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"Another Look at Shareholder Proposals in Proxy Statements"

One of the recent matters in the Commission that piqued the interest of people generally was the recently concluded General Motors proxy contest. The contest generated a bit of sloppy, sentimental thinking on the one hand and some closed-minded, baronial reactions on the other. So it might be helpful to review and reflect upon the history and objectives of the Commission's shareholder proposal inclusion requirement under its proxy rules.

If nothing else, the General Motors proxy contest has brought some renewed vitality to the proxy rules. It has lately appeared that tender offers and exchange offers have practically usurped the proxy contest as a scene of civilized corporate struggle. So there was some satisfaction as a lawyer in turning one's attention back to the older provisions of Section 14 of the Securities Exchange Act of 1934.

The elements that gave the recent General Motors proxy contest such notoriety, of course, were the automobile safety and environmental pollution issues involved. On those questions, needless to say, I have nothing to say here. The two proposals that the Commission did advise the company should be included in its proxy material were relatively narrow. They should be separated from the more glamorous safety and environmental issues.

The one shareholder proposal was to amend the by-laws of the company to increase the size of the board from 24 to 27 directors. That sort of shareholder proposal has always been considered includable and did not involve who should fill any new directorships created or what the philosophy of the nominess might be.

The other proposal was to create a committee to report to the shareholders on certain matters of corporate policy prior to the next shareholders meeting. The Commission placed two conditions on its approval of the proposal to create the committee. First, the committee's funding would only be in such reasonable amounts as determined by the board of directors. Second, information made available to the committee would be limited to areas which the board did not deem privileged for business or competitive reasons. Thus, the committee's role would be solely advisory and informational. The two conditions were intended to reflect the primacy and responsibility of the board of directors with respect to conduct of the corporate business.

Nonetheless, the GM shareholder proposals did focus new attention on questions of corporate responsibility and shareholder initiative and suffrage. In light of that, it might be helpful to review the policy basis and efficacy of the SEC's proxy rules and the pattern of regulation which they embody. Just so that my remarks this afternoon will not be misconstrued or my position overstated, I want to make clear at the outset that I have no basic quarrel with the existing rules or the way in which they have been administered by the Commission and its staff. As we shall see, the rules developed over a period of some 35 years. A great deal of thought and effort through many different administrations went into their development.

The Statutory and Administrative Framework of Rule 14a-8

Our inquiry must begin with the statute, the Securities Exchange Act of 1934. Typically, the Act begins with a broad prohibition and then gives the Commission broad authority to permit conduct in accordance with rules it is to promulgate. Section 14 of the Act states that it is unlawful to use the jurisdictional means -- the mails or instruments of interstate commerce or a stock exchange -- to solicit proxies in contravention of such rules as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. Thus, anyone who wants to solicit proxies must comply with the Commission's proxy rules. Since virtually every public corporation which is subject to the Exchange Act must solicit proxies, it is bound by the Commission's rules.

The proxy rules are an elaborate prescription of things which must be done in the solicitation of proxies. The focus of the rules is the proxy statement, which has become one of the three most significant corporate disclosure documents filed with the Commission. The rules detail the information that must be contained in the proxy statement. They also prohibit false or misleading information. They specify when and to whom the statement must be sent.

One of the more interesting and important rules is 14a-8, which deals with proposals of securityholders. Under this rule, the Commission requires that shareholders be permitted to submit proposals to management for inclusion in the proxy statement and for a vote of the shareholders. If management opposes the proposals, it must comply with the proposing shareholder's request to include a statement of not over 100 words in support of the proposal. In effect, this rule is a guarantee of more effective shareholder suffrage. But it is not all-encompassing.

For one thing, the rule does not apply to elections to corporate office or to counter-proposals to management proposals. In addition, certain other types of shareholder proposals may be omitted by management. Thus, proposals may be omitted if

--(1) they are not a proper subject for shareholder action under the laws of the corporation's domicile state;

--(2) they are submitted primarily for the purpose of enforcing a personal claim or grievance or primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes;

--(3) the proposals have been submitted to shareholders before and the dissident shareholder either hasn't bothered to show up at earlier meetings or the proposals have been defeated by certain percentages; or

--(4) the proposals deal with matters relating to the conduct of the ordinary business operations of the company.

Rule 14a-8 provides that when management decides to omit a shareholder proposal, it must notify the shareholder and also notify the Commission of its decision. In addition, management must give a statement of reasons why the omission is proper under the enumerated exceptions in the rule.

Administrative History of Rule 14a-8

Now, let me trace briefly the administrative history of the exclusionary provisions of existing Rule 14a-8. As in the case of other Commission rules, these were in large part the result of experience as much as a distillation of a fundamental concept.

When the proxy rules were first promulgated in 1935,[1/] there was no provision equivalent to 14a-8. There was, however, a provision comparable to present Rule 14a-7, which requires management to mail proxies on behalf of a securityholder at his expense. Thus, at the very beginning the Commission asserted that some procedure should exist to facilitate proxy solicitation by securityholders through the medium of the corporate machinery.

In 1938, the Commission completely revised its proxy rules,[2/] but again it included no provision comparable to 14a-8. Instead, the provision relating to mailings of proxies for securityholders was broadened by adding the requirement that the company furnish on request to securityholders information as to the number of holders of records management was soliciting and as to the estimated cost of mailing proxies to those holders. This information would be useful to securityholders who wanted to oppose management's solicitation or to solicit support for proposals of their own. But it was still a long way from requiring management to include a shareholder's proposal in the company's own proxy statement.

1/Release No. 34-378.

2/Release No. 34-1823.

Then, in 1942, the Commission added a provision that required that the management set forth shareholder proposals in its proxy statement and proxy, and include a statement of up to 100 words submitted by the proposing securityholder if management opposed the proposal.[3] The rule required that the proposal be "a proper subject for action by the security-holders."

Thus, the Commission gave shareholders a way to present proposals for corporate action to their fellow shareholders and, in the interests of corporate democracy, to make the company carry the message at its expense. At the same time, the Commission rejected a proposal by its staff that minority stockholders be given an opportunity to use the management's proxy material in support of their own nominees for director-ships.

The key requirement in the original version of what is now Rule 14a-8 was that the proposal be a "proper subject for action by the securityholders." The Commission recog-nized the importance of promoting shareholder suffrage and initiative. But it also appreciated the problems of permitt-ing any shareholder proposal to be put forth, regardless of its relevance to the power of the shareholders to act on the proposal.

As you might expect, the question of what subjects were proper for shareholder action elicited considerable debate right away. Without actually amending the rule, the Commis-sion attempted to clarify the meaning of the rule by releasing in 1945 an opinion of Baldwin Bane, the then Director of its Corporation Finance Division.[4]

3/Release No. 34-3347.

4/Release No. 34-3638.

In his opinion, Mr. Bane stated:

> ". . .it is the purpose of (the) Rule. . .to place stockholders in a position to bring before their fellow stockholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized. It was not the intent of (the) 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. Other forums exist for the presentation of such views."

Thus, in one fell swoop, Mr. Bane -- with the assent of the Commission -- expressed a concrete view of what types of shareholder proposals should be includable in management proxy statements. It took the Commission itself nine years and three successive revisions of the proxy rules before Rule 14a-8 fully reflected by its terms the substance of the Bane opinion. However, the revisions also covered the mechanics of dealing with shareholder proposals.

In 1948, the Commission began the process of formally tightening the requirements for inclusion of shareholder proposals.[5/] The revisions to Rule 14a-8 in that year provided specific exclusionary language designed, in the Commission's words, "to relieve the management of harassment in cases where (shareholder) proposals are submitted for the purpose of achieving personal ends rather than for the common good of the issuer and its security holders. . ." The Commission "found that in a few cases security holders have abused (the) privilege (of submitting proposals) by using the rule to achieve personal ends which are not necessarily in the common interest of the issuer's security holders generally."

5/Release Nos. 34-4114, 4185.

Thus, proposals for individual, as distinct from corporate, purposes were not required to be included. But the language of the rule very carefully limited the exclusion to cases where it "clearly" appeared that the proposal was submitted "primarily" for the purpose of enforcing personal claims or grievances. A proposal could not be excluded if it only incidentally benefited the proposing shareholder.

A further limitation on shareholder proposals was also added at this time. Proposals could be omitted where the proposals had been included in proxy materials previously, but had not been presented by the proposing securityholder at the meeting or had received less than 3% of the votes cast. These percentage limitations, which were later modified, are obviously important to management. This is demonstrated by the newspaper reports of GM's successful attempt to defeat the shareholder proposals by a wide margin.

The final change in the proxy rules in 1948 related to their administration. It was required that if management wished to exclude a shareholder proposal, it would have to file with the Commission a copy of the proposal and its own statement of reasons why omission was deemed to be proper. The proposing shareholder would also be notified of management's proposed exclusion. The rule also stated that the mere filing of the proposal by management would not be deemed compliance with the rule as a whole. In other words, the fact that the proposal was filed and the Commission took no action could not be construed as a finding that the rule had been complied with. Requiring filing with the Commission did, however, have the effect of focusing Commission attention on the shareholder proposals.

By 1952, the Commission was ready to tackle the question of proposals dealing with general economic, political, racial, religious, social or similar causes.[6/] It amended Rule 14a-8, in its words, to "relieve managements of the necessity of including in their proxy material stockholder proposals designed primarily to promote. . .(such) causes." As in the case of proposals dealing with individual claims, however, it must "clearly" appear that the proposal was submitted "primarily" for the excludable purpose.

6/Release Nos. 34-4668, 4775.

Apparently, the 1952 amendments did not adequately circumscribe the scope of excludable shareholder proposals. In 1954, the Commission adopted still further changes.[7] The public comments on the proposed changes were made in the form of letters and also in oral presentations to the Commission. Although it is not common to do so, in this case the Commission scheduled and held a public hearing on the proposed changes.

The Commission pointed out that nine years earlier, it had, by the publication of the Bane opinion, indicated that proposals might be omitted if, under applicable state law, they were not proper subjects for shareholder action. Now the Commission made the reference to state law explicit. In addition, the Commission provided that proposals could be omitted if they related to the conduct of the ordinary business operations of the issuer.

The Commission also tightened up the requirements with respect to proposals which had been submitted to shareholders in past years. Proposals could be omitted for a period of three years from the last previous submission if they had been submitted within the previous five years and received less than 3% in the case of a single submission, less than 6% upon a second submission or less than 10% upon a third or subsequent submission during the five year period. Thus, shareholder proposals are entitled to be considered more than once; but they must at least gain in popularity if they are to be included at the company's expense in its proxy statement. You might recall that the shareholder proposals in GM received less than 3%.

While the Commission more carefully delineated areas of excludability of shareholder proposals, it took occasion to note:

> "The rule places the burden of proof upon the management to show that a particular security holder's proposal is not a proper one for inclusion in management's proxy material. Where management contends that a proposal may be omitted because it is not proper under state law, it will be incumbent upon management to refer to the applicable statute or case law and furnish a supporting opinion of counsel."

7/Release Nos. 34-4950, 4971, 4979.

The Commission also modified the mechanics of dealing with shareholder proposals which management wished to exclude. It said:

> "So that the Commission will have more time to consider the problems involved in such cases and the security holder will have an opportunity to consider the management's position and take such action as may be appropriate, the amended rule provides that a copy of the proposal and a statement of reasons for its omission must be furnished to the Commission and the security holder not later than 20 days prior to the date of filing the management's preliminary proxy material."

It doesn't take very much reading between the lines to figure out what the Commission meant when it referred to the possibility of appropriate action by the proposing shareholder. The Commission might determine to take no enforcement action of its own. But this would not preclude the shareholder from bringing an appropriate injunctive action to compel management to include his proposals or to take other remedial action which might be available.

Rule 14a-8 and Corporate Social Responsibility

The interesting thing to me about the genesis of existing Rule 14a-8 is that it has fundamentally changed very little. The keystone of the rule is and always has been that shareholders should be able to present proposals to their fellow shareholders which are appropriate for shareholder action. The particular exclusionary provisions -- except for the vote percentage requirements on previously included proposals -- are really nothing more than interpretive gloss. It is apparent that the Commission has always regarded what is appropriate for shareholder action as a matter of state law. Thus, it has concluded that state law does not in any case enable shareholders to use the corporate machinery to advance solely personal interests, solely general community interests or matters of ordinary business-type corporate interest. If shareholders do not have the power under state law to make certain corporate decisions, there would appear to be no justification for requiring management to include proposals for such decisionmaking in proxy materials.

The practical effect of giving shareholders control over day-to-day corporate business decisions would, in my view, lead to confusion, disorder and corporate instability. I think that it has to be acknowledged that our system of corporate power and decisionmaking has worked reasonably well. In part, this is a result of the congruity of corporate goals shared by management and shareholders, each of which are generally seeking optimal returns on invested capital. The system has started with the factual assumption that shareholders today are neither interested in nor capable of making ordinary managerial decisions. The system has safeguarded shareholder rights mainly by recognizing the fiduciary obligations of management to the shareholders. Increased delegation of corporate functions to management has been accompanied by correspondingly greater management responsibility and accountability to shareholders.

That is not to say that shareholders must expect to be treated like second-class corporate citizens. The shareholders are, after all, the owners of the business and need remain passive recipients of dividend checks only by their own choice. As the owners of commercial and industrial institutions whose activities have a profound impact on all of us, shareholders' pride of ownership may extend to corporate policies as well as profits. Shareholders can play a major role in alerting corporate managements to the broader functions and responsibilities of the modern corporation to the community of which it is a part. They can, of course, also express the view that management should limit itself in that regard.

Ultimately, the shareholders do have the power to change the management of their corporations. If properly conceived shareholder recommendations to management are ignored, then the federal proxy machinery makes possible an attempt to displace existing management.

The logical and practical role of shareholder initiative can, it seems to me, be only in the broader areas of influencing broad corporate business policy rather than in the unwieldly and impracticable area of business decisionmaking. Responsible shareholder proposals cast in terms of recommendations to management as to basic corporate business policies can, when not carried to extremes, promote healthy participation in corporate life. On the other hand, proposals designed to

pre-empt the functions of the board of directors, which state law recognizes as primarily responsible for business decisions, might actually defeat the purposes of such proposals. Management can be responsive to declarations of corporate policy by shareholders. But it should not be relieved of its fundamental responsibility under state law to account to shareholders for business decisions which it alone must make.

The Commission's proxy rules, while not explicit on the point, appear to recognize this distinction between expressions of basic corporate policy by shareholders -- as to which properly framed proposals under 14a-8 may be includable -- and attempts by shareholders to diffuse managerial obligations which state law clearly places upon the board of directors.

What I believe we may be witnessing in these times is a groping toward some redefinition of corporate purposes, one that might include a larger role for private-profit corporations in solving community problems. Various court and administrative decisions have sought to deal in one way or another with such aspects of the corporate institution, and a number of business leaders have been speaking to it now over a period of years. Perhaps it is essentially a debate over what will be profitable to the corporation over the long run, rather than a question of removing the economic discipline that profit objectives impose on the corporation. To the extent shareholders seek to and properly can participate in these determinations, it seems to me it is the Commission's role not to judge the issues but only to assure that the shareholder franchise remains one that is exercisable in an orderly and informed way.

Thank you.