Reevaluating the Shareholder Proposal Rule in the Wake of Cracker Barrel and the Era of Institutional Investors

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COMMENTS

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Since the corporate principles of ownership and control first were identified, the scope of corporate accountability has been debated continuously.\(^1\) The philosophy underlying corporate accountability is that shareholders are the true owners of a public corporation, but the everyday control and management of a corporation resides with the board of directors and appointed managers.\(^2\) Charged with the duty of protecting investors,\(^3\) the Securities and Exchange Commission ("Commission" or

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\(^{\text{1}}\) See Kenneth R. Propp, The SEC's Shareholder Proposal Rule: Corporate Accountability at a Crossroads, 11 SEC. REG. L.J. 99, 117 (1983) (noting that the debate regarding the assumptions of accountability of corporations began in the 1930s and has continued for more than 50 years); see also Robert G. Vanecko, Regulations 14A and 13D and the Role of Institutional Investors in Corporate Governance, 87 Nw. U. L. Rev. 376, 376 (1992) (noting that the debate over corporate governance began with Berle & Means's theories of separation of functions and has continued ever since).

\(^{\text{2}}\) See ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 119-20 (1932). There have been two primary justifications for the belief that corporations should afford primacy to the shareholders. See David Millon, Redefining Corporate Law, 24 IND. L. REV. 223, 230-31 (1991). Berle & Means advocated the first justification, which is premised on a theory of trust and property. See id. at 230-31. They hypothesized that a trust relationship existed between shareholders and management, "with management holding the shareholders' property in trust for their benefit." Id. at 231. The second, more recent theory, is governed by contractual relations. See id. The advocates of this theory see the players in the corporation, both management and shareholders, as actors in the market governed by a "contractual ordering." Id.

\(^{\text{3}}\) The Commission is authorized to make and enforce all rules and regulations it deems "necessary or appropriate in the public interest or for the protection of investors." Securities and Exchange Act of 1934 § 14(a), 15 U.S.C. § 78n(a) (1994); see also WILLIAM L. CARY & MELVIN ARON EISENBERG, CASES AND MATERIALS ON CORPORATIONS 258 (6th ed. 1988) (stating that the purpose of the 1934 Act is to provide protection to investors ensuring "fair and orderly securities markets"). Congress gave the SEC broad power to develop rules to encourage shareholder participation. See S. REP. NO. 73-792 at
"SEC") enacted the Shareholder Proposal Rule in 1942 ("Rule" or "Rule 14a-8") to ensure shareholder participation in the important decisions of the corporation. The SEC intended the Rule to guarantee management's accountability to the shareholders, the true owners of the corporation. The driving force behind the Rule was the notion that shareholders did not have adequate or efficient means of participation in corporate governance. The SEC envisioned the Rule as a major step toward increased shareholder participation in corporate decision making and a method to further promote corporate accountability.

Since its enactment, the Rule has been a relatively ineffective mechanism for shareholders to participate in the decision making process of a corporation. Among the Rule's many exceptions, the most controversial

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12 (1934). "Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange." H.R. REP. NO. 73-1383, at 13 (1934).


6. See Solicitation of Proxies Under the Act, Exchange Act Release No. 3,347, 7 Fed. Reg. at 10,655 (stating that the Commission was acting pursuant to the powers and goals of the 1934 Act); see also H.R. REP. NO. 73-1383, at 14 (1934) (stating that a purpose behind the 1934 Act was the "duty of according shareholders fair suffrage," to ensure shareholder participation in corporate governance); see also Freeman, supra note 5, at 549-50 (explaining that Rule 14a-8 provides a mechanism whereby shareholders are made aware of proposals and the proponents' reasons for submitting the proposals, and are given an opportunity to vote on the proposal); Donald E. Schwartz & Elliott J. Weiss, An Assessment of the SEC Shareholder Proposal Rule, 65 GEO. L.J. 635, 636-37 (1977) (arguing that without the leverage the Act provided, management would not listen seriously to shareholders' proposals).


9. See Howard B. Adler, The Emerging Role of Activist Shareholders and Destabilizers, in THE NEW AGGRESSIVE ERA IN FINANCIAL INSTITUTIONS Mergers and Acquisitions at 133, 135 (PLI Corp. L. & Practice Course Handbook Series No. B-992, 1996) (arguing that due to the limited means of communication afforded to shareholders,
is Rule 14a-8(c)(7), the ordinary business exception ("ordinary business exception"), which allows management to exclude shareholder proposals on a broad range of topics, so long as the company shows that the proposal relates to its ordinary business operations. The amorphous language of the ordinary business exception has sparked much debate and litigation.

proposals have resulted in few substantive changes); see also Michael J. Connell, Shareholder Proposals, in PREPARATION OF ANNUAL DISCLOSURE DOCUMENTS 1997, at 397, 399 (PLI Corp. L. & Practice Course Handbook Series No. B-970, 1997) (noting that, until 1976, the Shareholder Proposal Rule was not frequently used and received little attention from corporations and shareholders alike).

One scholar, however, argues that the success of the Rule should not be evaluated in terms of the results that the proposal brings, but by whether the shareholder is provided an opportunity to hold management accountable. See Freeman, supra note 5, at 555. Freeman, one of the architects of the Shareholder Proposal Rule, explained his view as follows:

As we have seen, a stockholder almost never wins his point on a showdown vote at a meeting. However, by forcing the management to a public defense of its position, the shareholder may contribute to a better understanding between management and shareholders. In some cases he may even cause a reappraisal by management of some aspects of its position.

In judging the value of the stockholder proposal rule, I believe it is of no consequence whether a stockholder ever prevails or whether a management ever accepts a stockholder's proposal. The value which I see in the rule is that to the extent that stockholders challenge the judgment of management, management is required to make a defense of its position.

Id.

10. Shareholder Proposal Rule, 17 C.F.R § 240.14a-8(c)(7) (1998). The exception states that a proposal may be excluded from a proxy statement if it “deals with a matter relating to the conduct of the ordinary business operations of the registrant.” Id.; see also Alan R. Palmiter, The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation, 45 ALA. L. REV. 879, 890 (1994) (noting that the ordinary business exception is one of the most used and litigated grounds for exclusion of shareholder proposals).

11. See Grimes v. Ohio Edison Co., 992 F.2d 455, 458 (2d Cir. 1993) (holding that a shareholder proposal that sought to cap annual capital or construction expenditures at $300 million without prior shareholder approval was excludable under 14a-8(c)(7)); Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416, 428 (D.C. Cir. 1992) (holding a proposal requesting the phase-out of chloro-fluorocarbons excludable because the company already had a phase-out plan that was to take place “as soon as possible”).


The *Cracker Barrel* litigation, for example, dealt with this exception. In 1992, the Commission issued a no-action letter in response to Cracker Barrel Old Country Store's notification of its intention to exclude a shareholder proposal regarding non-discriminatory employment policies. This matter resulted in litigation, ultimately upholding the SEC's choice not to act. The *Cracker Barrel* decision signaled the Commission's retreat from the principle of corporate accountability. The Commission changed its interpretation of what constituted ordinary business in favor of corporate management's increased exclusion of shareholder proposals. The Commission's enunciated policy in *Cracker Barrel* led to a severe limitation in the scope of shareholder proposals under Rule 14a-8 by excluding proposals pertaining to important social policy in employment related issues.

While shareholder participation in corporate governance has been...
limited,19 the traditional justifications for these limitations are no longer justified in light of changes in the characteristics of shareholders.20 Today an increasing number of shareholders are institutional investors.21 An in-


20. See Institutional Voting Research Service Client Advisory Letter, in INSTITUTIONAL INVESTORS: PASSIVE FIDUCIARIES TO ACTIVIST OWNERS at 33, 34 (PLI Corp. L. & Practice Course Handbook Series No. 704, 1990) (stating that "[c]oncentrated ownership has given rise to a new form of corporate governance whose ultimate shape and structure has yet to be fully defined"); see also HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, 3D SECURITIES AND FEDERAL CORPORATION LAW 13-74 (1997) (noting that an increasing number of institutional investors have complained that the federal proxy system has created a barrier to their participation in corporate governance); Lynne L. Dallas, The Control and Conflict of Interest Voting Systems, 71 N.C. L. REV. 1, 4 (1992) (noting that "[t]he current system of shareholder voting rights is inadequate to meet the needs of the modern corporation"); James A. White, Shareholder-Rights Movement Sways a Number of Big Companies, WALL ST. J., Apr. 4, 1991, at C1 ("The solid wall of corporate opposition to shareholder-rights proxy measures is beginning to crumble, as big pension funds win concessions from an unprecedented number of large companies."); infra Part I.B (discussing the shift from individual shareholders to institutional investors).

21. See Richard H. Koppes & Kayla J. Gillan, The Shareholder Advisory Committee, DIRECTORS & BOARDS, Spring 1991 at 29, 29-30 (noting that the number of institutional investors is growing and will continue to grow.) This growth will result in a shareholder group that is different from the traditional shareholder group. See id.; see also Robert A. Kindler & Rachel R. Gerstenhaber, Shareholder Initiatives, Institutional Investors and the SEC: 14A-8 Proposals and the New Proxy Rules, in 24TH ANNUAL INSTITUTE ON SECURITIES REGULATION at 9, 15 (PLI Corp. L & Practice Course Handbook Series No. B-793, 1992) (noting that institutional investors recently have increased their share of holdings). Institutional investors now hold an estimated fifty-three percent of outstanding equity shares. See id. at 17; Grienenberger, supra note 18, at 175-77 (discussing institu-
institutional investor, unlike an individual investor, is a corporate entity such as an insurance company, a pension fund, or similar institution that invests in stock to make profits for its venture.  

The changes in the fundamental identity characteristics of corporate investors has increased the potential for meaningful shareholder participation in corporate governance; and it has prompted the need for reevaluation of the Shareholder Proposal Rule and in particular its exceptions.  

A new attitude of shareholder activism has emerged that views the principal corporate goal as the maximization of shareholder value in the corporation. The Commission recently has recognized the changes in corporate structure, the nature of investors, and prevailing attitudes and has realized the need to reevaluate the current Shareholder Proposal Rules to reflect those changes.

This Comment explores the history of the Commission's Shareholder Proposal Rule and focuses on the ordinary business exception. This Comment traces the history and purpose of the Rule in light of the goal of corporate accountability to shareholders. Part I focuses on the ineffectiveness of the Shareholder Proposal Rule to obtain its stated goals and the role of the Commission in hindering the achievement of corporate accountability. It analyzes the revisions of the Rule and the Commission's struggle to define what constitutes a "proper subject" or "ordinary investors, their increased presence, and current problems associated with corporate governance); see also Patrick J. Ryan, Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy, 23 GA L. REV. 97, 103 (1988) (noting that, due to the rise of institutional investors, "the traditional debate about shareholder proposals has become somewhat dated"). The increased presence of the institutional investor provides an opportunity to reexamine the Shareholder Proposal Rule and its future application. See id. at 103-04.

22. See Louis Lowenstein, Why Managements Should (and Should Not) Have Respect for Their Shareholders, 17 J. CORP. L. 1, 3-6 (1991) (discussing the successful investment of Dupont in GM during the first half of the century as an example of an institutional investor and the benefits that flow to both investor and company).


24. See infra notes 179-286 and accompanying text (discussing the factors creating a need for reevaluation of the Rule).

25. See Adler, supra note 9, at 133 (advocating that traditional corporate goals of "benefitting the corporation's community or its employees" should be subordinated to the goal of maximizing shareholder value).

26. See John H. Matheson & Brent A. Olson, Corporate Law and the Longterm Shareholder Model of Corporate Governance, 76 MINN. L. REV. 1313, 1316 (1992) (citing the need for redress of the corporate governance system to accommodate the evolution of the modern institutional investors).
nary business.” Part II discusses the most recent interpretation of the ordinary business exception in the Cracker Barrel case. It will then examine the impact of the Cracker Barrel decision on corporate accountability and discuss the importance of institutional investors in reevaluating the Shareholder Proposal Rule to assure corporate accountability to shareholders. Next, it will explore the Commission’s failure to adhere to administrative procedures and its broad disregard for shareholders in their role as monitors of the corporation. This Comment then will analyze the impact of the Shareholder Proposal Rule on the future effectiveness of corporate accountability. Next, this Comment discusses the new rule issued by the Commission which begins the necessary reevaluation of the Shareholder Proposal Rule. In Part III, this Comment suggests the need to redefine the ordinary business exception to provide more guidance to shareholders and issuers alike. Part III also analyzes the changes to the Shareholder Proposal Rule the Commission has issued and the impact these changes are likely to have on corporate governance. Although this Comment concludes that the Commission has taken a step in the right direction, it argues that further revisions of the ordinary business exception are necessary. Additional revisions should include defined principles of application and guidelines, both for the protection of shareholders and management.

I. AN OVERVIEW OF SHAREHOLDERS’ IMPORTANCE IN THE CORPORATE STRUCTURE

The SEC has the authority to promulgate rules and regulations it deems “necessary or appropriate in the public interest or for the protection of investors.” An underlying purpose for creating the Commission, and its power to create rules relating to shareholders, was the assurance of “[f]air corporate suffrage.” By enacting this regulatory scheme, Congress sought to effect a new system of corporate governance that accounted for the opinions of shareholders, the true owners of a corporation. The Commission implicitly is authorized to enforce regulations to control the solicitation of shareholder proxies. This is an important task

28. H.R. REP. NO. 73-1383, at 13 (1934). The legislative history behind the creation of the Commission shows Congress’s desire to afford shareholders certain rights that would hold management accountable and create an incentive to engage in “[f]air corporate suffrage.” See id.
29. See id. The congressional intent in creating the Commission was focused on creating a regulatory agency that would help shareholders control the important aspects of the companies they owned. See id.
30. See Propp, supra note 1, at 102 (noting that although the primary activity of the
for the Commission to undertake because of shareholders' power to submit proposals to corporate management for inclusion in a corporation's annual proxy statement.31

Distinguishing the shareholders' ownership of the corporation from management's control of the corporation is extremely important.32 Although shareholders are entitled to submit proposals, they do not have any control over the day-to-day operations of the corporation.33 The control of the corporation is vested solely in the officers and the board of directors who manage the company for the benefit of the shareholders.34

Commission that Congress envisioned was regulatory, the Commission also would need to control the conditions for proxies and shareholder proposals; see also DIVISION OF CORPORATION FINANCE, SECURITIES AND EXCHANGE COMMISSION, 96TH CONG., 2D. SESS., STAFF REPORT ON CORPORATE ACCOUNTABILITY 143 (Comm. Print 1980) [hereinafter STAFF REPORT] (stating that it is consistent with the courts' broad interpretation of Rule 14a that the Commission has taken control of the proxy system to ensure shareholders an adequate means of communication).

31. See Shareholder Proposal Rule, 17 C.F.R. § 240.14a-8 (1998). A shareholder need only meet certain criteria to have a proposal included in the proxy statement. See id. §240.14a-8(a). The shareholder must own at least one percent or $1,000 in “market value of such voting securities of the registrant throughout the required one year period,” and must declare in writing that he intends to retain the securities at least through the date of the scheduled meeting. Id. §240.14a-8(a)(1)(ii)(B)-(C). All of this information must be documented with specified forms that the SEC regulates. See id. §240.14a-8(a)(1)(ii); see also Ronald M. Loeb & Henry Lesser, Some Recent Significant Developments in the SEC's Shareholder Proposal Regulation, in ADVANCED SECURITIES LAW WORKSHOP 1992, at 327, 330 (PLI Corp. L. & Practice Course Handbook Series No. 784, 1992) (noting that the Shareholder Proposal Rule is essential to shareholder participation in corporate affairs because it affords shareholders an avenue to voice their concerns at a minimal expense).

32. See BERLE & MEANS, supra note 2, at 119-25 (explaining that the interests in control and ownership of the company are often divergent and therefore it is important to understand the separation of these functions).

33. See id. at 68-119 (pointing out the principal differences between those in a control position and those who are owners of a corporation); GORDON DONALDSON, MANAGING CORPORATE WEALTH: THE OPERATION OF A COMPREHENSIVE FINANCIAL GOALS SYSTEM 45-46 (1984) (stating that while shareholders want dividends, management would rather retain earnings to permit growth without outside financing); Richard A. Booth, Junk Bonds, the Relevance of Dividends and the Limits of Managerial Discretion, 1987 COLUM. BUS. L. REV. 553, 553 (stating that shareholders' primary desire is a high return on investment).

34. See generally BERLE & MEANS, supra note 2, at 68-119. Berle and Means developed the theory of separation of ownership and control in great detail. See id. The roles of stockholders and management are divergent and each has a particular function. See id. at 119-25. Shareholders' interests include (1) earning maximum profits "compatible with a reasonable degree of risk;" (2) receiving as great a distribution of dividends as possible without encountering anything that may impair their rights to receive a share of the profits; and (3) ensuring that the stock remains "freely marketable." Id. at 121. Management, however, is motivated by its aims. If it is assumed that the prime motivation of management is personal profits, then management's goals are going to diverge from shareholders goals. See id. at 122. Management is willing to sacrifice the company's profit at the expense of the value of the stock. See id. Management may see it more beneficial to rein-
Professors Berle and Means set forth the principle of separation of corporate ownership and control in 1932, while at the same time articulating the inherent problems with this structure. Shareholders are considered "passive owners," which Berle and Means posited would lead to inefficiency throughout the corporation.

On the basis of Berle and Means's theories, the SEC determined that shareholders needed some method of acquiring information about corporations and participating in corporate governance. The Securities Act of 1933 ("1933 Act") was passed to address matters such as the disclosure of corporate information to shareholders. The 1933 Act was the first step in ensuring corporate accountability to shareholders through shareholder knowledge and participation. In 1934, the 1933 Act was
supplemented with the Securities Exchange Act of 1934 which would come to include the Shareholder Proposal Rule.\textsuperscript{41}

Shareholder proposals are the primary tools shareholders utilize to present their opinions and concerns to the management of a corporation.\textsuperscript{42} Although shareholder proposals are recognized as a valuable tool for shareholders,\textsuperscript{43} the Commission did not adopt a shareholder proposal rule into the 1934 Act until 1942.\textsuperscript{44} Rule 14a-8 requires a corporation to include in its annual proxy materials, and distribute to its shareholders, all proposals shareholders present to a corporation.\textsuperscript{45} If the corporation does not include the shareholder proposals, then the Commission has the authority, through an enforcement action, to compel the corporation to include a proposal that meets all the substantive and procedural criteria.\textsuperscript{46} The only restriction initially placed on this shareholder right was that the proposal relate to a “proper subject” for shareholder consideration.\textsuperscript{47}

See id.; see also Melvin Aron Eisenberg, \textit{Access to the Corporate Proxy Machinery}, 83 HARV. L. REV. 1489 (1970) (stating that the shareholder proxy voting system is the primary tool for shareholder decision making in publicly held companies).

41. See Schwartz \& Weiss, \textit{supra} note 6, at 635 (noting that shareholder proposals can play a unique role in corporate governance and are “virtually the only device shareholders can employ to influence corporate decisions”).

42. See Thomas A. DeCapo, Note, \textit{Challenging Objectionable Animal Treatment with the Shareholder Proxy Proposal Rule}, 1988 U. ILL. L. REV. 119, 138-39 (discussing how shareholder proposals give shareholders the opportunity to influence the decisions of management). The Shareholder Proposal Rule was adopted to provide shareholders an opportunity to “express their views on issues affecting their corporation.” \textit{Id.} at 138; see also Marilyn B. Cane, \textit{The Revised SEC Shareholder Proxy Proposal System: Attitudes, Results and Perspectives}, 11 J. CORP. L. 57, 88 (1985). Cane recognizes that shareholder proxy proposals are a significant way in which shareholders may voice their concerns to management. Management, in turn, is under an obligation, according to Rule 14a-8, to address shareholder proposals. \textit{See id.; see also} Marilyn B. Cane, \textit{The Revised SEC Shareholder Proxy Proposal System: Attitudes, Results and Perspectives}, 11 J. CORP. L. 57, 88 (1985).


45. \textit{See id. at 10,656.}

In granting shareholders this right, the Commission envisioned more shareholder responsibility and participation in corporate activity. The Commission, however, did not intend the Rule to become a consensus device for shareholders on matters of social or economic policy and other issues. This right was entirely consistent with the legislation's purpose of conferring upon the Commission the power to promulgate rules necessary and appropriate to safeguard investors. The Rule was a major step in restoring corporate accountability to shareholders.

However, the Shareholder Proposal Rule has not achieved its goal of ensuring corporate accountability to shareholders. The complicated and convoluted history of the Rule has prevented the accomplishment of that goal.


48. See Sadat-Keeling, supra note 47, at 164 (noting that Rule 14a-8 was created to address the issues of (1) "the need to hold large corporations and their managers accountable to society for their actions;" and (2) "the proper role of the shareholder within this 'socially accountable' system of corporate governance"). Shareholders have used the Rule to present proposals on many issues, especially dealing with public interest, "not generally considered within the traditional purview of the business corporation." Id.; cf. Gocha, supra note 16, at 411 (recognizing that the inception of the Shareholder Proposal Rule alarmed corporate managers).

49. See Sadat-Keeling, supra note 47, at 167-68 (noting that as the Rule allegedly was being abused and used for purposes other than it was intended, the SEC started restricting the shareholders' "privilege" of having proposals included in the proxy statement); see also John G. Ledes, A Review of Proper Subject Under the Proxy Rules, 34 U. DET. L.J. 520, 522 (1957) (stating the reason the Commission advanced for the revisions was to curb abuses of the rule "by persons seeking personal ends to the detriment of security holders and the corporation").

50. See H.R. REP. NO. 73-1383, at 14 (1934). Allowing shareholders a greater voice in corporate governance was the goal of the legislation. See id. By granting shareholders the right to include proposals in proxy statements, the Commission was acting in accordance with its stated mandate. See id.

51. See Propp, supra note 1, at 115 (citing from the SEC's staff report on corporate accountability that the Shareholder Proposal Rule is a democratic tool for shareholders). The Rule evidences the concern about "'legitimacy and the need to subject management to checks and balances'; it is a 'means of questioning a management which otherwise might tend to become self-seeking, ingrown and autocratic.'" Id.

52. See generally Colleen D. Ball, Comment, Regulations 14A and 13D: Impediments to Pension Fund Participation in Corporate Governance, 1991 WIS. L. REV. 175 (arguing that the Shareholder Proposal Rule impedes, rather than facilitates, shareholder participation). The repeated revisions of the Rule also evidence the failure of the Rule to attain its stated goals.
A. The History of the Shareholder Proposal Rule

1. 1948-1976: The "Proper Subject" Debate

The Rule, as initially promulgated, did not address what was considered a "proper subject" for shareholder consideration. This deficiency led to serious confusion, and ultimately to major revisions of the Rule.

In 1948, the Commission made its first revision to Rule 14a-8(c). This revision restricted the ability of shareholders to include proposals in proxy materials. The Commission for the first time explicitly addressed what constituted a "proper subject" for a proxy statement, by issuing a policy statement setting "proper subject" guidelines. The Commission stated that the purview of what constituted a "proper subject" was more appropriately left to the discretion of the individual states in accordance with state law. Although the decision was left to the states, the Com-

53. Welter, supra note 47, at 1983 n. 19 (citing David C. Bayne, S.J., The Basic Rationale of Proper Subject, 34 U. Det. L.J. 575, 591 (1957) (recognizing that the initial version of the Rule "contained no limitation whatsoever upon the shareholder as to what was proper for proposal at the annual meeting").

54. See Schwartz & Weiss, supra note 6, at 654-66 (discussing the Commission's attempt to clarify what is a "proper subject" due to the lack of clarity in the original Rule).

55. See infra notes 56-112 and accompanying text discussing the evolution of the Rule and historical amendments.


59. See id. The Commission stated:

Speaking generally, it is the purpose of Rule X-14A-7 (17 CFR, 240.14A-7) 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 . . . 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.

Id.

60. See id. (indicating that the Commission believed that definite principles of state
mission emphasized that shareholder proposals were not meant to be a tool for addressing general "political, social or economic matters." The Commission reiterated that these rules were designed to allow individual shareholders to bring matters concerning the corporation to the attention of fellow shareholders.

The Commission's attempt at a definition of a "proper subject" for shareholder proposals was vague and resulted in continuing problems. The Third Circuit addressed this issue in SEC v. Transamerica Corp., the sole enforcement action that the Commission brought to compel inclusion of a shareholder proposal. The shareholder proposal at issue in Transamerica advocated a repeal of a corporate by-law that gave complete discretion to the directors to exclude a proposed by-law amendment from shareholder meetings. The United States Court of Appeals for the Third Circuit agreed with the Commission that the definition of a "proper subject" was to be determined under state law, affirming the Commission's interpretation. Transamerica legitimized the use of state corporate law were the best measures of what would constitute a "proper subject" for shareholder consideration.

61. See id. The Commission issued this interpretation of the Rule in reply to a letter inquiring whether shareholder proposals that proposed that shareholder dividends not be subject to federal income tax where the income source of these dividends already had been subject to federal taxation of the corporation. See id. The proposal further asserted that the antitrust laws be revised. See id. The Commission held that this proposal was of a political and economical nature outside of the realm of a "proper subject" for shareholder proposals. See id.

62. See id. The Shareholder Proposal Rule was a means of opening the lines of communication to individual shareholders who traditionally had trouble organizing and, therefore, had little impact on the affairs of corporate governance. See Beth-ann Roth, Proactive Corporate-Shareholder Relations: Filling the Communications Void, 48 CATH. U. L. REV. 101, 114-17 (1998) (discussing the increased shareholder communication as a result of the Shareholder Proposal Rule); see also Paul M. Neuhauser, Facilitating Shareholder Communications, 17 J. CORP L. 213, 213 (1991) (noting that "[s]hareholder communication is critical" to the shareholder voting process and informed decisions); Vanecko, supra note 1, at 378-79 (citing the inability of shareholders to organize and work together as one of the reasons for the traditional lack of shareholder influence on corporations). See generally Mary McCue, Matching Perceptions to Reality: Communicating Effectively with Shareholders, INSIGHTS 1994 at 22 (discussing the need for enhanced communication in the overall corporate system).

63. 163 F.2d 511, 515 (3d Cir. 1947) (stating that this case would turn at least in part on the interpretation of what is a proposal which is a proper subject for action by security holders).

64. See id. at 513 & n.2, 516. The controversy in Transamerica stemmed from a shareholder action to regain some control over the corporation from management. See id. at 513. Management had discretion to exclude proposed by-laws from shareholder meetings, thus excluding shareholders from voicing their opinions on the proposed amendments, due to a provision in the corporate by-laws that blocked shareholders from voting on any by-law amendment. See id. at 516.

65. See id. at 514, 518.
law to define the proper scope of shareholder proposals and limit federal power over the proxy process.66

2. The Evolution of the Ordinary Business Exception of Rule 14a-8(c)

The next significant revision to the Rule signaled the beginning of a restrictive trend of decreasing corporate accountability to shareholders.67 This 1954 revision68 set forth the principle known today as the ordinary business exception.69 This controversial amendment gradually led to further revisions that permitted management to exclude shareholder proposals that dealt with public policy issues.70 The Commission broadly defined public policy matters to include economic, racial, and religious issues.71 Further, this exception disregarded the express congressional purpose of the Shareholder Proposal Rule: to enhance corporate governance by shareholders.72

In the early 1970s, consistent with the political and social climate of the time, the controversy surrounding the ordinary business exception centered on shareholder proposals dealing with public policy issues.73 In re-

66. See id. The court’s decision gave authority to management to look to state law to determine whether a proposal had to be included or could be excluded.
69. See id. The exception, as stated in 1954, authorized management to exclude proposals from inclusion in proxy materials “if the proposal consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer.” Id.
70. See DeCapo, supra note 42, at 140. The revisions allowed management to “omit proposals that primarily promote general economic, political, racial, religious, social, or similar causes (public policy proposals); proposals to enforce or redress a personal grievance; and proposals relating to the company’s ordinary business operations.” Id.
71. See id.
72. See Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 676 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972). The court in Medical Committee stated that the Commission’s interpretation of Rule 14a-8(c) may have violated the congressional intent of the Rule, and that “[i]t is obvious to the point of banality to restate the proposition that Congress intended . . . to give true vitality to the concept of corporate democracy.” Id.
73. See generally id. (disagreeing with the SEC’s determination that a shareholder proposal was within the scope of the ordinary business exception and thus excludable). The exclusion of the shareholder proposal to discontinue the making of Napalm may have been contrary to the congressional purpose of the legislation. See id. at 681. The Court espoused its view that the proxy rules could not be used to isolate a “political decision” from management, stating [w]e think that there is a clear and compelling distinction between management’s legitimate need for freedom to apply its expertise in matters of day-to-day busi-
response, the Commission again revised the Rule, for a short time allowing shareholders a greater degree of participation in setting the policies of a corporation, by authorizing shareholders to submit proposals on public policy issues so long as the proposal fell within certain parameters. This revision allowed corporate management to omit proposals on the same grounds as stated in 1954, but only if the proposals were not "significantly related" to the company's business or if the shareholder requested management action that was not within the control of the company. The practical consequence of the Commission's interpretation was a significant increase in shareholder proposals dealing with public

Id.

The court remanded the case to the SEC for further consideration. See id. at 682; see also Donald E. Schwartz, The Public-Interest Proxy Contest: Reflections on Campaign GM, 69 MICH. L. REV. 419, 425 (1971) (discussing Ralph Nader's comments that the Project on Corporate Responsibility was beginning to submit proposals designed to "tame the corporate tiger"). Campaign GM was the first major contest of the social responsibility proxies. See id. at 422-31 (discussing Campaign GM and its objectives.) A proposal that the Project on Corporate Responsibility submitted to GM called for the inclusion of "additional members on GM's board of directors: a female consumer expert, an environmental professor, and a black community leader." DeCapo, supra note 42, at 139. Management vigorously opposed this proposal. See id. A second proposal called for the creation of a Shareholder Committee for Corporate Responsibility, emphasizing the allegation "that corporate decision-making overemphasized profit concerns and neglected the social impact of corporate activities." Schwartz & Weiss, supra note 6, at 646. Again, management opposed this proposal. See id. at 647.

74. Solicitation of Proxies, Exchange Act Release No. 34-9784, 37 Fed. Reg. 23,178, 23,178-79 (Oct. 31, 1972) (to be codified at 17 C.F.R. pt. 240). The Commission amended Rule 14a-8 so that management could not omit proposals dealing with recommendations, requests, or mandates regarding general economic, political, racial, religious, social or other causes if it was 'significantly related' to the business of the issuer or was in the control of the issuer. See id. A proposal is not 'significantly related' to the business of a company if it relates to operations that account for less than five percent of the company's total assets, net earnings and gross sales, and is not otherwise significantly related to the company's business. See Connell, supra note 9, at 407 (discussing the concept of "significantly related"); see also DeCapo, supra note 42, at 140 (discussing the impact of the 1972 revisions in increasing the number of shareholder proposals submitted); Propp, supra note 1, at 107 (recognizing the change in the Commission's policy in 1972 as a result of the decision in Medical Committee).

75. Solicitation of Proxies, Exchange Act Release No. 34-9784, 37 Fed. Reg. at 23,178. The Commission, however, did not define what would constitute a proposal that was "significantly related" to the company's business. See id.

76. See id. Therefore, as in the case where shareholders called for the end of individual federal income taxation of shareholder dividends, the company would be able to exclude the proposal as one which was not within the power of the company to control. See supra note 61 and accompanying text (discussing a shareholder proposal advocating an end to taxation of shareholder dividends).
policy issues. The ramifications of this revision were apparent in the 1976 proxy season, in which there was a 537 percent increase from the 1972 season in shareholder proposals that dealt with public policy issues. With this new interpretation, the Commission found it difficult to determine which policy issues were "significantly related" to a company's business and which were outside the exclusion exception.


The ordinary business exception proved to be more confusing than helpful to investors, and the SEC realized the need to clarify the Rule. In an effort to end the confusion surrounding the ordinary business exception, the Commission set forth a new two-pronged test in 1976. For exclusion under Rule 14a-8(c)(7), the proposal must (1) "involve business matters that are mundane in nature," and (2) must not include "substantial policy or other considerations." This test added a new facet to the evaluation of shareholder proposals. If a matter of ordinary
business operations included a question of "substantial policy or other considerations," then it no longer would be excludable under the exception. In declining to modify the exception further, the Commission relied on historical evidence of the validity of the Rule and the ordinary business exception. The problem of what proposals a company automatically could exclude persisted, however, even after this revision.

In the wake of these revisions, the Commission's Division of Corporate Finance released a report ("Staff Report") on the issue of corporate accountability to shareholders. The Staff Report explored the problem of distinguishing between a "personal grievance" and a proposal "significantly related" to the business of the company. The Staff Report recommended that the Commission reconsider the significantly related test and its interpretation of the ordinary business exception.

The Staff Report also indicated that the underlying rationale for the Commission's control over shareholder proposal rules was to ensure "fair suffrage." It noted that courts had reinforced this principle, most notably in the case of Medical Committee for Human Rights v. Securities and Exchange Commission. In that case, the court recognized that the purpose of Rule 14a was to ensure that shareholders could exercise their rights to control important decisions. Therefore, the court invalidated

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85. See id. Any proposal that addresses a serious social and/or policy issue will no longer be excludable under the ordinary business exception as long as that issue is "significantly related" to the company's operations. See id.

86. See id. The Commission stated that in its view, the Rule had been successful in the past and needed no further revisions to enhance its viability. See id.

87. See STAFF REPORT, supra note 30, at 29. The Division of Corporate Finance issued this report after an investigation that was initiated to analyze the state of corporate accountability to shareholders. See id.

88. See id. The Commission was having great difficulty delineating between what was significantly related to the business of the company and what was a personal grievance. See id.

89. See id. at 186, 202. Even though the Staff Report did not recommend extensive changes to the Shareholder Proposal Rule, it recognized that the "significantly related" test and the ordinary business exception were broad terms that should be reevaluated by the Commission to promote shareholder activism. See id at 164, 186, 202.

90. See id. at 141 n.21. The reason for the Commission's power over the proxy system is to prevent the abuses that have denied shareholders a fair opportunity to vote and have thereby eroded the principle of corporate suffrage. See id. The overall goal of fair corporate suffrage provides the source for the Commission's power over regulation of shareholder proposals. See id.

91. See id. at 142 (reiterating the court's statement that the overriding purpose of 14a is to ensure shareholders the right to control the important decisions of the corporation which affect them as shareholders).

92. See Medical Comm. For Human Rights v. SEC, 432 F.2d 659, 681 (D.C. Cir. 1970). The court went further to say that management is hardly more qualified to control
the application of Rule 14(a) because it denied shareholders the right to
debate a "political" corporate decision. This precedent opened the
gateway for increased shareholder input in important corporate deci-
sions. The court emphasized that the underlying basis of these rights
stemmed from the premise that shareholders are the true owners of the
corporation. The court ultimately concluded that the Commission's in-
terpretation of the Rule was contrary to congressional intent and that the
shareholder proposal at issue was a proper subject for shareholder par-
ticipation. This new-found appreciation for shareholder participation,
however, was short-lived due to steps the Commission would take.

As a solution to this continuing problem, the SEC contemplated omit-
ting the Rule, but instead decided to keep the Rule intact with only slight
modifications. In 1983, the Commission revised the Rule to restrict
shareholder access to a company's proxy statements. The Commission
granted companies permission to omit proposals requesting a report
from the issuer or a committee the issuer formed if the matters pertained
to the corporation's ordinary business. Previously, a corporation could
not exclude requests for such reports because a corporation does not

the important decisions of the corporation than the beneficial owners of the corporation.
See id.

93. See id; see also Propp, supra note 1, at 120 (discussing the impact of the Medical
Committee decision of striking down a "political" issue which therefore would be an issue
significantly related to a policy issue).

94. See Letsou, supra note 19, at 771-72 (noting that the 1976 amendments revised
the interpretation of the Rule no longer to be applicable to proposals that involve "sub-
stantial policy or other considerations").

95. See Medical Committee, 432 F.2d at 680-81.

96. See id. at 680-682. The court stated that

the clear import of the language, legislative history, and record of administration
of section 14(a) is that its overriding purpose is to assure to corporate sharehold-
ers the ability to exercise their right—some would say their duty—to control
the important decisions which affect them in their capacity as stockholders and own-
ers of the corporation.

Id. at 680-81.

97. See Amendments to Rule 14a-8 Under the Securities and Exchange Act of 1934
from the SEC considering elimination of the Shareholder Proposal Rule completely. See id.
After much deliberation, however, the Commission decided to keep the Rule in a
modified state. See id.

98. See id.; see also Connell, supra note 9, at 399 (noting that the Commission revised
the Rule to create a balance whereby it would not unduly favor proponents and therefore
made more stringent the requirements for shareholders to include proposals in proxy ma-
terials).

99. See Amendments to Rule 14a-8 Under the Securities and Exchange Act of 1934
prepare reports on such issues in the course of ordinary business.\textsuperscript{100} These amendments broadened the scope of shareholder proposals that corporations could exclude.\textsuperscript{101} As a result, between 1983 and 1984, the overall number of proposals shareholders submitted declined forty-two percent\textsuperscript{102} and proposals dealing with public policy issues declined forty-eight percent.\textsuperscript{103} The Commission also issued no-action letters on seventy-five percent of corporations' requests to omit shareholder proposals for reports relating to ordinary business operations.\textsuperscript{104} As a result of these amendments and the Commission's passive stance, shareholders' ability to hold corporations accountable through proxy proposals declined even further.\textsuperscript{105} Limiting the scope of subjects for those proposals ultimately led to decreased shareholder participation and corporate accountability because shareholder participation is attained largely through shareholder proposals.\textsuperscript{106} At this point, shareholders were hesitant to expend their time and energy submitting proposals to corporations that were likely to precipitate a no-action letter from the Commission.\textsuperscript{107}

From 1976 to 1992, the Commission tried to promote shareholders' understanding of what it considered a "substantial policy consideration,"

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\textsuperscript{100} See id.; see also Sadat-Keeling, supra note 47, at 188 (citing the Commission's explanation that the change in policy is to avoid the matters of form over substance, which would allow sophisticated shareholders to bypass the exception by submitting their proposals in the form of a report request).

\textsuperscript{101} See Commodity and Security Exchanges, 17 C.F.R. § 240.14a-8 (1977). These amendments resulted in additional conditions for shareholders to meet restricting the scope of shareholder proposals. The 1976 amendment limited shareholders to two 300-word proposals per year and added new grounds for exclusion, including action which would violate state law, action that would violate the proxy rules, mootness, substantial duplication, and specific dividend amount issues. See DeCapo, supra note 42, at 141 n.225. Management now had a broader definition of the ordinary business exception under which it could exclude shareholder proposals. With all these changes, however, the Commission did not discuss the trouble in determining what was "significantly related to the company's business." See id. at 141.

\textsuperscript{102} See Decapo, supra note 42, at 142 (noting that commentators attributed the decline in the number of shareholder proposals submitted to the alterations in the SEC's policy regarding Rule 14a-8).

\textsuperscript{103} See id. (arguing that it is very difficult to include public policy proposals in proxy materials because the Shareholder Proposal Rule allows for omission of proposals on various grounds); see also Cane, supra note 42, at 71-72 (discussing the overall decline in shareholder proposals as a result of the 1983 amendments to the Rule).

\textsuperscript{104} See DeCapo, supra note 42, at 142.

\textsuperscript{105} See id.

\textsuperscript{106} See Schwartz & Weiss, supra note 6, at 635, (noting that "[s]tockholder proposals play a unique role in the governance of large corporations," because they are virtually the only way that shareholders can try to influence corporate decisions that affect them).

\textsuperscript{107} See supra notes 102-03 and accompanying text (discussing the decrease in the submission of shareholder proposals after the amendments).
that would render a proposal non-excludable. For example, the Commission held that a proposal dealing with the elimination of an affirmative action program fell outside of the ordinary business exception due to the inherent, serious policy considerations in such a proposal.

After the 1983 amendments, the SEC did not make any additional substantial revisions to the ordinary business exception for an entire decade. The Commission retained the two-part test it set forth in the 1976 release until 1992, when in a no-action letter, it reversed its own interpretation of the Rule without much explanation or procedure.

A new era of increased shareholder activism began in the early 1990's, and in response, the Commission revised its proxy rules affecting the Shareholder Proposal Rule. The stated purpose of this revision was to rebalance the Rule in order not to favor registrants unduly in this new era of increased shareholder activism.

B. Change in the Characteristics of Shareholders: The Emergence of the Institutional Investor

One of the primary reasons for increased shareholder activism beginning in the late 1980s and early 1990s was the emergence of the institutional investor. Before the advent of the institutional investor, the lack

108. See American Telephone and Telegraph Co., SEC No-Action Letter, 1988 WL 235275 (S.E.C.), at *15 (Dec. 21, 1988) (determining that a shareholder proposal dealing with the elimination of an affirmative action program is not excludable under 14a-8(c)(7)); TRW Inc., SEC No-Action Letter, 1986 WL 67666 (S.E.C.), at *6 (Jan. 28, 1986) (denying exclusion of shareholder proposal that dealt with policies of a company in Northern Ireland on the basis that they were serious policy considerations under 14a-8(c)(7)); Texaco Inc., SEC No-Action Letter, 1984 WL 48457, at *18 (Feb. 28, 1984) (S.E.C.) (denying exclusion of shareholder proposal regarding company policies, business dealings, and presence in South Africa on the basis on 14a-8(c)(7)). The proposal fell outside of the exception due to the serious policy considerations raised. See id.


110. See Cracker Barrel No-Action Letter, supra note 14, at 76,419.

111. See Securities and Exchange Commission Act of 1934, Exchange Act Release No. 31,326, 1992 WL 301258, at *3 (Oct. 16, 1992) (noting that "the proxy rules have created unnecessary regulatory impediments to communication among shareholders and others to the effective use of shareholder voting rights").

112. See generally id.; see also Connell, supra note 9, at 399 (explaining that, although the amendments were made to rule 14a-2(b), they were connected to solicitation of proxies relating to a 14a-8 shareholder proposal).

113. See Kindler & Gerstenhaber, supra note 21, at 16-17 (noting that individual shareholders historically failed to participate in corporate governance due to the related costs, but that institutional investors are not so constrained and, as a result, are more active participants); see also Adler, supra note 9, at 133-35 (indicating that recent shareholder activism has been most pronounced by U.S. financial institutions and providing re-
of adequate means of communication among individual shareholders and
the unresponsiveness to individual shareholder activism served as a bar-
rier to most shareholder participation in corporate governance.114 Historically, it generally was unheard of for institutional investors to partici-
pate in corporate governance absent a significant likelihood of disaster.115
The traditionally passive role of institutional investors, however, began
to change in the 80s and 90s.116

As of 1992, institutional investors held an estimated fifty-three percent
of outstanding equity securities in the United States.117 Major institu-
tional investors include pension and retirement plans, insurance compa-
nies, bank-managed accounts, mutual funds, and charitable endowment
funds.118 These institutional investors understand the economic benefits

114. See Adler, supra note 9, at 135 (noting that factors including the relatively small
holdings of individual investors and the inadequate means of shareholder communication
resulted in few substantive changes); see also Vanecko, supra note 1, at 378-79 (discussing
the relative lack of shareholder participation before the emergence of institutional share-
holders due to the inability of individual shareholders to communicate and organize.) Va-
necko noted the relative lack of influence that individual shareholders have traditionally
had on corporations. See id.; see also Matheson & Olson, supra note 26, at 1315 (discrib-
ing shareholders' behavior in the past as "passive, impotent and unconcerned").
115. See Adler, supra note 9, at 135 (discussing the evolvement of shareholder activ-
ism).
116. See id. (noting that the corporate "landscape" has changed due to the increased
size and availability of mutual funds and increased market investments by institutions); see
also Cane, supra note 42, at 87 (discussing the shift in attitude about shareholder participa-
tion as a result of the increase in institutional holdings). Institutional investors began to
move away from the "Wall Street Rule": that if shareholders are not happy they should
sell their stock. Instead, institutional investors are holding onto their stock and taking the
time to participate in changing unattractive aspects of corporate governance. See Cane,
supra note 42, at 87; see also BLOOMENTHAL & WOLFF, supra note 20, § 13.10[1], at 13-73
(discussing the increased presence of institutional investors).
117. See Barbara Franklin, SEC Seeks Freer Speech: Shareholder Communications
Proposal Debated, N.Y.L.J., July 2, 1992, at 5; cf. Calio & Zahralddin, supra note 23, 476-
77 (noting that in aggregate, institutional investors "own more than $6.5 trillion in assets");
Dye & Hair, supra note 81, at *352 (discussing the increase in institutional investors hold-
ings of publicly held companies); J. William Robinson, Developing and Analyzing A Cor-
porate Shareowner Profile, in SHAREOWNER ACTIVISM: THE EMERGING ROLE OF
INSTITUTIONAL INVESTORS, (PLI Corp L. & Practice Course Handbook Series), available
in 575 PLI/Corp 89, at *115-16 (1987) (stating that it is not uncommon for institutional in-
vestors to hold an excess of 50 percent of the outstanding voting stock of medium and
large corporations).
118. See Dye & Hair, supra note 81, at *351 (stating that there is no real consensus
about what constitutes an institutional investor; but listing those institutions considered
generally to fit the characterization).
of holding their investments for the long-term.\textsuperscript{119} Institutional investors' shift in focus from short-term profits to long-term profitability has sparked renewed shareholder activism\textsuperscript{120} and the need for a reevaluation of the Shareholder Proposal Rule.

II. POST-1992: THE SEC REEVALUATES THE CONCEPT OF ORDINARY BUSINESS

In the early 1990s, the Commission was faced with a request for a no-action letter that ultimately led to a substantial change in the interpretation of the ordinary business exception.\textsuperscript{121} In 1991, and again in 1992, the New York City Employees' Retirement System (NYCERS), an institutional investor, sent a letter and proposal to the Cracker Barrel Old Country Store ("Cracker Barrel") to be included in the company's proxy materials.\textsuperscript{122} The proposal called for the company to "(1) implement nondiscriminatory employment policies related to sexual orientation, and (2) add explicit prohibitions against such discrimination to the Company employment policy statement."\textsuperscript{123} NYCERS submitted this proposal in response to both the firing of gay and lesbian employees and a January 1991 policy statement released by Cracker Barrel's human resource department that stated Cracker Barrel employees must demonstrate normal heterosexual values.\textsuperscript{124} Although Cracker Barrel rethought this pol-

\textsuperscript{119} See Kindler & Gertenhaber, supra note 21, at 20 (noting that the increased return on long-term investments have prompted institutional investors to become more active in corporate governance); see also Calio & Zahralddin, supra note 23, at 477 (arguing that due to the large holdings of institutional investors, and the resulting difficulty and potential harm in disposing of such holdings quickly, the Wall Street Rule no longer presents a viable option for these investors). The institutional investor would face much difficulty in trying to quickly or effectively free itself of the unwanted equity, while at the same time saturating and significantly lowering the market price for those shares. See id.

\textsuperscript{120} See Kindler & Gerstenhaber, supra note 21, at 22-29 (discussing the range of strategies institutional investors have employed to enhance corporate accountability).

\textsuperscript{121} See Cracker Barrel Request for No-Action Letter, supra note 14, at 76,418.

\textsuperscript{122} See Letter from Elizabeth Holtzman, Comptroller of NYCERS, to Dan Evins, President, Cracker Barrel Old Country Store, available in 1992 WL 289095, at *4 (June 12, 1992). NYCERS is the New York City Employees' Retirement System that is responsible for the pension funds and retirement funds of New York City public employees.


\textsuperscript{124} See Letter from Paula L. Chester, General Counsel for New York City Employees' Retirement System, to the Securities and Exchange Commission, Division of Corporate Finance, available in 1992 WL 289095, at *5 (July 30, 1992). The release stated in part that Cracker Barrel is founded upon a concept of traditional American values... It is inconsistent with our concept and values, and is perceived to be inconsistent with
Reevaluating the Shareholder Proposal Rule

icy after protests, the company stated that in the future it would "deal with any disruptions in our units, regardless of the cause, on a store-by-store basis."\textsuperscript{125} When asked to clarify its employment policy, Cracker Barrel's response was evasive; the president stated simply that the company was not discriminating.\textsuperscript{126}

In June 1991, Cracker Barrel fired three more gay men from a store in Mobile, Alabama.\textsuperscript{127} Cracker Barrel became the target of many gay and lesbian organizations and, possibly in an attempt to mollify the critics, the company declared at its annual meeting that it was an equal opportunity employer but took no other action.\textsuperscript{128} In response to Cracker Barrel's lack of action, NYCERS brought forth its proposal regarding sexual discrimination for inclusion in the annual proxy statement.\textsuperscript{129}

NYCERS cited in its resolution that gay and lesbian workers continually were discharged from employment on the basis of their sexual orientation.\textsuperscript{130} NYCERS believed that the efficiency and production of the company would suffer as a result of this practice.\textsuperscript{131} As a consequence of lost patrons and profits, NYCERS believed that it would suffer as a shareholder.\textsuperscript{132} NYCERS stated that, as beneficial owners of the requisite amount of stock, it expected the proposal to be included under Rule 14a-8 of the 1934 Act.\textsuperscript{133}

those of our customer base, to continue to employ individuals in our operating units whose sexual preferences fail to demonstrate normal heterosexual values which have been the foundation of families in our society. Therefore, it is felt this business decision is in the best interests of the company. On the basis of this company policy, we understand that at least eleven workers were fired solely because they were Lesbian or Gay.

Id.

125. Id. at *6. Cracker Barrel did not rescind its employment policy nor rehire the employees formerly discharged on the basis of their sexual preferences. \textit{See id.}

126. \textit{See id.} Mr. Evins, president of Cracker Barrel simply stated that Cracker Barrel had acknowledged its mistake and apologized and that the company had no "morally discriminating policies." \textit{Id.}

127. \textit{See id.}

128. \textit{See id.} At the annual meeting statement, president Dan Evins announced that Cracker Barrel was an "equal opportunity employer that adheres to the letter and spirit of the law regarding non-discrimination in the work place." \textit{Id.} Cracker Barrel, however, refused to adopt a corporate policy to this effect. \textit{See id.}

129. \textit{See id.}


131. \textit{See id.} (arguing that "employment discrimination on the basis of sexual preference may deprive corporations of the services of productive employees, leading to less efficient corporate operations).

132. \textit{See id.}

133. \textit{See id.} (NYCERS believed it had met all the criteria for submission of a share-
A. The Cracker Barrel No-Action Letter — The Commission Makes a Policy Change

One month after receiving the NYCERS proposal, Cracker Barrel requested a no-action letter and informed the Commission of its intention to exclude the proposal from the company's proxy materials under the ordinary business exception. Cracker Barrel asserted that this proposal affected the day-to-day issues of hiring policies, which fell within the purview of the ordinary business exception, and therefore could be excluded from the proxy materials.

On October 13, 1992, the Commission issued a no-action letter to Cracker Barrel in connection with the NYCERS proposal. The Commission concluded that, although the proposal regarding the company's hiring practices included substantial policy issues, the Commission was having increasing difficulty in delineating what was includable and excludable based on social policy considerations. The Commission stated further that it had reconsidered its interpretation and application of Rule 14a-8(c)(7). Prospectively, the fact that a shareholder proposal concerning the general workforce and practices of a company was tied to an important social policy would no longer remove the proposal from exclusion under the “ordinary business exception.” Instead, “the employment-based nature of the proposal” would govern shareholder proposals. In issuing the no-action letter, the Commission took a position wholly inconsistent with its previously established position. A proposal relating to an important social policy would no longer mean the immediate exclusion of the proposal; instead, the Commission would evaluate a proposal, in-

135. See id. at *1; see also Letter from Robert G. McCullough, Baker Worthington, Crossley, Stansberry & Woolf, to William E. Morley, Chief Counsel of the Securities and Exchange Commission, available in 1992 WL 289095, at *15 (Aug. 11, 1992) (emphasizing that matters related to day-to-day business decisions are excludable from a company's proxy statement).
137. See id. at 76,419.
138. See id. (noting that it would be easier to have a clearer line of what was includable and what was excludable).
139. See id.
140. Id.
141. See id. (noting that this interpretation was a change from its previous interpretation of the Rule).
cluding such a policy issue, based on its relation to employment issues.\textsuperscript{142} This decision was the Commission's last enunciation to date regarding the shareholder proposal rules, and it served to further hinder the principles of corporate accountability to shareholders.\textsuperscript{143}

In response to the no-action letter, NYCERS instituted an action against the Commission in federal court.\textsuperscript{144} NYCERS alleged that the Commission had violated the Administrative Procedure Act (APA),\textsuperscript{145} by promulgating a new rule without complying with the APA's rule-making procedures.\textsuperscript{146} According to NYCERS, the Commission did not follow the APA's required notice\textsuperscript{147} and comment\textsuperscript{148} procedures when it promulgated the new rule.\textsuperscript{149} NYCERS argued that this new interpretation of Rule 14a-8(c)(7) was a "rule" within the meaning of the APA\textsuperscript{150} and asked the court to issue an injunction against the Commission invalidating its new position.\textsuperscript{151}

\textbf{Id.}\textsuperscript{142} See \textit{id.}

\textbf{Id.}\textsuperscript{143} Since 1983, the Commission has made no formal changes in its interpretation of the Rule with the exception of the 1992 no-action letter to Cracker Barrel.


\textbf{Id.}\textsuperscript{145} 50 U.S.C. § 553 (1994) (stating the procedures that must be followed in an administrative rule making).

\textbf{Id.}\textsuperscript{146} See \textit{NYCERS}, 843 F. Supp. at 863.

\textbf{Id.}\textsuperscript{147} See 5 U.S.C. § 553(b). Section 553(b) of the APA states:

\begin{quote}
General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
\begin{enumerate}
\item a statement of the time, place, and nature of public rule making proceedings;
\item reference to the legal authority under which the rule is proposed; and
\item either the terms or substance of the proposed rule or a description of the subjects and issues involved.
\end{enumerate}
\end{quote}

\textbf{Id.}\textsuperscript{148} See \textit{id.} § 553(c). Section 553(c) of the APA states:

\begin{quote}
After notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.
\end{quote}

\textbf{Id.}\textsuperscript{149} See \textit{NYCERS}, 843 F. Supp. at 867. The court ruled that the SEC had amended a prior legislative rule with the Cracker Barrel decision, thus requiring compliance with the APA's procedures. See \textit{id.} at 877.

\textbf{Id.}\textsuperscript{150} See \textit{id.} at 867 (arguing that the SEC promulgated "a new rule pertaining to an entire category of shareholder proposals without first following the public notice and comment requirements imposed by the APA").

\textbf{Id.}\textsuperscript{151} See \textit{id.} at 863. The NYCERS litigation is a good example of institutional investors not following the "Wall Street Rule" and fighting for the right to participate in corpo-
The Commission argued that because NYCERS had an alternative legal remedy, it was precluded from instituting a cause of action under the APA.\footnote{152} The Commission also argued that it did not promulgate a "rule"\footnote{153} as defined under the APA, but only an "interpretation" that is not subject to the APA's note and comment procedures.\footnote{154} The Commission also denied that its interpretation was arbitrary or capricious and argued that it was completely consistent with the legislative purpose of the rule.\footnote{155}

The district court determined that the Commission had issued a rule in the Cracker Barrel no-action letter.\footnote{156} The court ultimately agreed with NYCERS that the Commission failed to follow the mandatory APA procedures and issued an injunction prohibiting the SEC from taking any position with regard to the ordinary business exception that would be inconsistent with the provisions adopted in 1976.\footnote{157} Finding that the Commission had violated the procedures of the APA, the court found it un-
necessary to decide whether the Rule was arbitrary and capricious.\footnote{158}

The Commission was unsatisfied with the district court's decision and appealed.\footnote{159} The Second Circuit Court of Appeals agreed with the Commission that the Cracker Barrel no-action letter was interpretive and not a formal rule subject to the notice and comment procedures; therefore, the court vacated the injunction.\footnote{160} The court distinguished between a legislative rule\footnote{161} and an interpretive rule.\footnote{162} Unlike legislative rules, interpretive rules are not subject to the APA's notice and comment procedures.\footnote{163} The court held that the Commission's no-action letter was interpretive because the nature of all no-action letters is interpretive and non-binding.\footnote{164} The court realized that the Cracker Barrel no-action let-

\footnote{158. See \textit{NYCERS}, 843 F. Supp. at 881. The court's finding that the Commission violated the APA obviated the need for a finding on the merits of the arbitrary and capricious claim. \textit{See id.}}

\footnote{159. See \textit{New York City Employees' Retirement Sys. v. SEC}, 45 F.3d 7, 9 (2d Cir. 1995); \textit{see also} Lorne, \textit{supra} note 157, at 780 (stating that the Commission argued that its actions were reasonable due to the Commission's inability to develop consistent principles of what constitutes an ordinary business matter); \textit{Robert D. Tuke, Complying with Proxy Rules: Living With the Springtime Ritual, in NUTS AND BOLTS OF SECURITIES LAW}, at 371, 404 (PLI Corp. L. & Practice Course Handbook Series No. B-889, 1995) (noting that the SEC had declined to issue no-action letters regarding the ordinary business exception until the resolution of the Cracker Barrel case).}

\footnote{160. \textit{See NYCERS} 45 F.3d at 13-14 (stating that the SEC action in the Cracker Barrel matter did not constitute a legislative rule because the nature of no-action letters are non-binding and "do not oblig[e] or prevent action by the SEC, the parties, or the courts"); \textit{see also} \textit{Leban & Heller, supra} note 16, at 28 (citing that the court found that no-action letters are not subject to the rules of the APA). The court held that the no-action letter was not binding; therefore, the fact that the SEC did not follow the notice and comment procedures of the APA was not a violation. \textit{See NYCERS}, 45 F.3d at 13-14.}

\footnote{161. \textit{See NYCERS}, 45 F.3d at 12 (quoting \textit{White v. Shalala}, 7 F.3d 296, 303 (2d Cir. 1993) ("Legislative rules are those that 'create new law, rights, or duties, in what amounts to a legislative act."); \textit{see also} \textit{Edward McGonagle, Administrative Law}, 46 \textit{SYRACUSE L. REV.} 235, 249 (1995) (noting that although the court recognized that the no-action letter in question "went beyond [a] garden variety no-action letter," no-action letters are, by definition, not binding and therefore not legislative).}}

\footnote{162. \textit{See NYCERS}, 45 F.3d at 12 (quoting \textit{White v. Shalala}, 7 F.3d 296, 303 (2d Cir. 1993), and explaining that an interpretive rule does "not create rights, but merely 'clarif[i]es] an existing statute or regulation"); \textit{see also} \textit{McGonagle, supra} note 161, at 248 (noting that the court deemed the Cracker Barrel no-action letter "an informal response" by the Commission, not intended to bind any of the parties).}

\footnote{163. \textit{See 5 U.S.C. § 553(b)(A) (stating that the procedures required by the APA are not applied to "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice"); \textit{see also} \textit{NYCERS}, 45 F.3d at 12; \textit{infra} notes 164-165 and accompanying text (discussing the APA).}}

\footnote{164. \textit{See NYCERS}, 45 F.3d at 12 (citing Amalgamated Clothing & Textile Workers Union v. \textit{SEC}, 15 F.3d 254, 257 (2d Cir. 1994) for the proposition that no-action letters are deemed informal responses because they do not bind the Commission, the courts or the parties. Thus, a no-action letter is not legislative but interpretive in nature. \textit{See id.}}}
ter abandoned the Commission's established interpretation of the ordinary business exception in the 1976 release, however, it refused to label it a legislative rule because it had no "legal effect."165

In addition, the Commission's rule was not reviewable as arbitrary and capricious in the eyes of the court.166 The important question of whether the SEC actually followed the APA's statutory scheme has never been fully answered.167

B. Corporate Governance and Inapplicability of Traditional Justifications to the Exclusion of Shareholders

There are many theories of corporate accountability, ranging from the view that corporations have a social responsibility to the public, to the view that corporations' sole responsibility is to maximize profits.168 The Cracker Barrel decision has rekindled the controversy surrounding corporate accountability.169 In the wake of this decision, the question to

165. See id. at 13. The court stated that a no-action letter has no legal effect because (1) it does not create a legal basis for an SEC enforcement action, (2) the SEC did not publish the letter in the C.F.R. and (3) the SEC did not expressly invoke legislative authority. See id. at 13 (citing American Mining Congress v. Mine Safety & Health Admin., 995 F.2d 1106, 1112 (D.C. Cir. 1993)); see also Subcommittee on Annual Review, Annual Review of Federal Securities Regulation, 51 Bus. Law. 511, 561 (1996) (noting that the court in Cracker Barrel "upheld the authority of the SEC to announce a new interpretation of an agency rule in a no-action letter without first subjecting that interpretation to notice and comment procedures . . . of the APA").

166. See NYCERS, 45 F.3d at 14 (dismissing the plaintiff's claim that the no-action letter was arbitrary and capricious); see also Subcommittee on Annual Review, supra note 165, at 563 (noting that the court declined to reach the merits of the arbitrary and capricious claim against the Commission because NYCERS had the alternative legal remedy of pursuing a direct suit against Cracker Barrel).

167. See NYCERS, 45 F.3d at 14 (stating that it did not need to answer this question because NYCERS had an alternative legal remedy and the SEC had not created a legislative rule); see also Lorne, supra note 157, at 781 (recognizing that the court of appeals never reached the merits of the Commission's position in the Cracker Barrel no-action letter).

168. See Propp, supra note 1, at 117-20 (discussing different theories of corporate accountability including the market control theory, government control theory, and shareholder control theory); see also Peter F. Drucker, What is "Business Ethics"?, 63 THE PUBLIC INTEREST 18, 27 (1981) (arguing that it is the responsibility of business leaders to exemplify ethical behavior); Arthur S. Miller, A Modest Proposal for Helping to Tame the Corporate Beast, 8 HOFSRA L. REV. 79, 86-88 (1979) (arguing that corporations' activity should be classified as "state action"); Russell B. Stevenson, Jr., The Corporation as a Political Institution, 8 HOFSRA L. REV. 39, 59-61 (1979) (calling for an ethical approach to market control).

169. See Leban & Heller, supra note 16, at 30 (stating that as a result of the Cracker Barrel decision, shareholders will be forced to pursue other means to achieve their objectives concerning corporate social responsibility); see also Karl A. Groskaufmanis & Michael J. Rivera, The Rhyme of Securities Litigation: 1993 Judicial Update, 8 INSIGHTS 8, 11
whom corporations will be held ultimately accountable remains open.

1. The Impact of the Cracker Barrel Decision

Scholars continually have questioned the validity of maxim that a corporation should be accountable to its investors.170 Conversely, the traditional justifications for limiting shareholder participation also have been rebutted.171 It is apparent, however, from the history of the Securities and Exchange Act, that Congress expected shareholders to play a role in the governance of corporations in order to increase corporate accountability.172 The Commission and its rules have continually diminished the role that Congress envisioned for shareholders.173 The Commission’s interpretation of the exception in Cracker Barrel extended the trend toward diminished shareholder participation.174

(1994) (noting that the Cracker Barrel matter has become the latest source of controversy surrounding the Shareholder Proposal Rule).

170. See Henry G. Manne, Our Two Corporation Systems: Law and Economics, 53 VA. L. REV. 259, 261-62 (1967) (arguing that problems arise from the collective action of shareholders who only own small amounts of stock); see also CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 85 (1975) (asserting that if management acts to maximize profits, it is acting in accordance with shareholder expectations); Harold Demsetz, The Structure of Ownership and the Theory of the Firm, 26 J.L. & ECON. 375, 386 (1983) (arguing that no single ownership model is necessarily the best for profit maximization); E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145, 1161 (1932). Dodd argues that profit maximization cannot be the goal of the corporation and instead it is necessary to take into account “the attitude of the public and business opinion as to the social obligations of business.” Id.; see also Frank H. Easterbrook & Daniel R. Fischel, Voting in Corporate Law, 26 J.L. & ECON. 395, 401 (1983) (arguing that costs of contracting make it impossible for shareholder participation in corporate governance).

171. See Bernard S. Black, Shareholder Passivity Reexamined, 89 MICH. L. REV. 520, 522 (1990) (asserting that shareholder participation is not as problematic as some critics may urge); see also Dent, supra note 35, at 881-82 (1989) (noting the belief “that the separation of ownership and control leads to economic inefficiency and mistreatment of shareholders,” thus the participation of shareholders is not troublesome, but necessary); Carol Goforth, Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late, 43 AM. U. L. REV. 379, 401-08 (1994) (advancing the argument that the “typical” shareholder has changed, and the perceived problems of shareholder participation are no longer valid).

172. See supra notes 3-8 and accompanying text (discussing the reasons for the creation of the Commission and ultimately the promulgation of the Shareholder Proposal Rule).

173. See infra notes 183-85 and accompanying text (discussing the Commission’s revisions and the exceptions it created for proposals that need not be included in proxy materials that decreased shareholder participation).

174. See Cracker Barrel No-Action Letter, supra note 14, at 77,287. The SEC effectively further restricted the scope of permissive shareholder proposals by allowing the exclusion of proposals which contained substantial policy issues. See id.; see also Leban & Heller, supra note 16, at 30 (discussing the effect of the Second Circuit’s ruling, allowing
Cracker Barrel diminished the corporate accountability to shareholders need to effectuate legitimacy of the corporate structure.\textsuperscript{175} The decision does little to reassure already skeptical shareholders that companies will address their concerns seriously.\textsuperscript{176} This current policy is especially alarming given the changing identity and nature of shareholders. The new type of shareholder is the institutional investor.

2. The Era of the Institutional Investor

The nature of the corporate investor has changed immensely since Congress promulgated the 1933 and 1934 Acts.\textsuperscript{177} The era of institutional investors has begun and the Commission must consider new factors to ensure corporate accountability.\textsuperscript{178}

\textsuperscript{175} See Schwartz & Weiss, supra note 6, at 640 (noting that the legitimacy of management “rests upon accountability to and continued consent of the stockholders”); supra note 106, (discussing the role of shareholder proposals in corporate governance); see also Andrew J. Frackman & Achilles M. Perry, ACTWU v. Wal-Mart: Is this the Cost of Corporate Democracy?, 9 INSIGHTS 2, 3 (1995) (noting that after the Cracker Barrel matter, obtaining a no-action letter will no longer provide the assurances that it once did regarding the position of the Commission and accountability to corporate shareholders); A. A. Sommer, Jr., Corporate Governance: The Search for Solutions, 26 U.S.F. L. REV. 695, 710 (1992) (arguing that accountability is indispensable to corporate legitimacy). Sommer explains that “someone constrained to account for his or her conduct to someone who is truly independent and able to replace management is likelier to strain for superior performance.” See id. The shareholders need to retain the power to remain independent and remove insurgent managers from their positions. See id. Shareholders’ rights are limited even though the Commission has given them some “rights” to engage in corporate business. See Letsou, supra note 19, at 759-73. While shareholders have the power to (1) remove a director for cause, (2) fill newly created directorships between annual meetings, and (3) require corporations to issue certain types of reports, they do not have the “power to direct the corporation’s managers to make specific business decisions.” Id. at 755, 760; see also Barnard, supra note 113, at 38 (stating that the SEC has limited, or in some cases excluded, shareholder participation).

\textsuperscript{176} See Barnard, supra note 113, at 38. The SEC has excluded some shareholders and limited others from participating in corporate governance. See id. The SEC also has failed to support shareholders and their initiatives. See id.

\textsuperscript{177} See Goforth, supra note 171, at 402-03 (noting that the pattern of stock ownership has changed recently and institutional investors now account for ownership of “approximately one-half of the outstanding stock in public[ly held] companies”); see also Robinson, supra note 117, at *108 (citing the recent change in the “mix” of investors to include a great number of institutional investors); Jayne W. Barnard, Institutional Investors and the New Corporate Governance, 69 N.C. L. REV. 1135, 1135 (1991) (noting that there has been a marked shift from household investors to institutional investors).

\textsuperscript{178} See Robert D. Rosenbaum & Michael E. Korens, Trends in Institutional Shareholder Activism: What the Institutions are Doing Today, in INSTITUTIONAL INVESTORS, PASSIVE FIDUCIARIES TO ACTIVIST OWNERS, at 45, 47 (PLI Corp. L.& Practice Course Handbook Series No. 704, 1990). “Institutional [investors] have focused on three courses of action.” Id. First, these investors are trying to facilitate communications with management to increase their input in corporate affairs. See id. Second, they are attempting to
As a result of the emergence of institutional investors, new alternatives to shareholder control have become possible. The increase in the number of institutional shareholders has decreased the number and power of individual shareholders. Therefore, it is increasingly important for institutional shareholders to have a broader range of influence in corporate governance to assure corporate accountability. As a result, the Commission must reevaluate shareholder activism in corporate governance and the traditional justifications for limiting such activism.

enhance communication among all investors to ensure greater corporate accountability. See id. Third, they are lobbying for congressional change to facilitate their input in corporate affairs. See id.

179. Alfred F. Conard, Beyond Managerialism: Investor Capitalism? 22 U. Mich. J.L. Reform. 117, 119 (1988) (noting that these institutions include “principally pension funds, mutual funds, endowments, and stock ownership plans”); see also The Impact of Institutional Investors on Corporate Governance, Takeovers, and the Capital Markets: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 101st Cong., 1st Sess. 6 (1989) (report of Dr. Carolyn Kay Brancato, Institutional Investor Project, Columbia Center for Law and Economic Studies, entitled “Institutional Investors and Corporate America: Conflicts and Resolutions”). The institutional investors include pension funds, mutual funds, insurance companies, banks, foundations, and endowments. See id. With an institutional investor, the money will be invested by an institutional investor and professionally managed, in contrast to individual shareholders. See id.

180. See Conard, supra note 179, at 119 (advocating a system of “investor capitalism,” whereby a number of institutions with large holdings could join together to create a new system of control over management). See also Black, supra note 171, at 572-75 (arguing that institutional shareholders could monitor a campaign adequately, to ensure that the company is protecting the best interest of the shareholders); Dent, supra note 35, at 898-901 (arguing that the current system of governance is inadequate to protect shareholders).

181. See Conard, supra note 179, at 131 (noting the possibility that individual shareholders would become active in corporate governance was reduced as the potential power of institutional shareholders grew); see also BOARD OF GOVERNORS FED. RESERVE SYS. FLOW OF FUNDS ACCOUNTS: FINANCIAL ASSETS AND LIABILITIES YEAR-END, 1961-84 at 35-36 (1985). While institutional ownership of equities increased from eleven percent to twenty-nine percent from 1961-84, “household” ownership decreased from eighty-six percent in 1961 to sixty-six percent in 1984. See id.

182. See Conard, supra note 179, at 135 (noting that “investor capitalism” is a means of “restoring primacy to the interests of the suppliers of capital” and that it operates “according to the traditional justifications of capitalism”); see also Dye & Hair, supra note 81, at *385 (noting that the concentrated presence of institutional investors has dramatically changed the structure of shareholder voting and thus, the system must be reevaluated); Martin Lipton, Corporate Governance in the Age of Finance Corporatism, 136 U. Pa. L. Rev. 1, 6 (1987) (arguing that institutional investors have the power potentially to create a system whereby management would be held accountable to shareholders); Vanecko, supra note 1, at 377 (noting that there is a broad consensus “that institutional investors should play a greater role in corporate governance”).

183. See Vanecko, supra note 1, at 379 (explaining “the rise of the institutional investor has led to a reexamination of the structure of corporate governance”); see also Letsou, supra note 19, at 774-99 (arguing that traditional justifications such as the costs of shareholder activism, safeguarding the economic function of the corporation, and the potential
The influential role institutional investors possess is based on the reality that these investors have a greater incentive to participate in corporate governance, due to concentrated ownership, than do individual shareholders. Unlike individual shareholders, these institutional investors have the resources and the inclination to participate actively in corporate governance.

As a result of modern resources, all shareholders are increasingly calling for shareholder activism in corporate governance. Moreover, in the wake of the emergence of the institutional investor, the number of shareholder proposals relating to corporate governance has increased. At the same time, these proposals are receiving increased support from fellow shareholders.

Due to the current rules and regulations, individual and institutional investors’ capacity to participate in corporate governance is diminished. An atmosphere of management dominance is created by the rules and exceptions governing for shareholder proposals, especially the ordinary business exception.

Cracker Barrel’s elimination of shareholder participation regarding important social policies is another step in the wrong direction. The decision separates further the duties of ownership and control, instead of problems of collective shareholder activism, are no longer sufficient to outweigh the benefits of shareholder activism in corporate governance.

184. See Edward B. Rock, The Logic and (Uncertain) Significance of Institutional Shareholder Activism, 79 GEO. L.J. 445, 453-59 (1991) (noting that institutional investors with concentrated holdings do not have the communication problems of individual shareholders); see also Vanecko, supra note 1, at 381 (noting that institutional shareholders have the economic incentive, due to their concentrated holdings, and the power to engage in the process of corporate governance).

185. See Goforth, supra note 171, at 404-06 (stating that this change in structure and resources is yet another reason why the traditional barriers and justifications to shareholder participation are no longer valid).

186. See Goforth, supra note 171, at 408 (stating that with the evolution of the institutional shareholder, it is “no longer accurate to depict the typical stockholder as a completely passive investor waiting for dividends to roll in”); see also Vanecko, supra note 1, at 378-79 (noting the increasing call for shareholder participation).

187. See Barnard, supra note 113, at 1137 (stating that matters of corporate governance have become a popular focus of shareholder proposals).

188. See id. (stating that there is an increased number of proposals from shareholders relating to matters of corporate governance that previously received minimal attention); see also BLOOMENTHAL & WOLFF, supra note 20, § 13.10[1], at 13-74 (noting that CALPERS, a major institutional investor, submitted twenty-eight proposals, during a three year period, ten of which were supported by other institutional investors and “six [which] were voluntarily withdrawn after successful negotiations with the [corporation]”).

189. See Goforth, supra note 171, at 399-400 (noting that the procedural and substantive “requirements for shareholder proposals tip the balance in favor of management”).
unifying them as is needed to ensure a system of corporate democracy.\footnote{190}

One commentator has suggested that the separation of ownership and control stems exclusively from management’s control over the system of proxy voting.\footnote{191} Giving shareholders control of this system would remedy many other problems of corporate governance.\footnote{192} The Commission, however, has viewed this position as somewhat of a misnomer as evidenced by its decision in \textit{Cracker Barrel}. Instead of trying to unify the systems of ownership and control, the Commission has again diminished the role of shareholders by making it more difficult for shareholders to participate in the corporation’s decision making process.\footnote{193} The separation of ownership and control violates the principles of democracy.\footnote{194}

\section{The SEC’s Violation of the Spirit of the APA}

The \textit{Cracker Barrel} decision undermines corporate accountability to shareholders, whether they are individuals or institutional investors.\footnote{195} Congress granted the Commission the authority to promulgate rules “necessary or appropriate in the public interest or for the protection of the investors.”\footnote{196} The Commission exceeded that authority in the

\footnote{190. \textit{See supra} note 175 and accompanying text. \textit{See generally} Dent, supra note 35, at 907 (arguing that “giving shareholders control of the proxy [voting] system” is the only way to provide for a system of corporate accountability to shareholders).

191. \textit{See} Dent, supra note 35, at 882 (asserting management’s dominance over the proxy system is seen as inevitable due to the inability of numerous shareholders to organize and coordinate voting efforts).

192. \textit{See id.} at 882-83 (arguing that relinquishing control of the proxy system to a committee of the corporation’s largest shareholders would “unite ownership and control” of the corporation and eliminate other problems, such as “tender offers, ineffective boards of directors, skewed executive compensation, shareholder derivative suits, and de-equitization”).

193. \textit{See supra} note 43 and accompanying text (discussing how shareholder proposals are the primary means of shareholder participation, thus limiting proposals that can be submitted, furthers the gap between ownership and control). Shareholders are more limited now by the scope of what is a “proper subject” for shareholder consideration. \textit{See supra} Part II.B.1 (discussing the impact of the \textit{Cracker Barrel} decision).

194. \textit{See} Dent, supra note 35, at 893 (noting that in a democratic system, the decision to spend “other people’s money,” should be made by elected officials). Investing a broad spending power “in a self-selected corporate oligarchy, violates this principle” that these decisions should be made by those who own the company or have been elected. \textit{See id.; see also} Eugene V. Rostow, \textit{To Whom and For What Ends is Corporate Management Responsible?}, in \textit{THE CORPORATION IN MODERN SOCIETY} 46, 64 (Edward S. Mason ed., 1959) (asking whether democracy would “set any limit upon the directors’ discretion in spending corporate funds for what they decide is the public good”).

195. \textit{See} Frackman & Perry, supra note 175, at 3 (noting that “[t]he uncertainty reflected in the \textit{Cracker Barrel} no-action letter undermines the utility of [the Shareholder Proposal Rule]”).

196. 15 U.S.C. § 78n(a) (1994); \textit{see also supra} notes 3-8 and accompanying text (dis-}
Cracker Barrel case. Not only did the Commission revise its "interpretation" of the ordinary business exception, by narrowing the approved topics of shareholder proposals, it also did so without providing an opportunity for the public to participate.\textsuperscript{197}

As an administrative agency, the Commission is subject to the procedures of the APA.\textsuperscript{198} Although the court agreed with the Commission that it technically had not violated the APA,\textsuperscript{199} nonetheless, the SEC violated the spirit of the APA because the purpose of the APA is to ensure the participation of all interested parties in rulemaking and agency decisions.\textsuperscript{200} The Second Circuit agreed with the Commission that it had not promulgated a rule; however, the Commission's "interpretation" significantly changed the rights of the shareholders and thus, the Commission should have complied with the notice and comment procedures prescribed by the APA.

The Commission is hardly "protecting investors" when it is further restricting the participation of investors in corporate activities.\textsuperscript{201} The decision in Cracker Barrel once again decreased shareholder accessibility to proxy materials, thus decreasing shareholder participation in corporate governance.\textsuperscript{202} Although the Commission generally has endorsed a system of corporate accountability, it has never endorsed formally the view that shareholders should function as an instrument to ensure fair corporate suffrage; this presents a major problem.\textsuperscript{203}

\textsuperscript{197} See supra notes 157-58 and accompanying text (discussing the fact that the SEC did not utilize the notice and comment procedures of the APA when it issued the new interpretation of Rule 14a-(c)\textsuperscript{(7)} in the Cracker Barrel no-action letter).

\textsuperscript{198} See 5 U.S.C. § 551 (1994) (defining an "agency" subject to the APA, as "each authority of the Government of the United States, whether or not it is within or subject to review by another agency"); see also, Commercial Capital Corp. v. S.E.C., 360 F.2d 856, 857-58 (7th Cir. 1966) (stating that the APA applies to the SEC).

\textsuperscript{199} See supra notes 164-65 and accompanying text.

\textsuperscript{200} See H.R. REP. No. 79-1980, at 18 (1946) (stating that the purpose of the APA is "to provide for publicity of information" and to ensure "procedures which adequately protect the private interests involved").

\textsuperscript{201} See Millon, supra note 2, at 225 (discussing the ongoing abrogation of the traditional notion of shareholder primacy, the basic premise of corporate law); see also Gocha, supra note 16, at 412-13 (noting that the amendments the Commission made seem to remove power from the minority shareholders whose influence is already limited). See generally George W. Dent, Jr., SEC Rule 14a-8: A Study in Regulatory Failure, 30 N.Y.L. SCH. L. REV. 1, (1985) (providing a thorough discussion on the evolution of the Shareholder Proposal Rule).

\textsuperscript{202} See generally Cracker Barrel No-Action Letter, supra note 14, at 77,287. Shareholder participation is directly decreased by limiting the scope of issues on which proposals may be submitted.

\textsuperscript{203} See Propp, supra note 1, at 115 (noting that "the SEC ha[s] not formally endorsed
C. The Commission’s Hazardous Shift in Focus

Scholars have severely criticized the Commission’s evolving shift in its policies and philosophy. The Commission has become increasingly concerned with the raising of capital at the cost of abandoning the concept of corporate accountability to shareholders. The major problem with the Commission’s perceived lack of interest in corporate accountability is that corporate accountability is more pertinent to the “protection of investors” than the forming of capital within the corporation. The Commission, therefore, may not be fulfilling its congressional mandate; instead, it may be carving out a role for itself in the internal affairs of corporations.

By its nature, the Commission has the unique ability to impact the internal affairs of corporations. This tremendous power should be used to benefit investors, whose interest the Commission is statutorily obligated to protect. The Commission, however, as recently evidenced in *Cracker Barrel*, is minimizing the impact that shareholders will have on corporations and thus, decreasing overall corporate accountability.

The *Cracker Barrel* decision is the unfortunate and harmful result of a
well-intentioned rule that has withstood many damaging revisions. Since its inception, the Shareholder Proposal Rule has been inefficient and unsuccessful in obtaining the goals of Congress.\textsuperscript{211} The Rule was enacted to ensure that shareholders could enforce their rights as owners of corporations to control important decisions.\textsuperscript{212} Congress intended to provide an opportunity for shareholders to question the actions of management.\textsuperscript{213} The Rule also was envisioned as a mechanism by which the shareholder could keep his stock and attempt to have an impact, rather than sell his stock when dissatisfied with the management.\textsuperscript{214} Today, however, the Rule does little to ensure shareholder participation as "owners" in the corporate system of governance.\textsuperscript{215} The exceptions that provide for the exclusion of proposals, especially the "ordinary business exception," have proved fatal to the effectiveness of the Rule.\textsuperscript{216} The reasons for its failure are numerous, but as one judge noted, "[t]he term 'ordinary business operations' is neither self-explanatory nor easy to explain."\textsuperscript{217}

Although the Commission has acknowledged the need for enhanced corporate accountability to investors, it has been reluctant to enact

\textsuperscript{211} See generally Gocha, supra note 16, at 440 (concluding that the evolution of Rule 14a-8 has been to restrict shareholder access).

\textsuperscript{212} See supra note 3-8 and accompanying text (discussing the intent behind the Shareholder Proposal Rule).

\textsuperscript{213} See Schwartz and Weiss, supra note 6, at 641 (noting that shareholders have used the Rule to hold management accountable for various actions); see also STAFF REPORT, supra note 30, at 157 (summarizing a comment letter the Commission received which stated that Rule 14a-8 provided an effective means for shareholders to compel management to discuss matters that are important to shareholders and reasonably related to the corporation's activities).

\textsuperscript{214} See Schwartz & Weiss, supra note 6, at 642. The Shareholder Proposal Rule is an alternative approach to the "Wall Street Rule," which provides that shareholders who are not satisfied with the corporation should sell their stock and reinvest. See id. This alternative was welcome, because the "Wall Street Rule" does not provide an adequate mechanism to deal with specific issues that shareholders would like to redress. See id.

\textsuperscript{215} See Palmiter, supra note 10, at 886. Palmiter asserts that the Shareholder Proposal Rule does not "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." Id. See generally Goforth, supra note 171, at 380-430 (citing reasons and examples for the failure of the Shareholder Proposal Rule to increase shareholder participation in corporate governance).

\textsuperscript{216} See Address by SEC Commissioner Bevis Longstreth before the National Association of Manufacturers, reprinted in [1980-83 Transfer Binder] MUT. FUNDS GUIDE (CCH) §11,348 (Dec. 11, 1981) (stating that only two shareholder proposals not supported by management have ever been approved by shareholders as of that date).

\textsuperscript{217} New York City Employees' Retirement Sys. v. Dole Food Co., 795 F. Supp. 95, 100 (S.D.N.Y. 1992), vacated as moot, 969 F.2d 1430 (2d Cir. 1992).
measures to accomplish this goal. The Commission's past decisions and shifts in policies have served to undermine the system of corporate accountability. In the Staff Report issued by the SEC, the Commission explicitly acknowledged that its framework of corporate accountability needed strengthening, and focused on the role of shareholders in this process. Since the issuance of that report, there have not been any substantial changes in the rules favoring shareholder participation in corporate governance. However, the SEC has recently taken steps to begin the process of remedying the situation.

III. THE NEED TO REEVALUATE THE ORDINARY BUSINESS EXCEPTION IN THE ERA OF INSTITUTIONAL INVESTORS

There is no doubt that the Shareholder Proposal Rule, and especially the ordinary business exception, need to be reformed. The current Rule and the limitations on shareholders are unreasonable in the quest to create the "shareholder-management balance" that has been envisioned. Therefore, advocates for change state "that the SEC [must] expand, or at least maintain, shareholder access to management proxies." As a result, many proposals to revise the Rule have been advanced.

218. See Protection of Shareholders' Rights Act of 1980: Hearings on S. 2561 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs, 96th Cong., 2d Sess, 33-67 (1980) (Commission Chairman Williams, recognizing the need for corporate accountability to shareholders, expressed his "severe reservations about the wisdom of legislation designed to regulate the corporate boardroom").

219. See supra note 211 and accompanying text.

220. See STAFF REPORT, supra note 30, at 156, 205-08 (recognizing the problems that have been encountered when implementing the Shareholder Proposal Rule and the need to make changes to the Rule).

221. See id. at 156-59, 164 (discussing the role of the shareholder in corporate accountability and the need for changes to the Shareholder Proposal Rule).

222. The 1983 amendments were the last substantive amendments to the Shareholder Proposal Rule, however, the 1976 amendment was the last amendment to the ordinary business exception. See DeCapo, supra note 42, at 139-42 (discussing the evolution of the Shareholder Proposal Rule).

223. See infra notes 248-56 and accompanying text (discussing the new Shareholder Proposal Rule).

224. See supra notes 236-37 and accompanying text (discussing the need for reevaluation of the Rule).

225. See Harnisch, supra note 67, at 441 (arguing that the 1983 amendments cannot maintain the delicate "shareholder-management balance" set by the 1976 amendments).

226. Id. at 441 (arguing that in light of the growing political and social influence of American corporations in world affairs, it is imperative for the Commission to expand or at least maintain the level of shareholder access to proxy materials).

227. See Jonathan E. Gottlieb, Regulation of Shareholder Proposals—Recent Devel-
With any revision, however, there is a tradeoff. The challenge in revis-

opments and Some Suggestions for Reform, 7 INSIGHTS 25, 28-29 (1993) (noting the likelihood that the Commission will change its treatment of shareholder proposals). The author advances six alternative approaches to the Shareholder Proposal Rule: (1) allowing the Commission to “reassess its major interpretations after each proxy season and . . . issue an interpretive release announcing any major new interpretations”; (2) amending Rule 14a-8(c)(7) adopting “broad principles and specific factors for determining if a shareholder proposal involves ordinary business”; (3) “amend[ing] Rule 14a-8(c) to permit an issuer to omit any proposal that is primarily intended to promote social or political causes;” (4) discontinuing the process of no-action letters; (5) “reduc[ing] the standards in Rule 14a-8 to a minimum and permit[ting] issuers to establish additional limitations in their by-laws;” (6) “replac[ing] the substantive requirements of Rule 14a-8 with an arbitrary rule that requires issuers to include no more than a fixed number of proposals in their proxy statements each year.” Id.; see also Dye & Hair, supra note 81, at *364-67 (summarizing the numerous approaches taken by shareholders to effectuate corporate accountability); Neuhauser, supra note 62, at 221 (advocating an increase in shareholder communication as a solution “for improving corporate responsiveness, accountability and responsibility without imposing costs or undue burdens on registrants or others”). For a good discussion and synopsis of proposed reforms, see Matheson & Olson, supra note 26, at 158-68.

228. See Gottlieb, supra note 227, at 28-29 (identifying the drawbacks to each proposed reform). With each option there will be some kind of tradeoff. See id. For example, there may be uncertainty for issuers in denying access to proxy materials or toleration by both issuers and shareholders because proxy statements may include proposals that have “little interest or relevance to either group.” Id. at 29. Some revisions would make it “more difficult for shareholders with proposals that are directly tied to the business of the issuer to get those proposals included in the proxy statement.” Id. However, at the same time, the costs involved in deciding whether to include or exclude a proposal would be reduced. See id. The investors and management simply need to decide how far they are willing to bend. See id.; see also Matheson & Olson, supra note 26, at 1323 (stating the argument that shareholder and nonshareholder interests are divergent). The authors suggest that

The challenge for corporate law is to facilitate the development of a corporate structure that allows management the discretion to utilize its expertise on behalf of shareholders, but at the same time establish safeguards in situations in which management might utilize that discretion to favor itself at the expense of shareholders.

Id. (quoting American Law Institute, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS introductory note to part VI, at 519), (Proposed Final Draft) (1992); see also American Law Institute, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS Part III & IIIA intro. Note, (Proposed Final Draft) (1992). The ALI recognized the dichotomy in positions and stated “there are two highly important social needs regarding [publicly held] corporations: the need to permit a corporation to be highly flexible in structuring its operational management [and] the need for processes that ensure managerial accountability to shareholders.” Id.; see also Lyman Johnson, The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law, 68 TEX. L. REV. 865, 879-80 (1990). Professor Lyman argues that there are two “strands” of corporate law: shareholder welfare and management discretion. See id. at 879. He advocates that the power of management should be broad enough to allow management to be creative and flexible, but not at the cost of shareholder welfare. See id. at 880. He argues that each can “check, if not negate and overwhelm, the other.” Id.
Reevaluating the Shareholder Proposal Rule

The need for change in the Rule and the changing structure of the corporate shareholder also calls for a rule and exceptions that are narrowly defined. The SEC has examined further the idea that the ordinary business exception should set forth broad principles of what constitutes ordinary business. Advocates of this approach argue that at the very least, it would reduce uncertainty and the Commission's appearance of arbitrariness in regulating shareholder proposals would be reduced. The fact that shareholders are important to the corporate function provides incentive for the Commission to strengthen, rather than weaken, the shareholder proposal rule.

A. The SEC Attempts to Revise Rule 14a-8(c)(7)

The Commission proposed a change to the Shareholder Proposal Rule in September 1997. This proposal explicitly advocated changes to Rule

229. See Frackman & Perry, supra note 175, at 4 (discussing the inability to reach a consensus on the substance of the reforms needed and the various substantive calls for reform of Rule 14a-8 from the Commission's Division of Corporation Finance, Commissioners of the SEC, the American Society of Corporate Secretaries, and shareholder activists).

230. See Vanecko, supra note 1, at 378 (noting that many scholars, business people, pension fund managers, and union officials have called for a change to the Shareholder Proposal Rule to encourage more institutional investor activism); supra note 117 and accompanying text (discussing the increased presence of institutional investors).

231. See supra notes 208-09 and accompanying text (discussing the unique attributes of the SEC in regulation); see also Securities Exchange Act of 1934 §14(a), 15 U.S.C. § 78n (a) (1994) (granting the Commission the power to take actions it deems "necessary or appropriate in the public interest or for the protection of investors"); H. R. REP. NO. 73-1383, at 14 (1934) (discussing the need for the 1934 Act during the time when the Commission was part of the Federal Trade Commission).

232. See infra notes 236-37 and accompanying text (discussing the most recent proposed rule); see also Gottlieb, supra note 227, at 29 (advocating that the Commission set forth broad principles of what involves ordinary business to alleviate the uncertainty and appearance of arbitrariness in the Commission's regulation of shareholder proposals).

233. See id. at 29.

234. See Harnisch, supra note 67, at 442 (asserting that shareholder proposals are valuable to corporations in many respects). To ensure the continuity of these proposals, the Commission will need to provide a meaningful right of access to the corporations' proxy materials. See id.

The proposal deals with the major points of contention of investors including the *Cracker Barrel* policy,\(^{236}\) the lack of guidance the language of the Rule provides,\(^{237}\) and the opportunity for shareholders to “override” a managerial decision to exclude a shareholder proposal from the proxy materials.\(^{238}\)

This proposal was in part a product of the controversy surrounding the *Cracker Barrel* decision.\(^{240}\) In addition, the Commission noted that a great number of proposals each year focus on corporate governance matters and social policy issues.\(^{241}\) As a result, in proposing these changes, the Commission suggested that the current Rule was inadequate to deal with shareholders’ concerns.

The Commission proposed that Rule 14a-8 be revised into a question and answer format, and specifically that Rule 14a-8(c)(7) be reworded to include substantive examples of what might be excluded by its language.\(^{242}\) The proposal advocates a change in the “ordinary business exception” that would read:

Management functions: If the proposal relates to specific business decisions normally left to the discretion of management;

Note to paragraph (i)(7): Examples of such matters include the way a newspaper formats its stock tables, whether a company charges an annual fee for use of its credit card, the wages a company pays its non-executive employees, and the way a company operates its dividend reinvestment plan. For an investment company, such matters include the decision whether to invest in the securities of a specific company.\(^{243}\)

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236. *See id.* at 50,688-689 (discussing the proposed changes to Rule 14a-8(c)(7)).
237. *See id.* at 50,688.
238. *See id.* at 50,684-685 (discussing the proposal to revise the Rule 14a-8 in Plain English and to “recast the Rule into a Question [and] Answer format”).
239. *See id.* 50,690-691 (proposing an “override” mechanism whereby three percent of the shareholders could override a company’s decision to exclude a proposal).
240. *See id.* at 50,688. During the proxy season preceding this release, the Commission “declined proponents’ requests that [it] review three Division no-action responses implicating the interpretation, and concerning companies’ affirmative action policies and practices.” *Id.* at 50,688 n.71.
241. *See id.* at 50,683 (stating that a significant number of proposals focus on matters such as repealing laws establishing a classified board, eliminating pension plans for non-employee directors, compensation matters, environmental matters, and the manufacture of tobacco).
242. *See id.* at 50,684.
243. *See id.* at 50,704.
The Commission has finally taken the long-needed, affirmative steps to revise the Rule and the ordinary business exception to include substantive definitions and rules of application. The Rule, as it now stands, is amorphous and is left to administrative or judicial interpretation to determine the substance of its confines.\textsuperscript{244} Shareholders need a substantive guideline to follow so that they will not pursue a proposal topic that is ultimately determined to be beyond the confines of a "proper subject" for shareholder consideration. A revision, such as the one the Commission has proposed, including definite principles of application, will serve to help investors and issuers alike by eliminating needless litigation\textsuperscript{245} and lulls in the Commission’s processes.\textsuperscript{246}

Requiring the Commission to expound principles of what constitutes an “ordinary business exception” reduces uncertainty in the interpretation of this exception. Furthermore, if the required principles are tailored narrowly enough, the Commission would be forced to undertake notice and comment procedures when attempting to change the interpretation of a rule that would affect an individual’s rights.\textsuperscript{247}

\textbf{B. The Final Rule}

In May 1998, the Commission issued the long awaited final rule amending the Shareholder Proposal Rule.\textsuperscript{248} The final Rule states that the Commission is “adopting [its] proposal to reverse the \textit{Cracker Barrel} position.”\textsuperscript{249} The Commission notes that this proposal was overwhelmingly supported and adopted by the Commission due to the “better understanding [it has gained] of the depth of interest among shareholders in having an opportunity to express their views to company management on employment-related proposals that raise sufficiently significant social policy issues.”\textsuperscript{250} This Rule, therefore, reverses the Commission’s provi-

\textsuperscript{244}. See Shareholder Proposal Rule, 17 C.F.R \S 240.14a-8(c)(7) (1998). There is a noticeable absence of definitions in the Rule. Thus, the definitions are left up to judicial construction.

\textsuperscript{245}. A good example of needless litigation is the NYCERS litigation regarding \textit{Cracker Barrel}. Had the Commission defined what constituted ordinary business or a “substantial policy issue” this case never would have had to be litigated.

\textsuperscript{246}. For example, the Commission terminated the issuance of no-action letters pending the outcome of the \textit{Cracker Barrel} case.

\textsuperscript{247}. See \textit{supra} notes 147-48, 149 and accompanying text (discussing the requirements of the APA).


\textsuperscript{249}. \textit{Id.} at 29,108.

\textsuperscript{250}. \textit{Id.} Nearly all the comments the shareholder community submitted supported the reversal of the \textit{Cracker Barrel} position, while members of the corporate community did
sions relating to shareholder proposals regarding employment-based policies, however, it does not affect other areas of shareholder proposals. 251

The Commission also has adopted the suggestion to reformat the Rule into a question and answer format to facilitate investors’ and managements’ understanding of the Rule. 252 The Commission, however, declined to adopt the proposal to list illustrative examples of what would constitute ordinary business, due to the fear that the list may be read as exclusive as to what may be included as a proposal or may be seen as an interpretive change. 253 The Commission recognizes that “the phrase ‘ordinary business’ . . . [is] a term-Of-art [sic] in the proxy area” which the courts have developed over the years. 254

The Commission also has decided to adopt the proposal increasing the value of a company’s shares that a shareholder must own to submit a proposal from $1,000 to $2,000. 255 This amendment is an adjustment for inflation, and there was little opposition to the amendment, although some commenters did not believe that the increase was enough to be “meaningful.” 256

The Commission has taken some valuable steps toward increasing shareholder activism, at least with respect to employment-based proposals dealing with significant social issues. 257 The Commission, however, declined to adopt the proposed “override mechanism,” which would have allowed three percent of a company’s shareholder ownership to “override” management’s decision to exclude a proposal from proxy materials. 258 This amendment would have allowed institutional investors to have a broader range of influence over corporate governance. 259 The

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251. See id. The Commission states in the final Rule that “shareholders should bear in mind that the Cracker Barrel position related only to employment-related proposals raising certain social policy issues. Reversal of the position does not affect the Division’s analysis of any other category of proposals under the exclusion, such as proposals on general business operations.” Id.
252. See id. at 29,106-107.
253. See id. at 29,107.
254. Id.
255. See id. at 29,111.
256. See id. at 29,111-12.
257. See supra notes 248-51 (discussing the limited scope of the final Rule.)
259. See supra note 43 and accompanying text (discussing the role of shareholder proposals in corporate governance.) Thus, if shareholders can submit proposals on a broader range of issues, they will have more influence over corporate governance.
Commission's failure to adopt this amendment will have the effect of limiting the role of institutional shareholders to the detriment of all shareholders.

C. The Need For Expanded Reevaluation

The SEC has made strides in expanding the role of shareholders with recent amendments, but these are only the first steps toward a much needed change. Further revisions should be undertaken to ensure that shareholders are afforded the role they deserve in the governance of the corporation.

The revisions should focus on the rights and role of the institutional investor. Institutional investors have the resources and incentive to participate to a greater degree in corporate governance than do individual investors. The rules should reflect the reality that these investors are more active in the system of shareholder proposals.

One possible step that the Commission might evaluate is whether there should be an entirely different rule for shareholders with larger holdings, such as institutional investors, than there should be for shareholders with smaller holdings. As it stands now, all shareholders holding one percent or $2000 in "market value" of securities may include proposals in the proxy statement. Most institutional investors, however, possess much larger holdings than that required for proposal inclusion. Those investors willing to put more time and money into the corporation should accordingly be granted more access to the proxy materials of the corporation. Institutional shareholders should be given more opportunity than the "household" shareholder to control the direction of the corporation. The Commission should set a higher threshold requirement which affords those who qualify the opportunity to participate to a greater degree in setting the policy of the corporation. The September 1997 proposed

260. See supra notes 116-17 and accompanying text (discussing the ability and desire of institutional investors to become more active shareholders).

261. See supra notes 123-127 and accompanying text. These investors, contrary to the popular stigma attached to institutional shareholders, are not irrational or focused on the short-term gains of the corporation. See Dent, supra note 35, at 922-23 (stating that "several prestigious investment banks have created" leverage buyouts, whereby institutions become controlling shareholders which in turn "eliminates managers' obsession with quarterly earnings and the bad habits that it creates") (quoting Power Investors Call the Shots, Bus. Wk., June 20, 1998, at 126-27).


263. See note 115 and accompanying text (discussing the size and holdings of today's institutional investors).

264. See supra notes 116-17 and accompanying text (discussing the philosophy of institutional investors).
rule reflected this consideration, and it is unfortunate that the Commission declined to include the "override" in the final Rule.

The Commission initially advocated the "override" mechanism, whereby three percent of the share ownership could veto a company's decision to exclude a proposal, under 14a-8(c)(7). The Commission noted that this "mechanism would broaden the spectrum of proposals that may be included in companies' proxy materials." The "override" mechanism provided that the submitting shareholder could include his or her own shares in calculating the three percent necessary to override management's decision to exclude a shareholder proposal. The Commission also realized that in allowing this inclusion, a proponent who holds three percent of a company's outstanding stock could effect an "override" by itself.

The Commission, however, has not fully realized the need to afford institutional investors greater latitude in the realm of shareholder proposals, as evidenced by its decision not to include this amendment in the final Rule. The Commission says little about the reasons why it declined to adopt the mechanism, saying only that "[s]everal commenters opposed the proposal." In support of this statement, however, the Commission merely included a footnote from a few companies stating that they were "concerned that [the] proposal if adopted might be costly and disruptive for investment companies." Without any more explanation than this, the SEC dismissed an amendment that would have had far reaching affects in affording increased participation to shareholders. Releasing more control to such investors would not create the problems that are traditionally cited as justifications for limitations on shareholder partici-


266. See id. at 50,690-92 (noting that the current Rule does not provide for an "override" mechanism such as the one proposed).

267. Id. at 50,690 (noting that this mechanism allows shareholders to decide among themselves which issues are sufficiently relevant and important to all shareholders).

268. See id.

269. See id. (stating that the Commission believes that three percent "strike[s] the right balance" between establishing a high enough percentage to ensure that the proposal is "sufficiently relevant" to the shareholders and a low enough percentage so that an override would not be completely "unattainable").


271. Id. at 29,113 n.82.
ration in the proxy system. The limitations on shareholders are traditionally premised on the irrationality and procedural problems of individual or collective shareholder activism, and therefore, are no longer justified in the era of the institutional investor.

The Commission needs to reevaluate and restructure the Shareholder Proposal Rule and the “ordinary business exception” to provide shareholders more power over important corporate policies. Through Cracker Barrel, the Commission decreased shareholders’ already minimal amount of corporate accountability. The Commission’s interpretation, however, is contrary to the principle that shareholders are the “true owners” of the corporation; therefore, this interpretation needs to be reevaluated.

The Commission explicitly reversed the Cracker Barrel policy with its recent amendments to the Rule. As a result of the Commission’s adoption of these recent amendments regarding 14a-8(c)(7), “the fact that a shareholder proposal concerning a company’s employment policies and practices for the general workforce is tied to a social issue will no longer be viewed as removing the proposal from the realm of ordinary business operations of the registrant.” Although the Commission argues that the interpretation advanced in Cracker Barrel continues to have some validity, a change in policy is warranted within the “broader package of reforms.”

The impact of returning to a pre-Cracker Barrel policy will be to allow more shareholder proposals, thus fostering greater corporate accountability to shareholders. This change, however, comes at a price. There still is not a “brightline” test for inclusion or exclusion of proposals. The Commission will return to a system in which they evaluate the proposals on a case-by-case basis. Thus, it may be possible that a situation

272. See supra notes 181-85 and accompanying text (noting the increased activity in shareholder proposals from institutional investors as compared to the number of shareholder proposals individual investors submit).

273. See supra note 116 and accompanying text (discussing the philosophies and attitudes of institutional investors as compared to individual investors who simply followed the “Wall Street Rule”).

274. See supra notes 34-35 and accompanying text (discussing the principle of separation of ownership and management).


276. Id. at 50,688. This language speaks directly to the issue in Cracker Barrel.

277. See id.

278. See id.

similar to *Cracker Barrel* may occur in the future. Even in light of this concern, the final Rule goes further than the Commission has ever gone before to ensure corporate accountability to shareholders. The new amendments to the Shareholder Proposal Rule are a step in the right direction, but it should not be the end of the line.

IV. CONCLUSION

The need for reevaluation of the Shareholder Proposal Rule and the "ordinary business exception" was widely recognized as evidenced by the recent amendments to the Rule. The only agency that has the power to effectuate a change in policy has remained relatively silent until recently. The Commission has realized the need, in light of the present social culture, to reevaluate the role that shareholders should play in the governance of corporations.

The problems created by the divergence of ownership and control of a corporation have been recognized ever since Berle and Means established the principle in the 1930s. These problems, however, have never been dealt with adequately or effectively. In the dawning era of the institutional investor it is imperative that these problems be solved definitively. The prevalence and strength of institutional investors provides the outlet that has been missing to release power over shareholder proposals back to the investors. These rational, business-minded institutional investors deserve rights as owners of the corporation to control the important aspects of a corporation's business. Without relinquishing power to institutional investor shareholders, there will be a further decline in the level of corporate accountability that corporations will afford to shareholders.