1998

Proactive Corporate-Shareholder Relations: Filling the Communications Void

Beth-ann Roth

Follow this and additional works at: http://scholarship.law.edu/lawreview

Recommended Citation
Available at: http://scholarship.law.edu/lawreview/vol48/iss1/7

This Article is brought to you for free and open access by CUA Law Scholarship Repository. It has been accepted for inclusion in Catholic University Law Review by an authorized administrator of CUA Law Scholarship Repository. For more information, please contact edinger@law.edu.
PROACTIVE CORPORATE-SHAREHOLDER RELATIONS: FILLING THE COMMUNICATIONS VOID

Beth-ann Roth*

I. INTRODUCTION

The U.S. Securities and Exchange Commission ("SEC" or "Commission") recently amended its rules governing shareholder proposals.1 While the efforts of the Commission in this area are to be commended, the emphasis has unfortunately remained on the portion of the process that occurs after communications between shareholders and corporate management have already failed, or, worse yet, not even begun. The shareholder proposal rules encourage an adversarial approach to the relationship between the parties without fostering any kind of productive communications.

The purpose of this article is to explore what the author believes is a need to build into the corporate-shareholder communications structure a more formal mechanism for developing procedures pursuant to which shareholders can discuss their concerns with corporate management on an ongoing basis, and by which companies are encouraged to approach shareholders directly instead of solely via disclosure documents. Direct communication is more likely to lead to results with which both sides can be satisfied, and may more often lead to a resolution of issues without resort to the contentious shareholder proposal process. On those occasions when a vote of shareholders is appropriate to decide an issue of company policy, amicable communications among the parties well in advance of submission deadlines could result in a proposal crafted by consensus, or at least with substantive input from management.

* Ms. Roth is a member of the Investment Management and Latin American Practice Groups of Dechert Price & Rhoads in Washington, D.C., and acknowledges the help of Paul Spackman in preparing this article. She formerly was in-house counsel for an investment management firm, a lobbyist on business issues, and has served as a member of the staff of the SEC. Ms. Roth has been actively involved in matters regarding corporate-shareholder communications for the past fourteen years.

II. SHAREHOLDER PROPOSALS AND PROXY VOTING

An essential part of the corporate governance process is for shareholders to be able to communicate both with corporate management and with each other. How this has been achieved over the years has been primarily through the shareholder proposal process.

Shareholder proposals serve an essential function in the U.S. corporate governance arena. The very opportunity to submit proposals, even of an advisory nature, affords a safety valve for shareholder expression at a price to management that would seem to be relatively slight. In a meaningful way, the shareholder proposal process has provided an important mechanism for allowing shareholders to exercise their corporate franchise and communicate with management on issues of importance to them.

One way for shareholders to present an issue for a vote is to attend a company's annual meeting of shareholders in person and present the matter from the floor. However, because most shareholders do not attend the annual meetings in person, they would not, in this manner, have the benefit of learning about and voting on the issue being presented. Rather, the more prevalent means for a shareholder to present a matter for a vote is by having the question disseminated to other shareholders in

---


3. Cane, supra note 2, at 57.

4. See Regulation of Securityholder Communications, Exchange Act Release No. 29,315, 56 Fed. Reg. 28,987, 28,987 (1991) (proposed June 25, 1991) (not adopted). Shareholders "exercise their right - some would say their duty" of corporate governance through the exercise of their corporate franchise. Id. at 28,988 n.11 (quoting Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 680-81 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972)) ("[S]hareholders . . . control the important decisions which affect them in their capacity as stockholders and owners of the corporation."). See also SEC v. Transamerica Corp., 163 F.2d 511, 517 (3d Cir. 1947) ("A corporation is run for the benefit of its stockholders and not for that of its managers.").
the company's proxy statement preceding the annual meeting. "Proxies have become an indispensable part of corporate governance because the \"realities of modern corporate life have all but gutted the myth that shareholders in large publicly held companies personally attend [sic] annual meetings\".\(^5\)

In order to present a matter before the shareholder body for a vote, a shareholder files a proposal with the secretary of the corporation and requests that the proposal be included in the proxy statement mailed before an annual or special meeting.\(^6\) There are minimum share ownership requirements and holding periods, as well as time restrictions for filing a proposal.\(^7\) The shareholder may include with the request a supporting statement that will accompany the voting item in the proxy statement.\(^8\)

Once a corporation receives a shareholder proposal, it has several options. The corporation can simply include the proposal in its proxy statement and may add a statement regarding its views on how shareholders should vote on the matter.\(^9\) Alternatively, representatives of the corporation may believe that the corporation has a legal right to omit the proposal from its proxy statement because the proposal falls under one of the enumerated exclusions of the shareholder proposal rules.\(^10\) Bases for exclusion include that the proposal: (1) is not a proper subject for action under state law; (2) would require a violation of the law to implement; (3) would result in putting forth false or misleading information in a proxy statement; (4) would result in a personal benefit to an individual shareholder, and not to the group as a whole; (5) relates to operations accounting for less than 5% of assets, and is not significantly related to the company's business; (6) relates to a matter beyond the company's control to implement; (7) deals with the ordinary business operations of the company; (8) concerns an election of office; (9) is counter to a proposal being submitted by the company; (10) is moot; (11) substantially duplicates one already being included as submitted by another propo-

---

7. See id. § 240.14a-8(a)(1), -8(a)(3).
8. See id. § 240.14a-8(b)(1).
9. See id. § 240.14a-8(e). If the company chooses to include a statement in opposition to the proposal, it must send a copy of the statement to the shareholder proponent. If the proponent believes the statement in opposition is materially false or misleading in contravention of Exchange Act Rule 14a-9, 17 C.F.R. § 240.14a-9 (1997), the proponent may so advise the SEC staff in writing. See id. § 240.14a-8(e).
10. See id. § 240.14a-8(c).
If the company believes the proposal may be omitted pursuant to one of the enumerated exclusions, it must notify the SEC in writing of management's intent to omit the shareholder proposal from the company's proxy statement. In response to the written submission, the SEC staff will either concur or decline to concur with the company's assessment of the proposal's excludability. While the SEC staff cannot dictate what action the company takes, if the staff refuses to concur, and the company omits the shareholder proposal, the staff may decide to refer the matter to the SEC's Division of Enforcement for further review. Likewise, a concurring opinion by the SEC staff does not mean that the company may lawfully omit the proposal; the shareholder is free to seek redress through the courts. Such a course of action, however, is costly for all parties involved and often deters shareholders from pursuing what they believe to be their state-law right to vote on a matter concerning the policy formation of the company they own.

There are also courses of action between those described above. For example, shareholders may first approach a company to discuss the matter of concern, and, depending on the level of response, may choose not to file a shareholder proposal. Alternatively, a company that has received a shareholder proposal may reach out to the shareholder and attempt to resolve the issue without putting forth the matter for a vote of the entire shareholder body, and the satisfied shareholder may then choose to withdraw its resolution. It is the time period preceding the shareholder proposal process that appears to merit more formal guidance from the SEC.

III. SEC RULES GOVERNING SHAREHOLDER PROPOSALS AND PROXY VOTING

The shareholder proposal rules provide a mechanism by which shareholders, particularly small investors, may voice their views and concerns

11. See id.; infra Part III.A.2. (ordinary business exclusion); infra Part III.B.1. (personal claim or grievance exclusion); infra Part III.B.2. (little economic relevance exclusion); infra Part III.B.3. (resubmission requirement).
12. See 17 C.F.R. § 240.14a-8(d).
14. See id.
15. See Cane, supra note 2, at 60.
on policy issues relating to the operation of the companies in which they have an ownership interest. Throughout the years, there has been increasing tension as both shareholders and corporate management see themselves short-changed by the process. Shareholders believe they are not given enough of a voice with respect to certain issues relating to the company's operations. Members of management, on the other hand, often feel besieged by demands they see as infringing on their own responsibilities, and as a result, view the resources dedicated to the shareholder proposal process as a waste of their time and the company's assets.

A. The 1998 Amendments

In an effort to address the concerns expressed by both shareholders and corporate management, the SEC proposed changes to its rules in the fall of 1997. With respect to shareholders, the SEC's intent, as stated in its Proposing Release, was to "make it easier for shareholders to include a broader range of proposals in companies' proxy materials." For the benefit of companies, the SEC proposed to clarify the procedures for excluding proposals that have not met a certain threshold level of approval in past votes.

The SEC adopted amendments to its shareholder proposal rules on May 28, 1998. In undertaking the task of revising the rules to meet the needs of all of the parties, the SEC staff drafted the proposed rules, taking into account the extensive feedback it received from different stakeholders involved in the process. Accordingly, in the Proposing Release, the SEC staff addressed many issues that are of great concern to all involved. However, while the resources dedicated to the project were well used, it is my belief that the amendments do not address the core issue that gives rise to the contentious nature of the shareholder proposal process; i.e., a sound foundation for productive communication. Following is a discussion of certain Exchange Act Rule 14a-8 amendments recently adopted, along with a summary of some of the changes not providing an avenue of communication for small investors.

18. See Cane, supra note 2, passim.
19. See id. at 70 (providing the results of a survey relating to corporate attitudes on the shareholder proposal process).
21. Id.
22. See id.
adopted.

1. New “Plain English” Format

The SEC proposed to recast Exchange Act Rule 14a-8 using a plain English question-and-answer format to promote a clearer understanding of the rule. Some of the proposed modifications did not change the substance of the provisions, and others were revised to reflect current interpretations of the SEC or its staff. The SEC requested comments on the usefulness of the question-and-answer format, and whether, in the public’s opinion, the changes reflected the SEC’s interpretations. As a general proposition, there was a presumption that a proposal should be included in a company’s proxy statement unless it was excludable by the rule or by state law.

The Commission adopted the recommendation to recast the rule using a plain English question-and-answer format, making this the first SEC rule to be styled in that fashion. Several minor revisions have been made to the proposed amendments in response to public comments, revisions as proposed with respect to other rules, and minor revisions have been made to the language of rules for which the proposed substantive amendments were not adopted or where amendments were adopted but the proposed language changes were rejected as a result of public comment.

---

25. See id.
26. See id.
27. See id. at 50,682-83.
29. See id. at 29,107 (citing changes to paragraph (1) under Question 9, former Rule 14a-8(c)(1)).
30. See id. (citing changes to paragraphs (8)-(11) under Question 9, former Rule 14a-8(c)(8)-(11)).
31. See id. As discussed below, proposed substantive amendments to Rule 14a-8(c)(5) were not adopted, and only nonsubstantive changes were made to the text of the rule. See id.
32. See id. (referring to paragraph (7) under Question 9, former Rule 14a-8(c)(7), in connection with which substantive changes were adopted (see infra Part III.A.2., below), but regarding which certain recommended plain English language changes were not made).
2. Exclusion of a Proposal Relating to the Company's Ordinary Business Operations—Reversal of Cracker Barrel

The Rule 14a-8(c)(7) exclusion for proposals dealing with "ordinary business operations" has generally been one of the most used provisions of the proxy rules as a basis for excluding shareholder proposals, and has probably engendered more controversy than any other provision of the shareholder proposal rules.\textsuperscript{33} The SEC designed the ordinary business operations exclusion to prevent the introduction of shareholder proposals that, if adopted, would present the impractical result of shareholder involvement in the minutiae of day-to-day operations of a company's business.\textsuperscript{34} However, companies often relied on the provision to exclude proposals that raised questions of considerable importance to companies and their shareholders.\textsuperscript{35}

In response to this experience, in 1975 the SEC proposed an amendment that would have narrowed the exclusion in order to curb abuses by companies. But commentators objected to the proposal, and the Commission abandoned its attempt substantively to rewrite the exclusion. Instead, in its release adopting other amendments to Rule 14a-8, the Commission opted to retain the existing language with respect to the exclusion, but took great efforts to explain that it should be "interpreted in a somewhat more flexible manner than in the past."\textsuperscript{36}

Specifically, while certain matters in the past had been excluded because they related to a company's ordinary business operations, the Commission announced that those operational questions with "significant policy, economic or other implications inherent in them . . . will in the future be considered beyond the realm of an issuer's ordinary business operations."\textsuperscript{37} In the 1976 release adopting amendments to Rule 14a-8, the Commission offered examples of the types of issues that would fall within the (c)(7) exclusion. In one example, a utility company's decision to construct a power plant would normally be considered part of the ordinary business operations of that type of company. However, where

\textsuperscript{33} See id.
\textsuperscript{36} Id. at 52,998.
the construction involves a nuclear power plant, "the economic and safety considerations . . . are of such magnitude that a determination whether to construct one is not an 'ordinary' business matter." Thus, the SEC staff would refuse to concur with a company's request to omit certain proposals that related to the day-to-day operations of the company if the proposals also had significant policy or economic implications.

In a shift of interpretation, the SEC staff announced in 1992 that proposals relating to a company's employment policies and practices would no longer be viewed as an exception to the ordinary business operations exclusion, thereby creating a "bright line" approach for employment-related proposals. The event leading up to the change was a shareholder proposal to Cracker Barrel Old Country Stores, Inc. by the New York City Employees' Retirement System ("NYCERS") requesting that the company implement a change in its employment policy. Specifically, when Cracker Barrel announced a policy that it no longer would include among its workforce "individuals . . . [who] fail to demonstrate normal heterosexual values which have been the foundation of families in our society," NYCERS proposed that Cracker Barrel solicit a vote on a policy prohibiting discrimination based on sexual orientation.

Cracker Barrel sought assurance from the SEC staff that the staff would not recommend enforcement action against Cracker Barrel were it to exclude the proposal from its proxy statement, under Rule 14a-8(c)(7), on the ground that the proposal dealt with an employment matter related to the ordinary business operations of the company. The SEC staff granted "no-action" relief, but inserted into its general boilerplate letter

41. See Cracker Barrel No-Action Letter, supra note 39, at 77,287. "No-action" letters are informal responses by the SEC staff to persons or companies requesting the staff's confirmation that it will not recommend enforcement action against the person or company for engaging in a specific course of action. No-action letters "do not impose or fix a legal relationship upon any of the parties, [and] . . . do not bind the SEC, the parties, or the courts." New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 12 (2nd Cir. 1995) (hereinafter NYCERS) (citing Amalgamated Clothing and Textile Workers Union v. SEC, 15 F.3d 254, 257 (2nd Cir. 1994)). Furthermore, no-action letters "should not be regarded as precedents." Procedures Regarding Public Availability of Requests for No-Action and Interpretive Letters and Responses, Exchange Act Release No. 5,098, 35 Fed.
an announcement changing the application of its rule to an entire class of proposals. Specifically, the letter carved out an exception to the rule that particular business operations-related issues may be appropriate for shareholder consideration where they implicate significant policy concerns. The full Commission reviewed and affirmed the staff's decision in a letter dated January 15, 1993. This interpretive change announced in the *Cracker Barrel* no-action letter caused much concern in the shareholder community, and has been the subject of a lawsuit and a rule change petition seeking a reversal of the SEC's position. In response to this concern, the revised rule that appeared in the 1997 release proposed that the SEC staff revert to a case-by-case analysis with respect to employment-related shareholder proposals raising social policy issues, rather than automatically concur in a decision to omit an employment-related proposal. This, in effect, would reverse the *Cracker Barrel* no-action letter. In a concurring


42. 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. Rather, determinations with respect to any such proposals are properly governed by the employment-based nature of the proposal.


44. See *NYCERS*, 45 F.3d at 10-11 (explaining the controversy was spurred by the SEC's change in interpretation having been announced in the context of a no-action letter rather than in a more formal manner).

45. See id. at 7.

46. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39,093, 62 Fed. Reg. 50,682, 50,682 (1997) (proposed Sept. 26, 1997). In July 1995, the Interfaith Center on Corporate Responsibility, Calvert Group, Ltd., and the Comptroller of the City of New York jointly submitted a “Petition for Rule Change” pursuant to Rule 201.400 of the SEC's Rules of Practice. See id. at 50,683 n.15. Rule 201.400 does not contain a provision requiring a response from the Commission within a specific period of time. See Rules of Practice, 17 C.F.R. § 201.400 (1997). Rather, the SEC's practice is to deliver a petition to the division responsible for the subject matter of the petition, which is then supposed to make a recommendation to the Commission with respect to a response. In this case no action was taken on the petition, but the substance of the request was achieved with the adoption of the May 1998 revisions to the shareholder proposal rules. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 39,093, 62 Fed. Reg. at 50,688 n.71.

statement accompanying the Proposing Release, SEC Commissioner Wallman urged the SEC to reverse its interpretation with respect to employment-related proposals in time for the upcoming 1998 proxy season, and not to tie that reform to the adoption of rule amendments. The proposed change ultimately was adopted along with the rule amendments, though not in time for the 1998 proxy season, and became effective prospectively as of May 21, 1998.

In connection with the change, which addressed only employment-related shareholder proposals, the Commission took the opportunity to reiterate its position with respect to the ordinary business operations exclusion. As a general matter, the Commission stated that the “exclusion is consistent with the policy of most state corporate laws: to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting.” More specifically, the policy involves two basic principles, the subject matter and the complexity of the proposal. With respect to the first, the SEC stated that “[c]ertain tasks are so fundamental to management’s ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight.” However, reiterating the SEC’s long-standing position, the Commission went on to state that even these types of matters would not generally be excludable by a company if the tasks relate to “sufficiently significant social policy issues” since “the proposals would transcend the day-to-day business matters and raise policy issues so significant that [the proposal] would be appropriate for a shareholder vote.”

---

48. See id. at 50,706.
50. See id. at 29,108 n.33 (indicating the reversal of the position also will apply to no-action submissions received prior to the May 21, 1998 effective date if the SEC’s Division of Corporation Finance has not already issued a response by the close of business on May 20, 1998).
51. See id. at 29,108.
52. Id.
53. See id.
54. Id. (providing examples cited in support of this principle such as management of the workforce (i.e., hiring, promoting and firing employees), production-related decisions (i.e., quality and quantity), and the selection of service providers).
55. Id. (citing a 1992 no-action letter in which the SEC staff refused to allow a shareholder proposal to be excluded when the subject matter of the proposal involved senior executive compensation).
With respect to the second principle, the Commission noted that matters too complex in nature could not be presented in adequate depth in a shareholder proposal to be voted on by shareholders as a group, and therefore, are management's responsibility. Examples of such matters would be proposals involving intricate detail, proposals seeking to impose specific time-frames for taking action on a matter, or methods for "implementing complex policies," although such proposals are not per se within the definition of "ordinary business" and therefore excludable under the rule.

The Commission also determined that it would be prudent to retain the reference to the exclusion as pertaining to the "ordinary business operations" of a company, rather than change the term as originally proposed. The change was proposed since the phrase "ordinary business" was used as a legal term of art and therefore might be confusing to some investors seeking to use the rule. For the same reason, however, it was decided that the phrase should be retained since, as stated by commenters from both the corporate and shareholder communities, this term of art now carries with it so much interpretive baggage that a change in terminology might be misconstrued as a change in interpretation.

B. Proposed Amendments Not Adopted

1. Exclusion of a Proposal that Set Forth a Personal Claim or Grievance

Rule 14a-8(c)(4) permitted companies to exclude a proposal that (1) related to a personal claim or grievance, or (2) furthered a personal interest not shared by shareholders as a group. Under the rule, when a company asserted that a proposal had been put forth by a shareholder for one of the purposes stated above, the SEC staff undertook an evaluation of the factual claim in order to determine whether to concur with the company's request to exclude the proposal.

56. See id. (citing the 1976 Rule 14a-8 amendments).
57. Id. at 29,109 ("Timing questions, for instance, could involve significant policy where large differences are at stake, and proposals may seek a reasonable level of detail without running afoul of these considerations.").
58. See id. at 29,107.
59. See id.
60. See id. at 29,107.
Under the proposed rule, the SEC would concur with a company's request to exclude a proposal only if the proposal “relate[d] to a personal grievance or special interest” by its terms. If a proposal were neutral, a company would still need to submit to the SEC staff its request to omit the proposal from its proxy statement, but the staff would automatically express “no view” instead of concurring or declining to concur with the request to exclude the proposal. The proposed change reflected the Commission’s “view that the Division’s ability to make the necessary factual findings is limited in the context of evaluating an otherwise ‘facially neutral’ proposal, and that companies and shareholders themselves possess much of the factual information relevant to the applicability of the ‘personal grievance’ exclusion.”

The SEC considered the proposed revision and ultimately determined not to adopt it. As a result of “serious concerns” expressed in comment letters, the Commission agreed that the proposed revision “might increase the likelihood of disputes between shareholders and companies,” and determined that it is preferable to make case-by-case decisions regarding whether a particular proposal merits exclusion from a proxy statement.

2. Exclusion of a Proposal with Little Economic Relevance to the Company’s Business

Rule 14a-8(c)(5) permitted a company to exclude a proposal if (1) it was not significantly related to the company’s business, and (2) the proposal related to operations that accounted for (a) less than 5% of the company’s total assets at the end of its most recent fiscal year, and (b) for less than 5% of the company’s net earnings and gross sales for its most recent fiscal year. Whether a proposal is deemed “significantly related” to the company’s business has required subjective determinations that have been difficult for the SEC staff to administer. Even with the addition of 5% standards in 1983, the subjective portion of the rule often has

66. Id.
67. 17 C.F.R. § 240.14a-8(c)(5).
68. Id.
precluded companies from omitting certain proposals.\textsuperscript{70} The SEC proposed to delete the requirement that a proposal not be "significantly related" to a company's business in order to render it excludable.\textsuperscript{71} What would remain would be a purely economic standard whereby a company could exclude a proposal if it related to services or products representing "$10 million or less in gross revenue or total cost[].\textsuperscript{72} An alternative test also was proposed that would produce a lower threshold for the benefit of smaller companies.\textsuperscript{73}

The SEC proposed four safeguards to prevent the omission of proposals that may be significant, notwithstanding an inability to meet the value test: (1) the exclusion would not be available if quantification was not practicable or the results would be unreliable; (2) availability of the lower threshold for smaller companies; (3) availability of the exclusion only where proposals related to "the purchase or sale of products and services;" and (4) availability of an "'override' mechanism."\textsuperscript{74}

The proposal did not receive much public support and the SEC chose not to adopt it.\textsuperscript{75} While commenters from the corporate community "agreed in concept" with the change, the consensus seemed to be that the proposed $10 million threshold was too low to make the exclusion


\textsuperscript{73} See id. at 50,686-87.

\textsuperscript{74} See id. at 50,687. A feature of the proposed rule was a mechanism for overriding a company's decision to exclude a shareholder proposal from its proxy statement. In order to invoke the mechanism, a shareholder would have been required to demonstrate that the holders of at least 3\% of the company's outstanding shares (which could include the proponent's own shares) agreed that the proposal should be included in the proxy statement. See id. at 50,690. The shareholder would be required to document that support. While under the present system a shareholder may bring suit against a company to prevent it from excluding the proposal from the proxy statement, the courts are not always in a position to make a timely determination of the issue. The override mechanism, therefore, had the potential to avert litigation that is costly and time consuming for both parties. The proposed changes were excluded from the final rule amendments, with the SEC citing opposition and/or concern expressed in the comment letters. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40,018, 63 Fed. Reg. 29,106, 29,113 (1998) (to be codified at 17 C.F.R. pt. 240). On the one hand, objections were raised that the "proposed 3\% threshold may be too low and lead to erosion of the 'ordinary business' and 'relevance' exclusions that would be subject to an override," and on the other hand "[s]ome shareholders thought . . . that 3\% support of a company's shareownership would be too difficult for a shareholder proponent to obtain." Id.

readily available to companies. Concerns expressed from the shareholder community included the potential difficulty to quantify the appropriate economic level with respect to a particular proposal, notwithstanding the safeguards.

3. Resubmission Thresholds

The SEC proposed to raise the thresholds for resubmitting a proposal that had been presented to shareholders for a vote but failed to pass. Rule 14a-8(c)(12) currently permits a company to omit a proposal if it has not received at least: (1) 3% of the vote on its first submission; (2) 6% of the vote on its second submission; and (3) 10% of the vote on its third submission. The revised rule would have permitted a company to omit a proposal that did not receive at least: (1) 6% of the vote on its first submission; (2) 15% of the vote on its second submission; and (3) 30% of the vote on its third submission.

One of the SEC's purposes in proposing the significantly higher thresholds was to address the concerns expressed by companies that they receive too many proposals that bear little relevance to their businesses. In addition, it was believed that the other proposed revisions would increase the number of shareholder proposals included in yearly proxy statements, so that the higher thresholds would serve as a counterbalance. Nevertheless, in response to concerns expressed by commenters from the shareholder community, the proposed revision was not adopted.

C. Shareholder Communications

1. Pre-1992

While the ability of shareholders to communicate with each other on matters of importance was enhanced by using the proxy statement to disseminate knowledge of issues of concern, the question ultimately became

76. See id.
77. See id.
79. See id.
81. See id.
82. See id.
whether the dissemination of proxy statements was a sufficient means of having an issue debated among shareholders. The problem arose because of the increasingly expanding application of what types of communications constituted a "solicitation" requiring the filing of a proxy statement with the SEC.

Specifically, when the Commission promulgated the proxy rules in 1935 to promote "fair corporate suffrage," application of the rules was limited to "solicitations" in connection with a request for a proxy or other consent to act from security holders. Over the years, however, the SEC expanded the definition of "solicitation" until in 1956 it applied to "any communication which could be viewed as being 'reasonably calculated' to influence a shareholder to give, deny or revoke a proxy." The probably unintended result was "potentially to turn almost every expression of opinion concerning a publicly traded corporation into a regulated proxy solicitation" requiring compliance with the proxy rules. For example, newspaper articles, public speeches, oral commentary via the media, and even private conversations among more than ten shareholders might invoke the proxy rules.

The determination of whether the rules applied depended on whether the communication was deemed to have been a solicitation. Because the evaluation of whether a solicitation had taken place occurred after the fact, those persons communicating with others or making statements could not know for certain at the time the communication was made whether there had been a "solicitation" requiring compliance with the proxy rules. If a solicitation was deemed to have been made, the ramifications was that proxy materials would have to be distributed to all those deemed to have been solicited. If the rules were invoked by a communication in the public media, all shareholders were deemed to have been solicited, forcing the communicator to deal with burdensome and costly compliance.

As a practical matter, however, if no materials were distributed at the

---

85. See id. at 83,356.
86. Id. at 83,355-56.
87. Id. at 83,356.
88. Id.
89. See id.
90. See id. at 83,358.
91. See id.
92. See id. at 83,356.
time the communication was made and the statements were later deemed to constitute a solicitation, then a violation of the law had occurred. The unfortunate result of this broadened definition of "solicitation" was to deter discussions by shareholders and other interested persons. Some institutional shareholders may have been in a position to launch a solicitation on their own, but even then the result was not a free flow of information.

2. Post-1992

Recognizing that more should be done to increase the ability of shareholders to communicate with each other, the SEC adopted new rules in 1992 to replace existing ones that "created unnecessary regulatory impediments to communication among shareholders and others and to the effective use of shareholder voting rights." Under the new rules, persons who qualify for the exemption may make announcements to the public or contact select shareholders to debate critical issues. The Commission's purpose in adopting these amendments is "to foster the free and unrestrained expression of views . . . by the removal of any regulatory cost, burden or uncertainty that could have the effect of deterring the free expression of views by disinterested shareholders who do not seek [proxy] authority for themselves."

The rule explicitly exempts from the proxy rules persons who: (1) are not seeking proxy authority, and (2) do not have a substantial interest in the matter, unless they fall within the categories of persons not entitled to claim the exemption. Solicitations "made by means of speeches in

93. See id.
94. See id. at 83,359.
95. Id. at 83,355. In adopting the shareholders' communications amendments to the proxy rules, the SEC intended to: (1) "eliminate unnecessary regulatory obstacles to the exchange of views and opinions by shareholders and others concerning management performance and initiatives presented for a vote of shareholders"; (2) "lower the regulatory costs of conducting a regulated solicitation by management, shareholders and others by minimizing regulatory costs related to the dissemination of solicitation materials"; and (3) "remove unnecessary limitations on shareholders' use of their voting rights, and improve disclosure to shareholders in the context of a solicitation as well as in the reporting of voting results." Id. at 83,353.
96. Id. at 83,359.
98. See id. § 240.14a-2(b). Persons who may not rely on the exemption are: (i) [the registrant or an affiliate or associate of the registrant (other than an officer or director or any person serving in a similar capacity); (ii) [an officer or director of the registrant or any person serving in a similar capacity engaging in a solicitation financed . . . by the registrant; (iii) [an officer, director, affiliate or as-
public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media, newspaper, magazine or other bona fide publication disseminated on a regular basis” do not require that the person making the communication disseminate proxy material to all solicited persons. This exemption is conditioned on (1) no form of proxy, consent or authorization being provided to a security holder in connection with the communication, and (2) there being on file with the SEC a definitive proxy statement. A Notice of Exempt Solicitation must be filed with the SEC by certain persons, though excluded from the notice requirement are oral solicitations (unless scripts are used), “speeches delivered in a public forum, press releases, published or broadcast opinions, statements, and advertisements appearing in a broadcast media, or a newspaper, magazine or other bona fide publication disseminated on a regular basis.”

99. Id. § 240.14a-3(f).
100. Id. § 240.14a-3(f)(1).
101. See id. § 240.14a-3(f)(2).
102. See id. § 240.14a-6(g)(1)(ii). Persons beneficially owning more than $5 million (market value) of the securities for which a solicitation is made must file with the SEC a Notice of Exempt Solicitation and copies of the written solicitations delivered to shareholders. See id. The Commission deemed this notice to be “the simplest means to get written soliciting material into the public domain.” Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051, at 83,361 (Oct. 16, 1992).
103. 17 C.F.R. § 240.14a-6(g)(2).
A safe harbor has been provided for shareholder announcements of voting decisions by excluding from the definition of "solicitation" statements of how a security holder intends to vote. Additionally, in connection with a proxy solicitation and on request of a shareholder, a company either must provide a shareholder list to the requesting shareholder, or mail the shareholder's soliciting materials to all shareholders.

IV. SUGGESTIONS FOR CHANGE

The SEC staff has, on many occasions, expressed an interest in refraining from the line-drawing inherent in evaluating whether a shareholder proposal is excludable under the SEC's rules. The author suggests that, with appropriate regulatory guidance during the critical period prior to an annual or special meeting, the SEC may succeed in doing what it has not been able to achieve before. Specifically, by providing a mechanism to foster communications either on an on-going basis or at least when concern about an issue first arises, the parties may be able to agree on how to address the problem in a nonconfrontational forum. Alternatively, should the matter be one that is appropriate for a vote by the entire shareholder body, the parties may be able to craft the proposal after productive discussions with mutual input. Either way, the SEC staff is virtually removed from the process, at least from the perspective of no-action requests. Following are some suggestions as to how those ideals might be achieved.

A common foundation for all of the suggestions, as one might expect, is healthy communication. Nevertheless, the timing of that communication is the key to avoiding conflict. Communications should be on-going and productive, with each company setting up a mechanism to solicit input from shareholders and thereby create a friendly environment. Likewise, from the shareholders' perspective, communications must never

104. See id. § 240.14a-1(l)(2)(iv). In order to qualify for the safe harbor, the communication must be (1) "made by means of speeches in public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media, or newspaper, magazine or other bona fide publication disseminated on a regular basis," (2) "directed to persons to whom the security holder owes a fiduciary duty in connection with the voting of securities of a registrant held by the security holder," or (3) "made in response to unsolicited requests for additional information with respect to a prior communication by the security holder made pursuant to [the safe harbor provision.]” Id. § 240.14a-1(l)(2)(iv)(A)-(C).

105. See id. § 240.14a-7 (explaining that the company has the option of electing either to provide a list or mail the materials; in the case of a roll-up transaction or if a proposal is subject to Rule 13e-3, however, the requesting shareholder selects between the alternatives).
Proactive Corporate-Shareholder Relations begin with the shareholder proposal process or by making demands of management using a shareholder proposal as the punishment for failing to accede to a shareholder's demands. Rather, communications should be used to facilitate dialogue among the parties and thereby enhance the company's position in its community of shareholders. After all, a company chooses to be public and accordingly accepts with that status the obligation to recognize the ownership interests of its shareholders and the rights those interests convey on an on-going basis, not just once a year.

By the same token, when an issue is appropriate for consideration by the shareholder body as a whole, the shareholder proposal should be seen for what it is—an efficient method of disseminating important information to the shareholder body in connection with the solicitation of a proxy. When shareholders use the threat of a shareholder proposal to try to gain leverage, or when management rushes to exclude a shareholder proposal as a first course of action, both parties act in bad faith and miss the point of the proposal process. For better or for worse, shareholders and management are parties to a marriage in a jurisdiction that does not permit divorce. It is time to take advantage of the partnership and channel resources toward the common benefit of the company and its stakeholders.

A. Corporate Department of Shareholder Relations

Companies often designate a person or department to "guard the door" from the nuisance of shareholder inquiries. That function is often served by the Legal Department, whose members instinctively protect their client, generally have no special training in public relations, and may not be the best representatives of a company to discuss business policy with shareholders or members of the public. At the same time, the prospect of visiting the company's lawyer hardly fosters an environment for a comfortable chat from a shareholder's perspective, whether institutional or individual. Some companies channel initial shareholder communications to the corporate secretary's office, which, like the Legal Department, has an identifiable regulatory function when it comes to shareholder relations and is not necessarily the ideal first contact for a shareholder seeking information.

Some companies, particularly those providing consumer goods, have a consumer relations department or even a shareholder relations group, which can be an excellent forum for an initial inquiry into an aspect of company business that interests the shareholder. From the other perspective, many institutional investors have internal procedures for initi-
ating dialogue with the companies they own, and often succeed in managing the relationship so as to achieve results without breeding conflict. Unfortunately, however, there are no regulatory standards to guide companies as to what is expected of them with respect to shareholder relations. The principal regulatory provisions that do apply to a company’s relationship with its shareholders address disclosure issues and the shareholder proposal process, neither of which invites a two-way dialogue.

Standards designed to create a forum for the acquisition of information could provide shareholders with a primary source of information directly from the company they own, as well as a means of requesting more formal communications with management. As an initial approach such an organization could ultimately dissuade more adversarial contacts. The SEC staff has stated informally that there is little the SEC can do to direct how communications are carried on outside of the proxy rules; it appears, however, that there is a great deal the SEC could do.

Specifically, a useful development would be to standardize, to a certain degree, the level of corporate communications resources available to shareholders. This standardization could be accomplished by requiring, either by regulation or interpretive pronouncement, that companies devise procedures for enabling shareholders to express their concerns to management. Companies should also be encouraged, though they would not be mandated, to go beyond reactive communications by proactively seeking out shareholder feedback.

By undertaking rulemaking or an interpretive pronouncement, the SEC would fill a void that currently exists in the area of corporate-shareholder relations. There are rules mandating that companies make certain disclosures available for public review, but the disclosures are in writing and do not, by their nature, foster two-way communication. Likewise, there are rules governing the shareholder proposal process, whereby shareholders submit a voting item to be read by other shareholders, management issues a written statement expressing its views on the matter, and still no one talks.

In connection with a rulemaking or interpretive initiative, the SEC could provide examples of how effective communications might be achieved. For example, companies could avail themselves of the extensive options available in the electronic medium to reach out to their shareholder constituencies. A corporate Web-site could link to a mailbox monitored by personnel trained to respond to shareholder issues. A company might establish e-mail links to shareholders to which regular communications are sent. In short, the goal would be to establish more regularized interactive contact for all companies for the purpose of
building a rapport among the parties. This would provide shareholders with important information about matters taking place within their company, and would give shareholders the opportunity to provide feedback when such activities are taking place.

While setting up such a procedure would involve substantial effort on the part of companies, the resulting quality of the company's relationship with its shareholders would make the effort worthwhile. *This should not be read to suggest that companies should invite shareholders to participate in the day-to-day management of the company, but rather the goal would be to keep shareholders apprised of activities in a manner calculated to foster an atmosphere of mutual trust.*

Such regular communications would encourage greater cooperation when important issues arise with respect to which the shareholder wants to provide input. Companies should be encouraged to "partner" with their shareholders to create mutually acceptable solutions in the same way corporate America joins hands with government and self-regulatory organizations in an effort to produce legislation and regulation that reflects the needs of the corporate community. Just as companies attempt to avoid unworkable regulatory surprises by taking an active role in formulating government initiatives, companies can conceivably avoid what unfortunately is viewed as the dreaded proxy season spate of shareholder initiatives by working with shareholders throughout the year to address concerns on an ongoing basis. Certain issues may not be appropriately addressed solely by corporate outreach—for example, by questionnaires soliciting shareholders' views on a particular issue for management consideration—but rather merit a vote by the entire shareholder body. Management's ongoing partnership with shareholders should help the company avoid unpleasant surprises, and likewise may help encourage less resistance to shareholder access to the proxy statement. Instead of the new year ringing in increased tension as the company braces for proxy season, the company, as an active partner with shareholders, could help give direction to the proxy statement's contents with respect to shareholder proposals, or at least have a better understanding of the issues being proposed so as to avoid a confrontation.

**B. SEC Office of Corporate-Shareholder Relations**

Taking a cue from the success of the SEC's Office of Investor Education and Assistance, the SEC should consider forming an independent Office of Corporate-Shareholder Relations or Office of Corporate Governance. Together with SEC pronouncements on expectations with respect to setting up procedures to encourage regular shareholder commu-
communications and outreach programs, the role of the Office would be to assist institution-building in a way that could have a lasting, positive influence on corporate-shareholder relations.

The Office could serve as a clearinghouse for information on the types of programs that have proven successful in developing a healthy rapport with shareholders. The Director of the Office could establish outreach and training sessions designed to encourage companies to evaluate their effectiveness in communicating with shareholders. Partnering programs could be developed whereby companies further along in the process would be willing to serve as “mentors” to help other companies implement their programs, thus extending the Office’s resources.

Associations and organizations tend to serve either companies or shareholders, thus having the unintended (and unfortunate) consequence of fostering the polarization of the partners and fomenting mistrust and contention in their dealings. In contrast, programs that the office could establish would have the potential to become popular fora for the exchange of ideas that will help enhance the regularization of corporate-shareholder communications and provide an opportunity for nonadversarial contact between the corporate and shareholder communities.

V. A Goal for the Future

The SEC is at a crossroads in corporate-shareholder relations. Having just reversed the interpretation originally announced in the Cracker Barrel no-action letter, the SEC must take affirmative steps to make certain that the environment that induced the SEC to issue the Cracker Barrel position does not recur.

SEC Chairman Arthur Levitt has called on American business to practice “responsive corporate governance.” He emphasizes the importance of full and fair disclosure, and the responsibilities of board members as fiduciaries acting on behalf of the company’s shareholders. But if history provides any lessons, we must know that an improvement in the sometimes strained relations between management and shareholders, unless coaxed, will take too long to make a meaningful difference anytime soon.

Accordingly, the SEC should act immediately by charting a course different from the one that has engendered so much debate over the past

106. See supra Section III.A.2.
108. See id. at 2-3.
twenty-five years but has not settled the issues. Specifically, the SEC should step back from its focus on the shareholder proposal process. Instead, it should encourage companies to assign shareholder relations functions to a dedicated group of employees, and adopt procedures that foster outreach and a free flow of information between companies and their shareholders. In an effort to help achieve these goals, the SEC should establish an Office of Corporate-Shareholder Relations to popularize the notion that effective communication is a strategy that produces winners in all camps.