation by expunging the (c)(5) "substantially related" exclusion and the (c)(7) "ordinary business matter" exclusion, and by requiring that management make a "clear and convincing" showing to exclude any proposal under the state-based (c)(1) "proper subject" exclusion.\textsuperscript{170}

\footnotesize

168. "The struggle for the freedom of the press was primarily directed against the power of the licensor." Lovell v. Griffin, 303 U.S. 444, 451 (1938) (invalidating ordinance that prohibited distribution of leaflets without obtaining the permission of a city manager). In fact, at common law the protection against prior restraint was directed exclusively at systems of "administrative censorship." See Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations, 413 U.S. 376, 389-90 (1973).
170. The current rule places the burden on management to show the availability
2. Supplement the current anticongestion rules by limiting the number of shareholder proposals that each company need include to seven (7) per meeting; if shareholders submit more, the proposals sponsored by the seven shareholders (or groups) with the largest shareholdings would be inadmissible. This would impose a modified minimum ownership requirement.

3. Strengthen the antiecrackpot exclusions by adding a new category of exclusions for proposals that are "vexatious, frivolous, or unintelligible."

This proposal harkens back to one advanced by then-Commissioner Bevis Longstreth, and floated by the SEC in its 1982 reconsideration of the rule, that would have required the inclusion of all proposals that are proper under state law and do not involve the election of directors, subject to a numerical maximum of twelve per company. In a like vein, SEC Commissioner Mary Schapiro has recently urged a broad rule of inclusion, with exceptions only for proposals that are "misleading, duplicative or trivial" or that relate to a social policy not "directly tied to the business operations of the issuer."

My proposal consciously does not address the more formidable issue of shareholder access to the nomination and election of directors. In many respects shareholder access to the board selection process parallels access to the reform initiation process. Shareholder rights to nominate and elect directors, like their rights to propose and approve reform initiatives, arises under

---


173. Mary L. Schapiro, Shareholders Should Have a Soapbox, WALL ST. J., Mar. 9, 1993, Letters to the Editor, at A19 ("We could require the economic nexus for social policy questions to be a real and substantial one.").

Others have recently advanced similar proposals. For example, the Council Of Institutional Investors has urged that the SEC impose procedural requirements without controlling the shareholder "thought processes." Institutional Investors to Seek SEC Review of Rules Governing Proposals, BNA'S CORP. COUNS. WKLX., Nov. 18, 1992, at 2.
state law. Many of the same rationales for the enabling mechanisms of a merit-free Rule 14a-8 also support subsidized access to the nomination process. Nonetheless, the danger that nominating shareholders will abuse the subsidy, particularly when the stakes are the discretionary power of board membership rather than precatory recommendations or structural bylaw changes and because board cohesion may be sacrificed by a fragmentary selection process, cautions against a complete analogy. That is, corporate law may reflect a shareholder choice that the selection process, absent a proxy fight, be in the hands of incumbent management. In any event, Congress may be taking up the question of permitting larger shareholders to include their nominees in the company’s proxy materials.\textsuperscript{174}

\section*{B. Rule 14a-8 Without Merit Regulation}

Abandoning the current “proper subjects” exclusions and substituting a numerical cap raises at least three principal objections.

1. \textit{The excessive-litigation argument}.—The first objection, one raised by the SEC in 1983 when it rejected the Longstretch twelve-proposal idea, is that eliminating SEC review of the propriety of proposals “would result in costly and time consuming litigation.”\textsuperscript{175} Though unexplained, the fear would seem to be that under an easy-access rule, management would resort to state courts to block proposals that previously SEC staff would have blocked.\textsuperscript{176}

Will there be more state court litigation, and if so, would it be a bad thing? Compare how my proposed open-access rule

\begin{itemize}
\item \textsuperscript{174} \textit{Markey Plans to Introduce Bill in 1993 To Empower Shareholders}, BNA Pensions & Benefits Daily (Nov. 4, 1993) (describing a proposed bill that would require a “single proxy ballot listing all nominees to the corporate board, no matter whether they are management or shareholder candidates”; a “threshold level of shareholder interest” would be a condition to nominating a director).


\item \textsuperscript{176} Because shareholders have no subsidized access to court, experience shows shareholders are infrequent 14a-8 plaintiffs. Management, on the other hand, can use corporate funds. Although shareholders could bring derivative suits, which allow successful litigants to seek reimbursement of their litigation expenses, an open-access rule could make this unlikely.
\end{itemize}
would operate on a recent proposal by the California Employee’s Retirement System (CalPERS) to amend Pennzoil’s bylaws to create an advisory committee elected by shareholders that would review corporate activities and advise the board concerning shareholders’ views. Under the current rule, the SEC staff’s conclusory view that the proposal “appear[s]” to be inconsistent with state law, a view at odds with earlier no-action positions, left much to be desired. For CalPERS, that was the end of the matter.

A rule without merit regulation would operate something like this: If management made a “clear and convincing” showing that the proposal violates the company’s charter or the corporate statute—with presumably more than the tenuous opinion of counsel offered by Pennzoil’s management—SEC staff could exclude it. Normally this would be the end of the matter, unless the shareholder appealed to a federal court on the narrow question of “clear and convincing” state law or brought a derivative suit (potentially at company expense) in state court seeking a declaration of applicable law.


178. Pennzoil Corp. at *2. SEC staff accepted Pennzoil’s exclusion “given the questionable validity” of the proposed bylaw amendment since it appeared to be inconsistent under with Delaware’s statute that makes the board responsible for managing the corporation’s affairs.


180. A shareholder may be entitled to reimbursement whether the challenge is of federal policy under the Securities Exchange Act or under state fiduciary law. See Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 92 Civ. 5517, 1994 U.S. Dist. LEXIS 2548 (S.D.N.Y. Mar. 7, 1994) (awarding attorneys’ fees and costs to plaintiffs arising from their successful challenge to management exclusion, since “litigation produced a benefit shared in common by all Wal-Mart shareholders”); Bosch v. Meeker Cooperative Light & Power Ass’n, 101 N.W.2d 423, 427 (Minn. 1960) (awarding attorneys’ fees when litigation produces substantial non-pecuniary benefit and achieves a “result which corrects or prevents an abuse which would be prejudicial to the rights and interests of the corporation”).
If management failed to make this showing, which would be the usual case given the undeveloped nature of state law in this area, management would have to argue to the shareholders that the proposal offends the well-conceived structure of exclusive board management or is otherwise a bad idea. In making its case, management would have two potent allies against shareholder initiatives: inherent shareholder passivity and the supposed efficiency of the time-tested corporate model of centralized management in which the board usually initiates corporate reform.

If management's arguments were to fail and shareholders adopted the proposal, management would then have to consider the wisdom of balking at an interpretation of the "corporate contract" supported by a majority of shareholders. If management remained adamant in its reading of the "contract," it could take the issue (at company expense) to a state judge.\textsuperscript{181} Although there would be greater expense and delay for the few cases subjected to state court review under this system, there is little reason to believe they would be more frequent than the rising number of federal 14a-8 cases.

More important, one would expect more satisfying answers than the SEC staff's sometimes contradictory, usually unsubstantiated, and always conclusory no-action positions—hardly inspiring the confidence of a well-considered judicial opinion on a novel corporate device. The "corporate contract" places such questions in the hands of state judges—for most public companies, in the hands of Delaware judges—who as participants in the market for corporate charters have a greater interest in getting the answer right.\textsuperscript{182} Moreover, state law is mildly self-correcting. State judicial mistakes, like the early invalidation of poison pills and the application of a \textit{de facto} merger doctrine to asset sales, are capable of legislative correction. Congress has

\textsuperscript{181} This is the procedure for dissenters' appraisal remedy set forth in the American Bar Association's Model Business Corporation Act. \textit{REVISED MODEL BUSINESS CORP. ACT} § 13.30(a) (1991) (if dissenter is unsatisfied with corporate payment in fundamental transaction, "the corporation shall commence a proceeding . . . and petition the court to determine the fair value of the shares and accrued interest").

\textsuperscript{182} Jonathan R. Macey & Geoffrey P. Miller, \textit{Toward an Interest-Group Theory of Delaware Corporate Law}, 65 \textit{Tex. L. Rev.} 469, 499-505 (1987) (state judges in Delaware are closely linked to the corporate bar and seek to create a balance between various bar factions).
shown no inclination to correct the SEC's Rule 14a-8 mistakes.

State court litigation would, in fact, be a boon to the shareholder proposal rule. Because judicial review of the SEC's no-action procedure is not subsidized, few federal cases delineate the SEC exclusions, and SEC interpretations under the agency's no-action process have occupied the field of shareholder initiation rights. This is unfortunate. Judicial review of administrative action imposes accountability on bureaucracies and provides them a measure of legitimacy under our Constitutional system.\textsuperscript{183}

The stakes are considerable. Consider the SEC's recent positions on shareholder powers to amend the bylaws. On the one hand, the agency has accepted that shareholders can amend the bylaws regarding board composition.\textsuperscript{184} On the other, the agency has rejected the propriety of a bylaw that would give shareholders (including pass-through pension funds) one vote for each year they held their stock, up to a maximum of five votes per share.\textsuperscript{185} What distinguishes the proposals and what are the limits of shareholder power to amend the bylaws? The SEC staff does not explain. Corporate governance demands a better answer.

2. The ubiquitous "social/political gadfly" argument.—A recurrent theme of both the revisionists and the neo-reformers is their concern that social/political gadflies will abuse subsidized access to the proxy mechanism.\textsuperscript{186} My proposed easy-access rule would abandon this fifty-year old suspicion. And why not? I see nothing pernicious with a particular corporation opting for different models of profit-maximization.\textsuperscript{187} Many investors al-

\begin{footnotesize}
\begin{itemize}
\item[183.] See St. Joseph Stock Yards Co. v. United States, 298 U.S. 38, 84 (1936).
\item[187.] The D.C. Circuit made this point in Medical Committee: No reason has been advanced in the present proceedings which leads to the conclusion that management may properly place obstacles in the path of shareholders who wish to present to their co-owners, in accord with applicable state law, the question of whether they wish to have their assets used in a
\end{itemize}
\end{footnotesize}
ready make this choice. The Delaware courts have told us, for example, that the shareholders of Time Inc. invested in a "corporate culture" in which journalistic integrity could come before maximizing share prices.\(^{188}\) Today, mutual fund investors choose "green" funds that explicitly invest in companies that seek to combine environmental responsibility and profits.\(^{189}\)

Judge Easterbrook's observations about the judicial role regarding different models of state corporate law applies equally well to the SEC's role regarding private corporate ordering:

We have not been elected custodians of investors' wealth. States need not treat investors' welfare as their summum bonum. Perhaps they choose to protect managers' welfare instead, or believe that the current economic literature reaches an incorrect conclusion and that despite appearance takeovers injure investors in the long run.\(^{190}\)

Just as each state can constitutionally decide on the terms of the corporate contract that the state offers investors and managers, so too should shareholders be able to decide on the attributes of their investment vehicle—consistent with state law.

My proposal does not, however, call for an open social/political forum. The new rule would retain the state-based "proper subjects" exclusion, if management clearly and convincingly shows a proposal is improper under state corporate law or the company's charter.\(^{191}\) Furthermore, the seven-proposal limit places a cap on social/political communications and provides a means for larger shareholders, even in coordination with management, to drown out a social/political dialogue if those shareholders so desire.\(^{192}\)


\(^{191}\) Amanda, 877 F.2d at 502. The nonshareholder constituency statutes might well define state law in some jurisdictions.

\(^{192}\) See REVISED MODEL BUSINESS CORP. ACT § 7.02 (1993) (holders of at least
But even if more social/political proposals end up on the ballot than under the current rule, it is difficult to see the harm. If they force management to define a position or alert shareholders to a dimension of their investment they had not considered, it is hard to see how the corporation is hurt. An expanded rule would offer shareholders, in an era of increasing identity between equity ownership and political citizenship, another means of political discourse. The costs are minimal, the gains potentially large.

3. The "repugnance of numerical caps" argument.—If Rule 14a-8 merely serves to alert proxy voters of proposals to be presented at the shareholders' meeting—so the proxy solicitation process replicates attendance at the meeting—one might argue the rule should not impose numerical caps or ownership minima. State law does not impose such limits for shareholder resolutions and bylaw amendments.\(^{193}\)

State law, however, does require minimum ownership in other contexts, recognizing the misdirected incentives of shareholders, and has often imposed minimum ownership conditions as a surrogate for "proper" corporate motives. Many statutes once had minimum ownership requirements for seeking a shareholder list or for bringing a derivative suit without posting a bond for expenses. Many statutes still retain ownership minima for calling a special shareholders' meeting.\(^{194}\) Like state constitutional provisions that permit citizen referenda only after a given percentage of voters sign a petition,\(^ {195}\) these requirements filter out irrelevant and dangerously misleading initiatives. A seven-proposal cap in which larger shareholders have greater access rights than smaller shareholders serves a comparable filtering function.

Like citizens seeking to place a referendum on the ballot, shareholder-proponents could get together to aggregate their

---

193. See, e.g., REVISED MODEL BUSINESS CORP. ACT § 10.20(b) (1993) (bylaws may be amended by shareholders even if board has coterminous power).

194. See, e.g., REVISED MODEL BUSINESS CORP. ACT § 7.02(a)(2) (1993) (special meeting required if holders of at least 10% of all votes make written demand).

195. See, e.g., CAL. CONST. art. II, § 8 (requiring 5% of popular voters to place statutory amendment on ballot and 8% for constitutional change).
shares—something which frequently happens for social/political proposals and which the new SEC shareholder communications rule now permits. Just as corporate law empowers management to conduct proxy voting and federal proxy regulation facilitates the process, Rule 14a-8 could well choose managed access to the voting machinery for reform initiatives by shareholders.

V. CONCLUSION

The 14a-8 exclusions that purport to gauge the merits of shareholder proposals thwart the promise of shareholder access to the corporate proxy machinery and mock Justice Brandeis's great aphorism: "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." The SEC should abandon its failed attempt to define what are "proper subjects" for the corporate dialogue.

The agency’s vision of corporate democracy, no matter how sincere or how internally consistent, is bound to fail. Like any government agency that seeks to license public discourse, the SEC cannot hope to improve the corporate dialogue by delimiting its content. If the agency is to be true to the corporate governance structure and private corporate ordering, the SEC should abandon its half-century attempt to substitute its interpretation of the "corporate contract" for that of the corporate participants themselves.


198. LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914) ("Publicity is justly commended as a remedy for social and industrial diseases.").