New York Speech - Nov 15, 19

SPEECH BY COMMISSIONER JAMES C. TREADWAY, JR.
NOVEMBER 15, 1982

Good afternoon. I'm delighted to have the opportunity to speak before a group of former Commission staff members, and a former Commissioner, although I suppose that amount of collective experience places me at risk. Before proceeding, however, I must tell you that the views I express today are mine alone and do not necessarily represent the views of the Commission, any of my fellow Commissioners, or the staff. In addition, given your collective experience, I want to be sure that I reserve the right to change my views after hearing your comments.

I want to talk briefly about the proposed amendments to the shareholder proposal rule (Rule 14a-8). After my comments, I hope you will be candid in discussing your views on the topic and my comments.

I always get the feeling that before discussing shareholder proposals, I should pass out complementary doses of Inderal. The topic seems to raise people's blood pressure to a dangerous level. And I might observe that I always have been mystified by the intensity of emotion and outrage and by the volume of writing on this topic. Given this history, the staff's request for comments on Rule 14a-8 undoubtedly will provoke heated response from all sides. Unfortunately, I fear that much of it may not be rational.

But before addressing the specific proposals, let's look at two things: (1) some cold, hard statistics; and (2) the Commission's involvement.

The preliminary figures for the year ended June 1982 show that 850 shareholder proposals were submitted to only 300 of approximately 9,000 public companies. Thus, 97 percent of the public companies didn't even receive a proposal. By contrast, only 43 companies received 5 or more proposals, accounting for about 350 of the 850 proposals. Furthermore, almost half of all stockholders proposals submitted were either withdrawn or accepted uncontested.

1981 figures, reflect similar numbers: 991 proposals submitted to 376 companies.

With these statistics in mind, let's now look at the Commission's role in the process. The current process compels the staff of the Commission to arbitrate disputes through the mechanism of no-action positions. In this way, the staff becomes involved in resolving matters of state law, social engineering, corporate policy, and political philosophy to which there is little they can add and which are often totally unrelated to Commission's primary mission of protecting investors and preserving the integrity of the markets. Thus, staff becomes involved in the promotion of various private schemes that are generally beyond the purview of the federal

securities laws and which require difficult judgments of law and fact in areas in which the staff lacks any expertise.

Nevertheless, in 1981, 173 issuers submitted letters to the staff seeking no-action positions on 387 shareholder proposals that they intented to exclude. In 1982, 182 issuers sought relief for 487 contested proposals. The Division of Corporation Finance responded with 285 letters in 1981 and 313 letters in 1982.

As you know, these staff positions are not Commission decisions, are not legal precedent, and are not appealable as final agency actions. Yet, because of time, printing schedules, and other practical pressures, disputes between management and the proponents of the proposals are resolved without any realistic avenue of appeal or review beyond the staff decision. This is hardly the ideal procedure, and the process and results have not drawn rave reviews. Also, there is significant turn-over at the staff level, which some believe contributes to a lack of even-handed treatment and lack of consistent decisions.

Given the small number of proposals and companies involved, and despite the imperfect process, cynics -- as well as the ultra-rational -- might well ask why so much attention is focused on so little activity? It is cost ? Is it principle? Is it ego, on both sides? Well, the cost to corporations appears to be de minimis. In response to a Commission request

for cost data in 1976, only one corporation responded -- ATT. AT&T reported that its costs, including postage, printing, employee remuneration, and outside counsel fees, totalled approximately $150,000. That represents about five cents per shareholder. I reiterate, that's per shareholder, not per share; hardly a material amount by any standards. No other issuer provided any cost data to the Commission. I don't know why. But without any hard data to the contrary, it seems fair to conclude that what is at stake is not money, but rather principle or ego.

Against that background, let's turn to the staff's recent release on the subject. To begin with, the staff seeks advice on the fundamental question whether stockholder proposals should be regulated at all under federal law or left instead to state law. The simplicity of that approach has a certain appeal, but I doubt that it is likely to find broad support. Indeed, as I will mention later, issuers don't seem to find this attractive, despite the economics.

Apparently having reached a similar conclusion, the staff has came forth with three possible approaches for continued federal regulation of the shareholder proposal process. Proposal I would retain the current rule, but with certain revisions. Proposal II would permit an issuer, with shareholder approval, to adopt its own procedures for shareholder proposals, with Commission rules preserving certain minimum protections.

Proposal III would require management to include any proposal proper under state law and not involving the election of directors. Under Proposal III, however, the aggregate number of proposals required to be included in a proxy statement would be limited, based upon the total number of shareholders.

Proposal I

The major revision embodied in Proposal I is a heightened eligibility requirement. To be eligible to submit a proposal, a shareholder would be required to own for at least a year 1% of the issuer's securities eligible to vote at the meeting or securities having a market value of at least $1,000. Additionally, a shareholder would be limited to only one proposal a year. Proponents who engage in a general, written solicitation of proxies would not be eligible to use the provisions of Rule 14a-8 for the inclusions of a proposal in the issuer's proxy material for the same meeting.

If Rule 14d-8 is to be retained in modified form, the staff proposes changing the reference to business days to a comparable number of calendar days. Also two time periods would be extended. The deadline in paragraph (a)(3) for the submissions of proposals to the issuer would be changed from 90 to 120 days. Also the deadline in paragraph (d) for the issuer to file the reasons it believes specific proposals may be excluded from its proxy materials would be changed from 50 to 60 days prior to the filing of its preliminary proxy

materials. These two changes are in response to complaints that, because of the complexity and increased number of shareholder proposals and the longer lead time needed for printing proxy material, issuers are frequently left with as little as 10 days between the last date for submission of proposals and the filing date for preliminary material.

Again, as in 1981, the staff asks for comment on amending paragraph (a)(4) to permit a proponent a maximum of 500 words for a proposal and a supporting statement.

Certain changes also would be made to clarify the conditions allowing proposals to be excluded as personal grievances, as unrelated to business, or as involving the same matter as another proposal. Regarding personal grievances, the staff proposes changing paragraph (c)(4) to include explicitly the concepts of personal interest or benefit. The exclusion would then read:

> If the proposal relates to the redress of a personal claim or grievances against the issuer or any other person, or represents an attempt to further a personal interest or it is designed to result in a benefit to the proponent not shared with the other security holders at large.

With regard to matters not significantly related to the issuer's business, the staff believes that a totally objective standard is not feasible. However, the staff is inviting comment on amending paragraph (c)(5) to include an economic significance test.

The resubmission of proposals included in prior years has been one of the most controversial provisions of the rule. Historically, the staff has interpreted "substantially the same proposal" to mean one that it is virtually identical in form as well as substance to a proposal previously included in the issuer's proxy materials. Because of growing abuses in this area, the staff is reproposing an idea advanced in 1976, which would permit omission of a proposal if it "deals with substantially the same subject matter as a proposal previously submitted to security holders . . .." No change is proposed in the alternative interpretative test, which allows omission if a proposal is comprised essentially of elements of two or more proposals that were submitted for vote in prior years and failed to receive the requisite percentages.

The staff also seeks comment on the advisability of discontinuing the practice of issuing no-action letters. I note that if this practice were discontinued, an issuer would proceed at its own risk and could be subject to suit, both by Commission and shareholders, for improperly excluding a shareholder proposal.

Finally, the staff seeks advice on the advisability of charging proposing stockholders a fee for processing the proposal. The issuer would collect the fees from shareholders and pass them on to the Commission. The issuer would be required to refund the fee if the proposal did not come before the Commission for review, as would be the case, for example, if it were withdrawn.

Proposal II

Proposal II would permit an issuer to adopt its own procedures to govern shareholder proposals. The Commission would continue to regulate the submission, inclusion and exclusion of shareholder proposals (under whatever rules may generally be in effect), but a supplemental rule would permit the shareholders of an issuer to decide the extent of access to management's proxy statement to be provided to shareholders and the costs to be borne by the issuer. The issuer's plan would require initial shareholder approval, and periodic reapproval. The plan, however, would be subject to some limitations. For example, overly restrictive elegibility criteria or overly broad exclusionary criteria might be prohibited.

Disagreements between an issuer and a proponent about exclusion of a proposal would be resolved according to the plan and, in the last resort, by the courts. Only in the

area of personal grievances would the Commission continue to review proposals, and then only if the staff continued its present practice of issuing no-action letters.

Amendments to an issuer's plan could be proposed by the board of directors or by any shareholder, without regard to the eligibility requirements under the plan.

In recognition of possible delays in court determination of eligibility or exclusion, the staff has requested comment on the feasibility of relying on the courts to resolve disagreements.

Proposal III

Proposal III was originally proferred by Commissioner Longstreth last December. It is the most ambitious of the three proposals, and yet in many respects the simplest. Under this proposal, an issuer would be required to include in its proxy material all shareholder proposals which are not improper under state law and are not related to the election of directors. This approach would eliminate eleven of the existing thirteen grounds for the exclusion of proposals. Disputes regarding exclusion of a proposal would be resolved by the courts, not by the Commission's staff.

Under this approach, there would be a limit on the maximum number of proposals an issuer would be required to

include, which would be based upon the total number of the issuer's shareholders. If the number of proposals submitted were to exceed the allowable maximum, preference would be given to proposals submitted by proponents who had not had a proposal included in the previous three years. If the number of proposals submitted by these "new" proponents were to exceed the maximum, proposals would be selected by lot from among the proposals submitted by the "new" proponents. If the proposals submitted by "new" proponents were less than the maximum, additional proposals would be drawn by lot from the remaining proposals. The order of receipt of proposals would be irrelevant and duplicative proposals would be considered as one.

Four arguments or principles are said to support this approach. First, the shareholder proposal process serves the public interest, is an important element of shareholder democracy, and assures some degree of management accountability, and in that sense lends validity to the notion of a corporate entity. Second, shareholder proposals provide substantial benefit at minimal cost. Third, in this area of difficult factual and legal judgments, a simpler and more predictable regulatory process would serve both issuers and proponents better. Fourth, the necessity of the Commission's staff involvement in the process would be eliminated. This would be a small, but not unimportant, cost savings to the Commission, particularly in today's period of budgetary constraint. More

importantly, however, it would relieve the staff from the task of reaching judgments on issues for which they lack expertise and which do not involve questions of federal law.

Conclusion

Without prejudging the outcome, and by doing a fair amount of speculating about the comments I expect we will receive, Proposal III has a degree of appeal. Whatever the theoretical merits of shareholder proposals in advancing corporate democracy, and notwithstanding the debate about abuse and cost, simplicity, and therefore predictability, appears likely to produce the best result. It would do away with all the wheel-spinning, hair-splitting and ego trips we have seen. In making that comment, I am well aware that I may be accused of being simplistic merely to avoid making difficult or controversial decision. We should remember, however, that shareholder proposals are not the only avenue to corporate democracy, and perhaps not even the most important. Nor are the costs involved likely to affect the average balance sheet. And I would point out that this whole debate is over whether and when and how stockholder proposals can be included in or excluded from management's proxy statement. The right to engage in a proxy contest, and to disseminate an insurgent's proxy statement, would remain totally unaffected.

As I stated at the outset, a cynic might well easily conclude that this whole matter is the classic tempest in a

teapot. There comes a time when the pursuit of regulatory perfection, or ultimate fine-tuning, should be abandoned, a practical balance struck, and attention focused on more important matters. The regulation of shareholder proposals seems to me to be such a case.

However, I had the opportunity to discuss the staff's release on shareholder proposals last week with a group of corporate secretaries and general counsels. Their responses were both surprising and interesting. First, they were very outspoken in their belief that, having demonstrated a federal presence in the proxy area, it would be unfair for the Commission to abandon the field with regard to the exclusion of shareholder proposals and to leave it to state law. Some even characterized the proxy statement as a "federal creation."

Nor did they find Proposal II attractive. They expressed a concern that the use of terms like "overly broad exemption criteria" or "overly restrictive eligibility criteria" would result in a decade of litigation and uncertainty, with substantial attendant costs.

That group found Proposal III no more attractive. They were concerned that Proposal III provides no way to eliminate shareholder proposals that are abusive of the process, for example, those that are simply personal grievances and skillfully and artfully impugn the integrity of management. And they resented most strongly the idea that, under Proposal III,

the issuer would have to lend credence or dignity to such proposals and their pointed or slanted verbiage.

Proposal I seemed to have the most support but primarily because it was not attacked as ardently. Quite frankly, I suspect the only approach that would be totally satisfying would be one that bars shareholder proposals from management's proxy statement.

So where does all of this leave us? Does anyone -- on either side -- really want revisions, other than those that further their parochial interests? Can this issue be addressed rationally?

On the last point, I would certainly hope so. And the people in this room, and at similar sessions, can do much to make the process rational and productive. If not, we will have a classic lobbying effort, from the most extreme and parochial viewpoints. I personally hope that we will receive the thoughtful and informative imput this question deserves. Without it, the basis for action on our part will be subject to attack and second-guessing.

While I favor some revision -- given the way the debate has started, with emotional volleys from all sides -- I am having second thoughts as to whether this re-thinking can or will be productive.