Remarks Of

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Shareholder Proposals - Rule 14a-8

American Society of Corporate Secretaries--New York Chapter
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*/ The views expressed herein are those of Commissioner Roberts and do not necessarily represent those of the Commission, other Commissioners or the staff.

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I. Introduction

As everyone here is aware, the Commission has undertaken a comprehensive review of the proxy process. As a result of this review, the Commission has, earlier this year, proposed several amendments to its proxy rules that were intended: (1) to facilitate security holder communications in furtherance of the goal of informed proxy voting, and (2) to reduce the costs of compliance with the proxy rules for all persons involved in a proxy solicitation. The Commission is currently digesting the many comments which have poured in as a result of the proposed amendments, including a thoughtful one submitted by the Society.

The Commission's current review of the proxy rules is timely and appropriate for two reasons. First, it has been some time since there has been a comprehensive review of the proxy process. The last comprehensive revision resulted in the adoption of new rules around 1980, although a partial revision occurred in 1986 when the Commission adopted rules to streamline disclosure requirements and to add new requirements concerning independent

public accountants.[1] Second, the review will address the changes in shareholder composition that have occurred in recent years. Since the last comprehensive review, our securities markets have become increasingly institutionalized. For example, the 1990 New York Stock Exchange survey of "Shareownerhip" indicates that there are now over 25 million mutual-fund holders, nearly four times the total 1952 investor population and today, investment companies manage almost $1.5 trillion of assets. It is clear that mutual funds have become the investment vehicle of choice by most individual investors. There are now more than 2700 open-end investment companies - mutual funds - and over 500 closed-end investment companies. Approximately 25% of American households have over 63 million accounts in investment companies. In addition, many Americans participate in a wide variety of institutional investments indirectly through pension funds and other similar vehicles. The vast increase in mutual fund investments since the last comprehensive proxy review is best exemplified by the fact that the

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[1] Securities Exchange Act Release 23,376, 35 SEC Docket 706 (1985); 23,789, 36 SEC Docket 1203 (1986).

number of investors with mutual-fund holdings jumped by nearly 130% in the last five years and by more than 400% in the last decade.

As a result of the passage of time and of this dramatic change in equity ownership, the Commission has properly undertaken a review of the federal proxy rules. This review has included, but is not limited to, numerous proposals for proxy reform that either have been submitted to the Commission by issuers, individual or institutional shareholders, and other participants in the proxy process, or are the subject of debate in Congress and the academic and legal communities. As such, the review encompasses all aspects of the proxy process, including contested and uncontested solicitations, the shareholder proposal system, and shareholder communications mechanisms.

While the review itself has been comprehensive, there are indications that this comprehensive review will not necessarily result in comprehensive revisions. In fact, other than the proposed amendments to which I have previously alluded, few additional

proposals may be forthcoming. While I individually would have preferred a more comprehensive revision, it appears that any proxy reformist attitude that may have once existed at the Commission has lost its vigor.

However, it is my understanding that there is at least one additional proxy area where a revision is being contemplated by the staff of the Commission and that is with respect to Exchange Act Rule 14a-8, which involves basically the shareholder proposal system. This revision of Rule 14a-8 may take the form of a combination of: (1) a contraction of the ability of shareholders to offer proposals in furtherance of corporate social or political public policy objectives, and (2) an expansion of the ability of shareholders to offer proposals in the area of management compensation. There has already been a great deal of discussion in the public in general, in the media, and at the Commission in the area of shareholder proposals dealing with management compensation, including a Congressional hearing, Commission testimony to Congress, and legislation in both the House and

Senate. Since the subject of shareholder proposals in the area of management compensation has been so well ventilated, I intend to confine my remarks today predominantly to the corporate social or political shareholder proposal area. I intend to spend a few minutes discussing the general development of Rule 14a-8, as well as some of the proposals for revising Rule 14a-8 which may be considered by the Commission in the social or political shareholder proposal area.

II. The Development of Rule 14a-8

Section 14(a) of the Securities Exchange Act grants the Commission a broad mandate to promulgate rules and regulations relating to proxy solicitations which are "necessary or appropriate in the public interest or for the protection of investors." Rule 14a-8 was originally designed to avoid the problem of shareholders being misled and unwittingly conferring discretionary authority through a proxy solicited by management on matters management knew would be presented by shareholders at a meeting.[2] In 1942 a

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[2] See Securities Exchange Act Release No. 2376 (January 12, 1940).

formal procedure was adopted that required issuers to include in their proxy statements all shareholder proposals that were "proper subjects for action" and to give shareholders the ability to specify a choice through the proxy cards on such proposals.

Early staff efforts were directed almost exclusively toward ensuring that shareholders were afforded adequate disclosure and meaningful participation regarding such proposals. The question of the right or ability of a shareholder to submit a proposal for a vote at that time was framed solely in terms of what subjects were "proper" for shareholder consideration under applicable state law.[3]

Subsequent rulemaking efforts attempted to provide guidance on what constituted a "proper" subject. As state law was generally silent on what subjects were proper, these efforts marked the point where the Commission began establishing federal standards for the proper subject criteria. In attempting both: (1) to avoid shareholders conferring a proxy under circumstances where they were not afforded disclosure and a choice on a matter that would

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[3] Securities Exchange Act Release No. 3638 (January 3, 1945).

be considered at a meeting, and (2) to avoid undue costs and burdens on issuers, the Commission initiated a process whereby a proposal could be excluded even though it arguably involved a proper subject under state law.

Under current Rule 14a-8, shareholders who comply with the procedural requirements under paragraphs (a) and (b) may submit proposals unless the issuer or registrant demonstrates that the proposals may be excluded under one of the thirteen grounds for exclusion set forth in paragraph (c). While staff interpretations of each of the thirteen provisions of paragraph (c) have been questioned from time to time, it is the administration of subparagraphs (c)(1), (c)(5) and (c)(7) that has been the most problematic.

Subparagraph (c)(1) allows a registrant to omit a security holder proposal if the proposal is, under the applicable state law, "not a proper subject for action by security holders." Subparagraph (c)(5) allows omission if a proposal deals with a matter that does not account for a specified percentage of the registrant's assets,

earnings or sales and "is not otherwise significantly related to the registrant's business." Subparagraph (c)(7) allows omission if a proposal "deals with a matter relating to the conduct of the ordinary business operations of the registrant." These subparagraphs are grounded on state law which generally provides that management is responsible for the conduct of a corporation's day-to-day business. In this regard, state corporate statutes generally delegate to management the authority to conduct the business and affairs of a corporation under the direction of its board of directors.[4]

III. The Omission of Proposals that Involve Social or Political Issues

Since the 1970's, the Commission and staff positions indicated that proposals on social and political subjects, such as doing business with South Africa, discrimination in Northern Ireland, and equal employment opportunity, involved matters that were both otherwise significantly related to, and outside the conduct of, a registrant's ordinary business operations. In 1976 the Commission issued a release outlining the staff's informal procedures under

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[4] See, e.g., Del. Code Ann. tit. 8, § 141(a) (19xx).

Rule 14a-8.[5] That release noted that the staff's positions could change from time to time in light of reexamination, new considerations, or changing conditions. The release also reiterated that the burden was on the issuer to demonstrate that a proposal could properly be excluded.

In 1983, the Commission revised Rule 14a-8(c)(5) to impose certain economic tests as a basis for determining significance.[6] That revision also provided that proposals involving matters that were otherwise significantly related to a registrant's operations could not be excluded notwithstanding the economic tests.

As everyone here is aware, the D.C. court's holding in Lovenheim v. Iroquois Brands[7] in 1985 rendered the economic tests of subparagraph (c)(5) a nullity as a practical matter. As a result of the Lovenheim decision, the ability for an issuer to exclude a shareholder proposal on the basis that it was "not otherwise significantly related to a registrant's operations" became quite

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5 Release No. 34-12599 (July 7, 1976).

6 Release No. 34-20091 (August 16, 1983).

7 618 F. Supp. 554 (D.D.C. 1985).

narrow. This in turn prevented many registrants from excluding social or political shareholder proposals.

In another development in 1989, the staff issued a no-action letter regarding Shell Canada, which stated in essence that the potential for a registrant to become the target of a boycott meant that the proposal was significantly related to the registrant's business. As Donald Fried of Philip Morris stated in his February presentation to the Commission: "any company can be subjected to threats of boycott - and many are -- for supporting Planned Parenthood or for not supporting Planned Parenthood -- for placing advertisements in Playboy or Penthouse -- for performing experiments on live animals or for contributing to universities or hospitals which perform such experiments -- or for the political contributions that political action committees make to U.S. Senators."

For yet another development, but this time in a different direction, in March of this year, the staff reviewed a proposal that requested a ABC/Capital Cities report on certain EEO and

affirmative action information. The requested report would provide detailed statistical information drawn from government reports and would also include the company's programs and policies with respect to minority and female hiring, management, production and programing. The company (ABC/Capital Cities) argued that the proposal could be excluded under subparagraph (c)(7) -- as employment and programing matters which deal with ordinary business operations -- as well as under subparagraph (c)(10) -- as its existing policies and programs substantially implemented the questions raised by the proposal.

The staff of the Commission indicated that the proposal could not be omitted for two reasons. First, the staff noted that questions with respect to affirmative action involved policy decisions beyond those personnel decisions that constituted ordinary business operations. Second, based on the information provided, the staff was unable to determine that the concerns under the proposal had been rendered "moot" by ABC/Capital Cities.

ABC/Capital Cities requested Commission review of the staff's position, and subsequently the Commission reversed the staff's position. The Commission indicated that the proposal could be omitted under subparagraph (c)(7) as dealing with ordinary business matters because the proposal involved a request for detailed information on the composition of the company's work force, employment practices and policies, as well as program content. The Commission reversal was ultimately vacated at the request of the parties involved. Thus, the Commission's reversal decision has no precedential effect.

While I am inclined to believe that social or political public policy issues, no matter how attractive the cause, should not be proper subjects for shareholder proposals, the more relevant point is that the Commission's staff should not be in the business of deciding which social or political public policy issues are to be included in, or omitted from, a particular registrant's proxy materials. Judgments on those issues are, in my view, better left to Congress.

As a path out of this morass, it is my understanding that the Commission's staff is considering the following three proposals, in the alternative, or in some combination thereof, as amendments to Rule 14a-8:

1. Limit the subparagraph (c)(5) exclusion to matters that concern a registrant's operations on the basis of the economic percentage tests only, and thereby eliminate the alternative test of "not otherwise significantly related," with the result that shareholder proposals that pursue a social or political agenda could be excluded provided that the operations which are the subject of the proposal do not meet the economic percentage tests;
2. In lieu of the objective test contained in subparagraph (c)(5) based on an economic criteria, the Commission could provide a separate exclusion for proposals that promote social or political causes; and/or
3. As part of the attempt to limit the number of proposals involving social or political causes, the Commission could

increase the percentage thresholds required for resubmitting a proposal under subparagraph (c)(12). (Note: The Commission's 1983 attempt to increase the percentage required from 3, 6, and 10% to 5, 8, and 10%, respectively, was invalidated by a district court based on APA grounds).[8]

By limiting the staff's ability to review proposals that involve a social or political agenda, the Commission will appropriately reestablish that Rule 14a-8 is primarily designed for disclosure purposes. Accordingly, Rule 14a-8 would be used as a corporate governance device rather than as a tool to champion good corporate citizenry through shareholder democracy.

IV. Conclusion

In conclusion, there appears to be little argument, in my judgment, with the proposition that shareholder proposals should deal with matters of economic significance or corporate governance that have a bearing on a shareholder's investment and on which a

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[8] United Church Board of World Ministries v. Securities Exchange Commission, 617 F. Supp. 837 (D.D.C. 1985).

shareholder may make an informed decision. It would be my intention that the Commission retreat from the business of fielding social or political public policy questions during the proxy process. I hope that the Commission's review of its proxy rules provides the Commission with the opportunity to do so.