ROLL OUT THE BARREL: THE SEC REVERSES ITS STANCE ON EMPLOYMENT-RELATED SHAREHOLDER PROPOSALS UNDER RULE 14a-8 — AGAIN

I. INTRODUCTION

Recent headlines have shouted the news of multi-million dollar verdicts against large corporations and huge settlement agreements. Texaco, facing adverse publicity as a result of ninety-four discrimination claims, settled those claims for $172 million. Mitsubishi settled a sexual harassment suit filed by the Equal Employment Opportunity Commission (EEOC) for $34 million. Shoney's, Inc. a family restaurant chain, faced a $530 million racial discrimination lawsuit. Shoney's settled for $134.5 million and saw its earnings drop dramatically: "the company posted a $26.6 million loss [in 1992]." Moreover, "in 1996 The Wall Street Journal reported that Shoney's had spent more than $194 million on minority organizations and salaries to repair its image after the lawsuit." In February 1997, Publix Supermarkets settled a sex discrimination claim for $81.5 million. More recently, in November 1997, Home Depot had to pay out more than $104 million to settle sex discrimination claims against its West Coast locations. Consequently, the "November 1997 settlement reduced . . . Home Depot's fourth quarter earnings by 25 percent."

Against this backdrop of costly employment-related litigation and the subsequent reduction in corporate earnings, another development has
been emerging. Shareholdings, by "institutional investors,"10 have significantly increased from 23% in 1955 to 53.3% in 1990.11 This increased concentration of institutional shareholdings in publicly held corporations12 "has set the stage for a dramatic increase in the shareholder role in the modern publicly held corporation."13 As the sophistication of the shareholder increases, "the costs [associated with] playing the shareholder role decreases."14 This increased ownership, combined with increased emphasis on the fiduciary duties of institutional investors to vote their shares,15 has resulted in an increased reliance on the federal proxy process.16

These institutional shareholders react strongly to news of exorbitant employment discrimination settlements, like the one offered by Home Depot,17 and its accompanying drop in earnings.18 Institutional shareholders have pushed companies to include employment-related proposals with their proxy solicitations.19 Following the Home Depot settlement, institutional investors, representing $35 million in Home Depot stock, sponsored a shareholder resolution requesting that the company adhere to higher standards of accountability on diversity issues.20 Shareholders cite social policy and "shareholder value" concerns to support including their resolutions in the proxy solicitation.21 Management, on the other hand, has traditionally sought to exclude employment-related proposals from the proxy

10Alan L. Dye & Gregory W. Hair, Preparing for the Annual Meeting and Shareholder Activism, SB09 ALI-ABA 349 (1996) (defining "institutional investors" as generally including "banks and trust companies, insurance companies, investment companies (i.e., mutual funds), investment advisers, private pension funds, state and local pension funds, academic endowments, charitable foundations or other miscellaneous institutions.").
11See id. at 384.
12See William L. Cary & Melvin Aron Eisenberg, Corporations: Cases and Materials 244 (David L. Shapiro et al. eds., 7th ed. 1997) (reporting that "in 1994, . . . 56% of the shares of the 1,000 largest American corporations were held by institutions").
13Id. at 245.
14See id.
15See Dye & Hair, supra note 10, at 353.
16See id. at 354.
17See Business Wire, supra note 9, at 61.
19See Whitman, supra note 2, at 82.
20See Business Wire, supra note 9, at 1. See also infra Part III (discussing how ultimately the Home Depot voluntarily placed the proposal on its 1998 proxy ballot).
21See Whitman, supra note 2, at 89; see also infra Part II (discussing proxy voting).
material as falling under the "ordinary business operations exception" to Rule 14a-8.23

"One of the most frequently applied, and controversial exceptions under Rule 14a-8 is the exception for proposals that relate to 'ordinary business' matters."24 An intense interplay exists between a company's desire to reserve the management of the business to itself, and a shareholder's desire to have a voice in protecting the value of its investments.25 The Securities and Exchange Commission's (SEC) "checkered" interpretation of the ordinary business operations exception has not relieved this tension. Through 1992, before the SEC staff issued its Cracker Barrel no-action letter, a shareholder of Shoney's, Home Depot, or any other publicly held company subject to the federal proxy rules could place employment-related proposals in his company's proxy materials.27 Such a proposal, although related to employment issues, would have been sufficiently tied to a significant social issue and thus would not fit under the exclusion under Rule 14a-8(i)(7).28 In 1993, however, the SEC reversed itself and adopted a "bright-line test," which effectively excluded all shareholder proposals that raised employment-related issues, regardless of whether they were "tied to a social issue."29 The SEC announced its interpretive reversal in its no-action letter to Cracker Barrel Old Country Store, Inc.,30 when it responded to Cracker Barrel's request to exclude a shareholder proposal that called for the prohibition of discrimination on the basis of sexual orientation.31 In 1998, the SEC reversed itself again, continuing its trend of inconsistency in interpreting the ordinary business operations exception under 14a-8(i)(7).32

2317 C.F.R. § 240.14a-8(i)(7) (1998 & Supp. 1999). Note that Rule 14a-8(i)(7) had been referred to as Rule 14a-8(e)(7) prior to the 1998 amendments to the rule. Any further reference to the "ordinary business operations" exception will be referred to by its new designation 14a-8(i)(7).
24CARY & EISENBERG, supra note 12, at 363.
25See infra Part II (discussing proxy voting as a means for shareholder decision making).
27See Wallman, supra note 7.
28See id.
30See id.
31See id. at 77,285.
32See 1998 Amendments, supra note 1, at 29,106.
Reversal of the SEC's Cracker Barrel standard under Rule 14a-8(i)(7) does not resolve the tension between the conflicting expectations of management and shareholders. Nor does it provide a meaningful, objective standard by which both shareholders and management can assess whether a shareholder proposal can be properly excluded from a company's proxy materials.

It is difficult to predict the ultimate impact of the SEC's recent reversal. The return to the "pre-Cracker Barrel" standard may result in more employment-related resolutions being proposed in upcoming proxy seasons.33 Alternatively, its impact may be lessened by a growing trend of voluntary communication between shareholders and management on socially important issues.34

Part II of this note traces the evolution of the ordinary business operations exception under Rule 14a-8(i)(7), particularly as it relates to employment-related shareholder proposals. Part III addresses the shortcomings of the SEC's recent interpretive change in position regarding Rule 14a-8(c)(7), and anticipates the impact of the reversal on forthcoming proxy seasons.

II. THE EVOLUTION OF THE "ORDINARY BUSINESS OPERATIONS" EXCLUSION

A. Rule 14a-8

"Proxy voting is the dominant mode of shareholder decision making in publicly held corporations."35 Proxies are an integral part "of corporate governance because the '[r]ealities of modern corporate life have all but gutted the myth that the shareholders in large publicly held companies personally attend annual meetings."36 Proxy solicitation evolved from shareholders' preference to vote by proxy.37 The proxy solicitation process went largely unregulated by state law through the 1930s, and abuses were

33See id. at 29,108.
34See infra Part III (explaining how shareholder proposals on social issues are the investors means of expressing their views to management).
35CARY & EISENBERG, supra note 12, at 330.
37See CARY & EISENBERG, supra note 12, at 330 (discussing reasons why proxy voting became popular).

Section 14a authorizes the SEC to promulgate rules to regulate corporate proxy solicitation. The SEC is empowered to prescribe rules and regulations, "as necessary or appropriate in the public interest or for the protection of investors." Congress's intent was to address the abuses in the proxy solicitation process by promoting "[f]air corporate suffrage" and "by fostering disclosure and corporate democracy." Access to management proxy solicitations to sound out management views and to communicate with other shareholders on matters of major import is a right informational in character, [that is] properly derived from section 14(a) and appropriately enforced by private right of action.

The original shareholder proposal rule was promulgated in 1942 and subsequently amended many times. Rule 14a-8 provides a means by which shareholders can get their own proposals included in the proxy solicitation, at their company's expense. As originally enacted, Rule 14a-8 mandated that "management . . . include in its proxy material any shareholder proposal that was 'a proper subject for action by security holders." Proper subject" is tied to state law, presently management may exclude a shareholder proposal if it "is not a proper subject for action

---

38 See id. at 331.
40 See Cary & Eisenberg, supra note 12, at 331.
45 See Waite, supra note 43, at 1260 (noting that "[t]he shareholder proposal rule was originally enacted as Rule 14a-7"). Id. at 1260 n.47. See also Lazaroff, supra note 18, at 40 (observing that the SEC has significantly amended "Rule 14a-8 in 1948, 1952, 1954, 1972, 1976, 1983, and 1984").
46 17 C.F.R. § 240.14a-8 (1999); see also Solomon & Palmer, supra note 26, at 289 (discussing "the company-financed proxy machinery").
49 See id. at 1260-61.
by shareholders under the laws of the jurisdiction of the company's organization.\textsuperscript{50}

Rule 14a-8 now includes thirteen exceptions that management can rely on to exclude a shareholder proposal from its proxy materials.\textsuperscript{51} The

\textsuperscript{50}17 C.F.R. § 240.14a-8(i)(1) (1999). The SEC amended Rule 14a-8 to conform with its "question and answer format." See 1998 Amendments, supra note 1. The SEC indicated that "the reference to 'the state of the company's incorporation may appear narrower than the actual scope of the rule because some entities that may be subject to the rule, such as partnerships, are not incorporated." Id. at 29,107 (quoting ABA Letter, ICCR Letter; Investment Co. Inst., Dec. 30, 1997). "The laws of the jurisdiction of the company's organization" replaces "the state of the company's incorporation." Id.

\textsuperscript{51}17 C.F.R. § 240.14a-8 (1999) provides, in question and answer format, that:

(i) \textit{Question:} If I have complied with the procedural requirements, on what other bases may a company rely to exclude my proposal?

(1) \textit{Improper under state law:} If the proposal is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization;

(2) \textit{Violation of law:} If the proposal would, if implemented, cause the company to violate any state, federal, or foreign law to which it is subject;

(3) \textit{Violation of proxy rules:} If the proposal or supporting statement is contrary to any of the Commission's proxy rules, including §240.14a-9, which prohibits materially false or misleading statements in proxy soliciting materials;

(4) \textit{Personal grievance; special interest:} If the proposal relates to the redress of a personal claim or grievance against the company or any other person, or if it is designed to result in a benefit to you, or to further a personal interest, which is not shared by the other shareholders at large;

(5) \textit{Relevance:} If the proposal relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business;

(6) \textit{Absence of power/authority:} If the company would lack the power or authority to implement the proposal;

(7) \textit{Management functions:} If the proposal deals with a matter relating to the company's ordinary business operations;

(8) \textit{Relates to election:} If the proposal relates to an election for membership on the company's board of directors or analogous governing body;

(9) \textit{Conflicts with the company's proposal:} If the proposal directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting;

(10) \textit{Substantially implemented:} If the company has already substantially implemented the proposal;

(11) \textit{Duplication:} If the proposal substantially duplicates another proposal previously submitted to the company by another proponent that will be included in the company's proxy materials for the same meeting;

(12) \textit{Resubmissions:} If the proposal deals with substantially the same subject matter as another proposal or proposals that has or have been previously included in the company's proxy materials within the preceding 5 calendar years, a company may exclude it from its proxy materials for any meeting held within 3 calendar years of the last time it was included if the proposal received:

(i) Less than 3% of the vote if proposed once within the preceding 5
SEC created the exclusions to maintain the integrity of the proxy process by: "(1) . . . preserve[ing] the state law scheme of centralized corporate [management] decision-making . . . ; (2) . . . protect[ing] the proxy solicitation process from proposals that would interfere with management's usual solicitation efforts; [and] (3) . . . filter[ing] out illegal, deceptive and crackpot proposals."

B. The No-Action Process

If management wishes to exclude a proposal from the corporation's proxy materials, it has the burden of demonstrating a basis among the Rule's exceptions for excluding the proposal. Rule 14a-8(j) requires that management submit to the SEC staff six copies of the proposal, any supporting statements of counsel, and management's justification for leaving the proposal out of its proxy solicitation. If the SEC staff finds management's proffered reasons for exclusion inadequate, the SEC staff sends a letter to management indicating why the proposal should be included

calendar years;

(ii) Less than 6% of the vote on its last submission to shareholders if proposed twice previously within the preceding 5 calendar years; or

(iii) Less than 10% of the vote on its last submission to shareholders if proposed three times or more previously within the preceding 5 calendar years; and

(13) Specific amount of dividends: If the proposal relates to specific amounts of cash or stock dividends.

Id. (emphasis added).

This note focuses on the "ordinary business operations" exception, 14a-8(i)(7).

53SOLOMON & PALMITER, supra note 26, at 290; see also Alan R. Palminter, The Shareholder Proposal Rules: A Failed Experiment in Merit Regulation, 45 ALA. L. REV. 879, 889 (1996) (discussing the "anticrackpot conditions").

54See 17 C.F.R. § 240.14a-8(g) (1999). Rule 14a-8(g) reads: "(g) Question 7: Who has the burden of persuading the . . . [SEC] or its staff that my proposal can be excluded? Except as otherwise noted, the burden is on the company to demonstrate that it is entitled to exclude a proposal." Id. (emphasis added).

5517 C.F.R. § 240.14a-8(j) (1999). Rule 14a-8(j)(1) imposes a time requirement on a company wishing to exclude a shareholder proposal from its proxy solicitation: "[the company] must file its reasons with the . . . [SEC]." Rule 14a-8(j)(2) indicates that in addition to providing the copies of the proposal and reasons for exclusion to the SEC, the company should cite the most recent no-action letters issued by the SEC or other recent authority to support its grounds for exclusion. Id. The company also must send the proponents of the proposal a copy of the proxy materials filed with the SEC. Id.
with the proxy materials.\textsuperscript{55} If management thereafter continues to exclude the proposal, the proponent of the proposal can request a determination under Rule 14a-8 that the company is violating the proxy rules.\textsuperscript{56} The proponent of the proposal can seek to "enjoin management's solicitation as a violation of the proxy rules" and prevent the materials from being distributed without the proposal.\textsuperscript{57} Alternatively, the proponent of the proposal can attempt to force management to include the proposal by filing suit in federal court.\textsuperscript{58}

If the SEC staff finds that management has stated a legitimate basis for exclusion under one of Rule 14a-8's exceptions, the SEC will send management a "no-action" letter.\textsuperscript{59} Critics assert that the no-action letter process "has created a body of SEC 'common law'\textsuperscript{60} on the meaning of Rule


\textsuperscript{56}See SOLOMON & PALMITER, supra note 26, at 292.

\textsuperscript{57}See id.

\textsuperscript{58}1997 Proposed Amendments, supra note 55, at 50,682; see also Roosevelt v. E.I. du Pont de Nemours & Co., 958 F.2d 416, 421 (D.C. Cir. 1992) (noting that denial of "access to management proxy solicitations ... [are] appropriately enforced by private right of action").

\textsuperscript{59}See SOLOMON & PALMITER, supra note 26, at 290. An SEC "no-action" letter informs management that if a particular shareholder proposal is omitted from the proxy materials, the staff will not recommend that enforcement action be taken by the SEC. 17 C.F.R. § 240-14a-8(j) (1999). Robert Whitman, Including Employment Practice Data in Proxy Statements, N.Y. L.J. 1, at col. 1 (Nov. 6, 1997) (noting that "[w]hile no-action letters are not [legally] binding, they are effectively a license for a corporation to [omit shareholder proposals] without fear of enforcement action. In the 1997 Proxy Season 10 no-action letters involving [Rule 14a-8][i](7) were appealed to the ... [SEC], six were effectively affirmed and four were withdrawn prior to a decision"); see also Donna M. Nagy, Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework, 83 CORNELL L. REV. 921, 938 (1998) (discussing "pure no-action and interpretive letters").

\textsuperscript{60}See SOLOMON & PALMITER, supra note 26, at 290; see also 4 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2012 (3d ed. 1990) (stating that the SEC "has been building a 'common law' of its own as to what constitutes a 'proper subject' for shareholder action" when state law is silent); see also Waite, supra note 43, at 1261 (discussing how the SEC staff has developed its own common law).

While the SEC claimed to be relying on state law in determining what was a proper subject for shareholder action, the SEC more accurately appeared to be deciding what the state law was and influencing state courts in deciding the rare case that arose regarding what was a proper subject for shareholder action.

\textit{Id.} (citations omitted). See also Palmiter, supra note 52, at 881 n.9 ("In general, courts accede to the agency's no action positions.").
14a-8, which has not been entirely consistent.\textsuperscript{61} One area noteworthy of inconsistency is the ordinary business operations exception, set forth in Rule 14a-8(i)(7), particularly as it applies to employment-related shareholder proposals.

C. Rule 14a-8(i)(7): The Ordinary Business Operations Exception

1. Early History

The ordinary business operations exception was originally adopted in 1953.\textsuperscript{62} "As originally enacted, the exception provided that management could 'omit from its proxy material a proposal which is a recommendation or request with respect to the conduct of the ordinary business operations of the issuer.'\textsuperscript{63} The mission of the exclusion was simple: "to relieve the management of the necessity of including in its proxy material security holder proposals which relate to matters falling within the province of the management."\textsuperscript{64} Most state laws reserve "the conduct of ordinary business operations to corporate directors and officers rather than the shareholders."\textsuperscript{65} Consequently, shareholder proposals relating to "ordinary business operations," especially if framed in mandatory language,\textsuperscript{66} cannot be properly raised.\textsuperscript{67} The SEC wanted to "save management the cost and burden of including a proposal in proxy material that would be improper if raised by a shareholder at the annual meeting."\textsuperscript{68}

The SEC's original mission in adopting Rule 14a-8(i)(7) was revisited as more shareholders proposed resolutions that included social

\textsuperscript{61}See Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 885 (S.D.N.Y. 1993); see also CARY & EISENBERG, supra note 12, at 363 (noting the SEC's inconsistent application of Rule 14a-8); see also infra notes 116-19 and accompanying text (discussing the SEC's inconsistent applications of Rule 14a-8(c)(5)).

\textsuperscript{62}See 1997 Proposed Amendments, supra note 55, at 50,688.

\textsuperscript{63}Waite, supra note 43, at 1262 (citation omitted).

\textsuperscript{64}1997 Proposed Amendments, supra note 55, at 50,688 (citation omitted).

\textsuperscript{65}See Wal-Mart, 821 F. Supp. at 882-83; see also DEL. CODE ANN. tit. 8, § 141(a) (1991) ("The business of every corporation shall be managed by a board of directors.").

\textsuperscript{66}See Waite, supra note 43, at 1262.

\textsuperscript{67}See Wal-Mart, 821 F. Supp. at 882-83.

\textsuperscript{68}Id. at 883. See also Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 679 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972) (explaining that "management cannot exercise its specialized talents effectively if corporate investors assert the power to dictate the minutiae of daily business decisions").
policy issues in the 1960s. The ordinary business operations exception had frequently been used to omit from proxy materials proposals that were significant to "both the issuer and the security holder", consequently, the SEC reasoned that the ordinary business operations exception was not promoting an appropriate amount of "shareholder democracy" on policy (as opposed to operational) matters. The SEC's chief criticism of the exclusion was that "[a]s drafted, the rule provided no guidance on how to analyze [shareholder] proposals relating simultaneously to both an 'ordinary business matter' and a 'significant policy issue.' In 1976, an effort to design better language differentiating "'mundane' business matters [from] 'important' ones, the SEC proposed a change to the ordinary business operations exception.

2. The 1976 Interpretive Release Standard

The SEC proposed two alternative modifications of the ordinary business operations exception in 1976. The SEC withdrew both proposals after many of the comments opined that the proposed changes might create "interpretive difficulties" and would thus be unworkable. After the formal

---

69See 1997 Proposed Amendments, supra note 55, at 50,688.
70Waite, supra note 43, at 1262.
72See Waite, supra note 43, at 1262.
731979 Proposed Rules, supra note 55, at 50,688.
75See id. (citing 1976 Release, supra note 71, at 52,997-98).
76See 1976 Release, supra note 71, at 52,998; see also Waite, supra note 43, at 1262-63 (discussing the alternative proposals).
77See Waite, supra note 43, at 1263. The language of the ordinary business operations exception "[a]s originally enacted ... provided that management could 'omit from its proxy material a proposal which is a recommendation or request with respect to the conduct of the ordinary business operations of the issuer.' Id. at 1262 (quoting Adoption of Amendments to Proxy Rules, Exchange Act Release No. 4979 [1935-1956 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 72,247 (Jan. 6, 1954)). The first 1976 proposed modification would have changed that language to permit omission only if it "deal[t] with a 'routine, day-to-day matter relating to the conduct of the ordinary business operations of the issuer.' Id. at 1262-63 (quoting Exchange Release Act No. 12,598 [1976-77 Transfer Binder], 41 Fed. Reg. 29,982 (1976) (to be codified at 17 C.F.R. pt. 140) (July 7, 1976). The second 1976 proposed modification would have permitted management to exclude a proposal if it "deal[t] with a matter that the governing body of the issuer (such as the Board of Directors) is not required to act upon pursuant to the applicable State law or issuer's governing
notice and comment period was concluded, the SEC decided upon a modified version of the then-existing ordinary business operations exception.\textsuperscript{77} The standard already in effect was deemed "a [more] workable one if it [was] interpreted in a somewhat more flexible manner than in the past."\textsuperscript{79} Therefore, the language of the ordinary business operations exception was not significantly changed, and the SEC explained that the amended rule was meant to signal an "interpretive adjustment" in its position.\textsuperscript{80}

The 1976 Release, in essence, signaled that the SEC would interpret Rule 14a-8(i)(7) to mean "that corporations could not exclude proposals regarding matters which have significant policy, economic or other implications inherent in them."\textsuperscript{81} As a result, "[t]he ordinary business operations exception has been construed ... as a two-part test."\textsuperscript{82} "[W]here proposals [1] involve business matters that are mundane in nature and [2] do not involve any substantial policy or other considerations, the subparagraph may be relied upon to omit them."\textsuperscript{83}

The two-part test, however, still led to interpretive difficulties. Defining what constitutes a "substantial policy issue" within the ordinary business operations exception is subjective and difficult.\textsuperscript{84} Despite the SEC's efforts to define "substantial policy issue" through the no-action letter process,\textsuperscript{85} the SEC staff's treatment of employment-related shareholder proposals over time exemplifies the problem. The two-part test remained the framework by which the SEC staff evaluated employment-related shareholder proposals until 1992.\textsuperscript{86} In a series of instruments (such as the Charter or By-Laws)."\textsuperscript{87} Id. at 1263 (quoting 41 Fed. Reg. at 29,985).

\textsuperscript{77} See id. at 1263-64; see also 1976 Release, supra note 71, at 52,998 (adopting a version with a more flexible interpretation).

\textsuperscript{79} 1976 Release, supra note 71, at 52,998.


\textsuperscript{83} New York City Employees' Retirement Sys., 45 F.3d at 13 (holding that the SEC's departure from its 1976 Interprettative Release was not formal rulemaking and thus not subject to the Administrative Procedures Act); see also Abbott A. Leban & Jennifer Heller, Second Circuit Rules in Favor of SEC in Cracker Barrel, 9 INSIGHTS 29 (1995) (noting that the 1976 Release stated that Rule 14a-8(c)(7) could not be relied upon to exclude proposals of social importance such as equal employment opportunity (EEO) and affirmative action policies").

\textsuperscript{85} Waite, supra note 43, at 1255 (citing 1976 Release, supra note 71).

\textsuperscript{87} 1976 Release, supra note 71, at 52,998.

\textsuperscript{89} See Waite, supra note 43, at 1256.

\textsuperscript{83} See id.

\textsuperscript{90} See CARY & EISENBERG, supra note 12, at 364.
of no-action letters issued before 1983, the SEC staff determined that "[shareholder] proposals requesting reports on EEO [Equal Employment Opportunity] data and policies could not be excluded because the determination whether a report should be issued was a matter of policy rather than ordinary business operations."\(^8\) In 1983, however, the SEC refined its interpretation of the language of Rule 14a-8(i)(7)\(^8\) and decided that "the subject of the report requested, rather than the fact that the information requested was in the form of a report," would govern whether the proposal could be excluded.\(^9\) Since its 1983 refinement, the SEC has applied the two-part test to employment proposals as follows: First, the SEC staff "examin[es] whether the proposals relate to 'day-to-day' employment matters and, therefore, are excludable as relating to 'ordinary business operations.'\(^6\) Second, the SEC looks at whether the proposals relate to significant policy considerations; if so, they are not excludable.\(^1\) Through the no-action letter process, the SEC defined "day-to-day employment matters ... as including ... employee health benefits, general compensation issues not focused on senior executives, management of the workplace, employee supervision, labor-management relations, employee hiring and firing, conditions of employment and employee training and motivation."\(^9\)

Although employee hiring and firing was generally held to be a "day-to-day employment matter,"\(^9\) the SEC recognized through 1991 that equal employment opportunity and affirmative action proposals raise substantial policy considerations that take them out of the realm of "the excludable day to day issues."\(^9\) The SEC then changed its view of employment-related proposals when, by a 3-2 vote, it reversed its stance

---


\(^9\)See id.


\(^1\)See id. at 886-87.

\(^9\)Id. at 887.

\(^9\)See id.
outlined in the *Capital Cities/ABC letter.* The reversal appeared to be tied to the proposal's request for detailed timetables concerning the company's affirmative action plans. In October 1992, the SEC's reversal of its position on including EEO and affirmative action proposals in proxy materials appeared to be complete.

3. The Cracker Barrel No-Action Letter

The New York City Employees' Retirement System (NYCERS), an institutional investor in Cracker Barrel Old Country Stores, Inc. (Cracker Barrel), wanted a proposal that required the company to forbid sexual orientation discrimination to be included in the 1992 proxy material. NYCERS was reacting to Cracker Barrel's openly antigay employment policies. Cracker Barrel wrote a letter to the SEC's Corporate Finance Division (Division) inquiring whether the SEC would bring an enforcement action against it if it omitted NYCERS' anti-sexual discrimination proposal from its proxy solicitation. NYCERS argued that employment discrimination fell under the definition of "significant policy implications" as articulated by the SEC in previous no-action letters. Cracker Barrel argued that the proposal related to its everyday employment policies, and thus fell under the "ordinary business operations" exception.

The Division informed Cracker Barrel that it would not pursue an enforcement action if Cracker Barrel omitted NYCERS' proposal from the 1992 proxy solicitation. The *Cracker Barrel* no-action letter acknowledged the problems the SEC staff encountered when deciding whether a proposal raised significant policy issues. The SEC's rationale for issuing the *Cracker Barrel* no-action letter was that the staff was making

---

95See Wal-Mart, 821 F. Supp. at 887.
96See id. at 887-88.
97See id. at 888.
98See NYCERS v. SEC, 45 F.3d 7, 9 (2d Cir. 1995).
99NYCERS is the commonly used acronym for the New York City Employees Retirement System.
100See id.
101See id. at 10.
102See id.
103See NYCERS, 45 F.3d at 10.
104See id.; see also Cracker Barrel No-Action Letter, supra note 29 (reiterating Cracker Barrel's earlier position that the NYCERS proposal was properly excluded from its 1992 proxy materials).
105See NYCERS, 45 F.3d at 10.
distinctions that were "tenuous" at best; it indicated that "the line between includable and excludable employment-related proposals . . . has been increasingly difficult to draw." The Division announced in the letter that it had "reconsidered the application of Rule 14a[-]8[i]() to employment-related proposals"; and:

[a]s a result, the Division has determined that 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.

Thus, the SEC abandoned the two-part test articulated in the 1976 Release because it found the line-drawing involved in deciding which proposals involved substantial policy issues too difficult. This point is especially determinative in light of the later evolution of the ordinary business operations exception. The SEC replaced the two-part test with a "bright-line rule": "a shareholder proposal concerning a company's employment policies would no longer be removed from the ordinary business operations exclusion [simply] because the proposal is tied to a social issue.

4. The Wal-Mart Case

Wal-Mart stores omitted from its 1993 proxy solicitation an employment-related shareholder proposal that concerned its affirmative
action policies. The proposal noted that since the majority of Wal-Mart's customers were women and minorities, Wal-Mart's employment practices should reflect policies attractive to them. The proponents of the proposal sought to enjoin Wal-Mart's exclusion of the proposal by bringing an action in federal district court. "Judge Kimba Wood of the Southern District of New York enjoined Wal-Mart Stores from excluding this proposal, stating that the court would not defer to the SEC's position articulated in the Cracker Barrel Letter because it 'sharply deviates from the standards articulated in the 1976 Interpretive Release.' The court's analysis included a review of the SEC's history on employment-related proposals, noting that the SEC's position had not been consistent over two decades of no-action letters. The 1976 Standard had been promulgated after a formal notice and comment period, accordingly, Judge Wood opined that Wal-Mart could not exclude the proposal under the 1976 Standard.

5. NYCERS v. SEC

Meanwhile, NYCERS appealed the Division's Cracker Barrel decision and the full Securities and Exchange Commission affirmed the decision. "NYCERS and two other institutional investors, fearing that the Cracker Barrel no-action letter would frustrate any future attempts by them to change employment policies," sued the SEC for failing to comply with the notice and comment requirements of the Administrative Procedure Act (APA). The district court ordered the SEC to refrain from issuing no-
action letters contrary to the standard articulated in 1976. The SEC subsequently appealed and the Second Circuit reversed the district court, holding that "the Cracker Barrel no-action letter did not effectively amend the 1976 Adoption . . . and did not contain a legislative rule" under the APA. In addition, the court exhibited disdain for perceived abuses of the shareholder proposal process by institutional shareholders: "After investing in a company, the plaintiffs regularly use their shareholder status as a bully pulpit to promote non-discriminatory policies in the workplace."

Furthermore, the Second Circuit made questionable the utility of no-action letters issued by the SEC staff when interpreting the ordinary business operations exception. In fact, pending the result of the appeal of New York City Employees' Retirement System v. SEC, the SEC staff declined to rule on the ordinary business operations exception and did not issue no-action letters, thereby failing to offer guidance to companies seeking to exclude proposals from their proxy materials under that exception. The Second Circuit highlighted in its opinion the confusion surrounding "the proper application of the two-part test enunciated in the 1976 Release." While upholding the Cracker Barrel bright-line standard as a non-binding interpretive rule, the Second Circuit also noted that "the Cracker Barrel no-action letter did not effectively amend the 1976 Adoption." The two standards, in essence, co-existed. The court further stressed that despite a no-action letter, a frustrated shareholder could still bring suit against a corporation that improperly excluded a proposal.

Since the 1976 Standard was left intact, and the Second Circuit validated the SEC's Cracker Barrel stance, shareholders and corporations alike remained without any real guidance. As one commentator noted:

---

122See id. at 9.
123See NYCERS, 45 F.3d at 14.
124Id. at 9.
125See Adler, supra note 112, at 141.
12645 F.3d 7 (2d Cir. 1995).
127See BNA Securities Law Daily, Staff Ordinary Business Stance Leaves Counsel Over a Barrel in Proxy Season (Apr. 29, 1994) (noting that there were "11 instances in which issuers had to decide — without the usual help from the SEC's . . . [Division] — whether to exclude shareholder proposals from their proxy statements on the grounds that those proposals dealt with 'ordinary business operations')."
128Waite, supra note 43, at 1273.
129NYCERS, 45 F.3d at 14.
130See id.
The SEC’s administration of Rule 14a-8 has not proven to be an effective source of authoritative doctrine to guide proponents or the corporations in which they own stock. Despite the fact that literally thousands of no-action letters have been issued over the years, the abundance of materials has served more to confuse matters than clarify them.132

6. The 1997 Proposed Amendments133

The SEC staff’s "bright-line" test articulated in the Cracker Barrel no-action letter and upheld by the Second Circuit134 came under a barrage of criticism. Former SEC Commissioner Steven M.H. Wallman condemned it as "'a terrible mistake' because it sends 'the wrong message . . . as to what the . . . [SEC] believes is important."135 According to Wallman, the Cracker Barrel bright-line test excluded not only employment issues tied to social

---

132Lazaroff, supra note 18, at 45. See also Palmier, supra note 52, at 882 (noting that the SEC staff was 30% more apt in the decade leading up to Cracker Barrel to allow companies to exclude socially responsible proposals without formal rulemaking; the federal judiciary added to the confusion surrounding the rule by vacillating on the issue; and "the rule is today in chaos").

1331997 Proposed Amendments, supra note 55, at 50,682. The SEC proposed to amend the shareholder rules as follows:

- Recast the rule into a more understandable Question & Answer format;
- Reverse the Cracker Barrel policy . . . ;
- Make it more difficult to present proposals again that received an insignificant percentage of the votes cast on earlier submissions . . . ;
- Introduce an "override" mechanism permitting 3% of the share ownership to override a company's decision to exclude a proposal under certain of the bases for exclusion;
- Adopt a new qualified exemption from the proxy rules under Section 14(a) . . . and a safe harbor under Section 13d . . . to make it easier for shareholders to use the new "override";
- Streamline the exclusion for matters considered irrelevant to corporate business . . . ;
- Streamline [the] administration of the rule whereby companies are permitted to exclude proposals furthering personal grievances or special interests; and
- Provide clearer ground rules for management's exercise of discretionary voting authority when a shareholder notifies the company that it intends to present a proposal outside the mechanism of rule 14a-8.

Id. (emphasis added). Note that this note focuses on the proposed reversal of the Cracker Barrel position.

134See NYCERS, 45 F.3d at 14 (chronicling the 1976 Adoption and the "bright-line" test).

policy issues, but "any social, political, moral and other important legal issue . . . if it related to general employment issues."136

In 1997, the SEC proposed to amend its rules on shareholder proposals.137 This action by the SEC may have resulted for a number of reasons. The SEC may have been responding to either the Cracker Barrel holding or to prior petitions for rule making.138 However, the most likely reason for the SEC proposals lies within a mandate issued by Congress.139 The National Securities Markets Improvement Act of 1996140 required the SEC to conduct a comprehensive study of the shareholder proposal process to determine "whether shareholder access to proxy statements pursuant to section 14 of the Securities Exchange Act of 1934 ha[d] been impaired by recent statutory, judicial, or regulatory changes."141 The SEC was also directed to evaluate "the ability of shareholders to have proposals relating to corporate practices and social issues included as part of proxy statements."142 To conduct the study, the SEC distributed surveys143 and initiated a notice and comment period for proposed reforms to the shareholder proposal process.144

The SEC's survey clearly illustrated the tension between the positions of the shareholders, especially some of the institutional investors, and the corporations. Forty percent of companies ranked "as a top reform goal reduction of the types of proposals that they must include in their proxy materials,"145 whereas sixty-three percent of shareholders ranked "as a top goal of reform expanding the categories of proposals that companies must include in their proxy materials [as a top goal of reform]."146 Clearly,

136 Wallman, supra note 7, at 12.
137 See 1997 Proposed Amendments, supra note 55, at 50,682.
138 See id. at 50,683 n.15 (indicating that institutional investors and activist shareholders such as the Interfaith Center on Corporate Responsibility, the Calvert Group Ltd., and the Comptroller of the City of New York petitioned the SEC to modify its Cracker Barrel stance in July of 1995).
139 See id. at 50,683.
141 1997 Proposed Amendments, supra note 55, at 50,683 n.22.
142 Id.
143 See id. at 50,683.
144 See id. at 50,683 n.14.
145 1997 Proposed Amendments, supra note 55, at 50,683 (emphasis added).
146 Id. at 50683 n.14 (emphasis added).
shareholders felt the greater need for reform, and sought that reform through a more democratic shareholder proposal process.

Even more indicative of the polarity between management and shareholder was the survey question about the Cracker Barrel bright-line test for excluding shareholder proposals. The survey indicated that "91% of companies favored excluding employment-related shareholder proposals raising significant social policy issues under the Cracker Barrel interpretation, [whereas] eighty-six percent of the shareholders thought such proposals should be included."148

Those who did not respond by survey commented by fax and letter.149 Shareholders and companies flooded the SEC with comments critical of the proposed reforms.150 The battle lines were clear: "[B]ig U.S. corporations that want[ed] to minimize management challenges from pesky shareholders"151 versus activist investors, such as "socially conscious mutual funds."152 The chairman of the SEC, Arthur Levitt, consulted two legal experts to work out a compromise.153 As a result, not all of the reforms that had been proposed were adopted.154

7. The 1998 Cracker Barrel Reversal

On May 28, 1998 the SEC "reverse[d] [its] Cracker Barrel position, which provided that all employment-related shareholder proposals raising social policy issues would be excludable under the 'ordinary business

147See id. at 50,683.
148See id. (emphasis added).
150See id.
152Id.; see also Lazaroff, supra note 18, at 85 n.238 (citing "a tenfold increase in socially responsible investing strategies between 1985 and 1995").
153See Robaton, supra note 151, at *2 (revealing that the SEC went to Harvey J. Goldschmid from Columbia University School of Law and Ira M. Millstein of Weil Gotshal & Manges, LLP to help it reach a workable solution).
154See 1998 Amendments, supra note 1, at 29,106.
operations exclusion." The SEC noted that employment-related social issues had recently resurfaced as a subject of considerable controversy and shareholder interest. The goal of the reversal was to "make it easier for the shareholder to [include] a broader range of proposals" in companies' proxy materials. Most companies, however, viewed the reversal as a "major setback."

Discussing its decision to reverse Cracker Barrel, the SEC stated:

[It] will return to its case-by-case approach that prevailed prior to the Cracker Barrel no-action letter.... In making distinctions in this area, [it] will continue to apply the applicable standard for determining when a proposal relates to "ordinary business." The standard, originally articulated in the... [SEC]'s 1976 release, provided an exception for certain proposals that raise significant social policy issues.

While we acknowledge that there is no bright-line test to determine when employment-related shareholder proposals raising social policy issues fall within the scope of the "ordinary business" exclusion, the staff will make reasoned distinctions in deciding whether to furnish a "no-action" relief.

---

155 Id. at 29,108. The SEC did not adopt all of its proposed amendments after the notice and comment period. The amendments adopted:
- Recast rule 14a-8 into a Question & Answer format that is easier to read;
- Reverse ... Cracker Barrel ...;
- Adopt other less significant amendments to rule 14a-8; and
- Amend rule 14a-4 to provide shareholders and companies with clearer guidance on [the] companies' exercise of discretionary voting authority.

Id. at 29,106. The SEC did not adopt these original proposals: "to increase the percentage of the vote a proposal needs before it can be resubmitted ...; to streamline the exclusion for matters considered irrelevant to corporate business; ... to modify ... the rule that permits companies to exclude proposals that further personal grievances or special interests ... the proposed 'override' mechanism." Id.

156 See id. at 29,108. The SEC cites as support for the increase in shareholder interest in employment issues two specific articles: Walsh, supra note 1, at D-9; Andrea Adelson, Shareholders Press Shoney's on Bias Issue, N.Y. TIMES, Dec. 26, 1996, at D-1.


158 Id.

159 1998 Amendments, supra note 1, at 29,108.
Significantly, the SEC said that it would revert to the 1976 two-part test, which kept shareholder proposals that raised "significant social policy issues" out of the ordinary business operations exception. The SEC admonished shareholders and companies alike, however, to "bear in mind that the Cracker Barrel position related only to employment-related proposals raising certain social policy issues," and that "[r]eversal of the position does not affect the Division's analysis of any other category of proposals under the exclusion."

The SEC emphasized that the principal consideration in the application of the ordinary business operations exception is the underlying 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." Adherence to that policy would require the SEC to make two principal determinations when analyzing each proposal:

(1) [w]hether the proposal addresses issues that are so central to management's ability to run the company on a day-to-day basis that they would not practically be subject to shareholder oversight (examples include "the hiring, promotion, and termination of employees, decisions on production quality and quantity, and the retention of suppliers"); [and]

(2) [w]hether the proposal "seeks to 'micro-manage' the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment" (an example, "where the proposal involves intricate detail, or seeks to impose specific time frames or methods for implementing complex policies").

---

160 See id.; see also 1976 Release, supra note 71 and discussion supra Part II.C.2 (discussing the two-part test from the 1976 Interpretive Release standard).

161 See 1998 Amendments, supra note 1, at 29,108.

162 Id.

163 Id.

164 Id.

165 See Whitman, supra note 2, at *4.

166 Id. (quoting the 1998 Amendments, supra note 1, at 29,108).
Despite these guiding considerations, the SEC acknowledged that even these amended rules will continue to require it "to make difficult judgments about interpretations of proposals, the motives of those submitting them, and the policies to which they relate."167 The concerns voiced by the SEC here are reminiscent of the concerns it voiced when reversing its stance in the Cracker Barrel letter: the lack of an objective standard by which a shareholder or corporation could judge whether a shareholder proposal is properly excludable or not.168

III. ANALYSIS

The SEC's reversal of its Cracker Barrel interpretation of the ordinary business operations exception under Rule 14a-8(i)(7) portends a "return to subjective line-drawing" by the SEC staff.169 The SEC is returning to the two-part test that caused it to issue the Cracker Barrel letter in the first place: the staff indicated in the letter that it was becoming too difficult to decide when an employment-related shareholder proposal involved significant policy issues.170 The SEC issued no illustrative list of employment-related proposals that would raise significant policy issues. Thus, given its inconsistent no-action history with the exclusion, the SEC has left the actual application of the ordinary business exclusion to something like conjecture.171

Corporate critics feel that the SEC's vagueness is merely a way for the SEC to "broaden the list of 'socially significant' topics that transcend everyday issues of corporate governance."172 Who is the ultimate arbiter of when a policy issue becomes socially significant enough to take an employment-related proposal out of the realm of the ordinary business exception? Is it Congress? The SEC? The shareholders? The

1671998 Amendments, supra note 1, at 29,106.
168See New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 10 (2d Cir. 1995) ("[The letter] acknowledged that the opaqueness of the standard had led to decisions 'characterized by many as tenuous, without substance and effectively nullifying the application of the ordinary business exclusion to employment-related proposals.'); see also Whitman, supra note 2 ("[T]he SEC offered nothing to allay the concerns that led to the issuance of Cracker Barrel in the first place — the inability to make meaningful distinctions and draw lines."); see also discussion supra Part II.C.3 (discussing the Cracker Barrel No-Action Letter).
170See Cracker Barrel No-Action Letter, supra note 29; see also discussion supra Part II.C.3 (discussing the No-Action Letter).
171See Whitman, supra note 2, at 95.
172Id.
corporations? The institutional investors? To illustrate the scope of uncertainty, an example may be helpful. An employment issue that may make its way into this uncertain realm is the recent proliferation of outsourced contract, temporary, and third-party staffing arrangements. As corporations become leaner, to be better able to compete, they supplement their core group of workers. Labor unions have called for regulations concerning this contingent workforce. Is organized labor's impetus enough to get the matter on the proxy ballot? Before a company can answer in the negative, it needs to consider the sheer size of the holdings that union pension funds control. What if a proposal is brought by a non-union fund that believes in "socially-conscious" investment strategies such as benefits for contingent laborers? At what point does an employment-related proposal become tied to a significant policy issue? Will institutional investors take advantage of the uncertainty to reign from their "bully pulpit[s]?"

Shareholders, on the other hand, feel the reforms do not go far enough. "While Cracker Barrel may be reversed in form, ... it is unclear ... whether it will be reversed in substance." The concern is that while employment-related proposals are not "automatically excludable, neither will


173See Schroeder, supra note 173, at 732.

174Union activism has taken a more predominant role in the shareholder proposal process. See generally Marleen A. O'Connor, Organized Labor as Shareholder Activist: Building Coalitions to Promote Worker Capitalism, 31 U. Rich. L. Rev. 1345, 1346 (1997) (stating that unions are exercising their rights as shareholders to influence corporate decisions); Stewart J. Schwab & Randall S. Thomas, Realigning Corporate Governance: Shareholder Activism by Labor Unions, 96 Mich. L. Rev. 1018, 1019 (1998) (noting that "unions have become the most aggressive of all institutional shareholders" in the 1990s); Randall S. Thomas & Kenneth J. Martin, Should Labor be Allowed to Make Shareholder Proposals?, 73 Wash. L. Rev. 41, 41 (1998) (discussing how unions have been aggressively using Rule 14a-8 to push corporate governance reforms).

175See, e.g., Johnathan P. Hiatt, Policy Issues Concerning the Contingent Work Force, 52 Wash. & Lee L. Rev. 739, 740 (1995) (noting that "the current legal framework of collective bargaining is 'somewhat ill-suited' to the task of protecting the economic and personal rights of contingent workers") (citation omitted)).

176See Thomas & Martin, supra note 173, at 48 (stating that "jointly trusted national and local union [pension] ... funds' combined assets grew from a total of $55 billion in 1983 to about $216 billion in 1993").

177See Robaton, supra note 151, at *1.

178See NYCERS v. SEC, 45 F.3d 7, 9 (2d Cir. 1995).

179See 1997 Proposed Amendments, supra note 55, at 50,706.

180Id.
Shareholder activists contend "that company policies on [EEO issues,] affirmative action, sexual harassment, workplace safety, sexual orientation, and other issues, can expose the company to costly litigation," similar to that which plagued Texaco, Shoney's, Mitsubishi, and Home Depot. Therefore, these groups argue, those company policies "should be open to scrutiny by shareholders." Former SEC Commissioner Steven M.H. Wallman noted, "[S]hareholders, many of them large institutional investors, have been trying to attack employment discrimination through shareholder proposals. . . . They do so not only because discrimination is illegal and immoral but also because settlements have a bottom-line impact.

There is debate over whether "shareholder value' [is] a [valid] basis for determining whether an employment-related resolution falls within the 'ordinary business' rule. The SEC believes that "shareholder proposals on social issues may improve investor confidence in the securities markets by providing investors with a sense that as shareholders they have a means to express their views to the management of the companies in which they invest." Companies argue, however, that, given the "current legal climate," using shareholder value as a barometer of an employment-related resolution's social policy importance would require the company to include virtually all such proposals in the proxy solicitation. In their view, "[a]lmost everything a corporation does affects shareholder value, directly or indirectly, to some extent. Marketing, R&D advertising, and risk management . . ., [h]iring, retraining and firing employees . . . are about as

---

182 Id.
184 See Whitman, supra note 2, at 1; see also discussion supra Part I (discussing recent settlements of employment-related litigation).
185 Minehan, supra note 183, at 1.
186 Id. (quoting the comments of Steven Wallman); see also Dye & Hair, supra note 10, at 352 (noting that institutional investors have been trying to fulfill their fiduciary duties by exercising their voting rights to maximize shareholder value); Whitman, supra note 2, at 8 (quoting Wallman "that it is a terrible mistake for anyone to conclude that [employment issues] have no impact on shareholder values [because] . . . [t]hey unequivocally do").
187 Whitman, supra note 2, at 8.
188 1998 Amendments, supra note 1, at 29,117.
189 See Whitman, supra note 2, at 8.
190 See id.
'ordinary' as business practices get.\textsuperscript{1191} For example, a typical discrimination action, which might arise as a normal part of business operations, could be characterized as a shareholder value concern simply because Title VII\textsuperscript{1192} allows for punitive damages.\textsuperscript{1193} Arguably, big-ticket settlements like Texaco's or Home Depot's are not the norm, so they should not be used as a ticket to backdoor employment issues that arise in the normal course of business. To include every shareholder proposal that includes issues only remotely raising social policies, but which \textit{may} affect shareholder value is to put a heavy burden on management.

The SEC has not taken a clear stance on this debate. While opining that "investor confidence in the securities markets" may increase as a result of shareholders' improved communication with management,\textsuperscript{1194} it also cites studies which conclude that "[s]hareholder proposals could have a positive or negative impact, or no impact, on the price of a company's securities."\textsuperscript{1195} Consequently, the SEC's about-face in its position on Rule 14a-8(i)(7) has done little to resolve the tension between management and activist shareholders.

The impact of the 1998 \textit{Cracker Barrel} reversal remains to be seen. From May 21, 1998 forward, all no-action letters on employment-related proposals were to reflect the new approach.\textsuperscript{1196} The SEC predicted that its \textit{Cracker Barrel} reversal "may . . . increase . . . the number of employment-related proposals tied to social issues that are submitted to companies each year, and that companies must include in their proxy materials."\textsuperscript{1197} Certain industry experts, like former SEC Commissioner Wallman, do not believe there will be "'an overwhelming impact' because, in most cases where proposals were excludable under [the \textit{Cracker Barrel}] rationale, the corporations either included the proposals . . . anyway or voluntarily released the information called for by the proposal."\textsuperscript{1198} For example, reacting to the Home Depot's 1997 discrimination settlement, institutional

\textsuperscript{1191}\textit{id. See also Minehan, supra} note 183 (opining that "given the current mood at the SEC . . . it seems likely that inclusion of employment-related shareholder proposals on proxy ballots will be permitted in some form, so human resource professionals should be prepared for the possibility of shareholder oversight of their companies' employment-related policies").


\textsuperscript{1193}\textit{See} Whitman, \textit{supra} note 2, at *8-*9.

\textsuperscript{1194}\textit{See} 1998 Amendments, \textit{supra} note 1, at 29,117.

\textsuperscript{1195}\textit{id.} at 29,116.

\textsuperscript{1196}\textit{See id.} at 29,108 n.33.

\textsuperscript{1197}\textit{id.} at 29,116 (noting that "[d]uring the 1997 proxy season, the Division received . . . 30 submissions involving employment-related proposals tied to social issues").

\textsuperscript{1198}Whitman, \textit{supra} note 59, at col. 1.
investors sponsored a shareholder proposal to be included in the company’s proxy materials. That proposal asked for reports on the company’s diversity initiatives and requested copies of demographic data that had been sent to the EEOC over the previous five years. Despite receiving the SEC’s permission to exclude the proposal, Home Depot voluntarily included the proposal with its 1998 proxy solicitation.

As Wallman pointed out, "[M]any public companies are required to disclose to government agencies the same kinds of information that proponents of shareholder resolutions demand." For example, the EEOC, the Department of Labor, and the Office of Federal Contract Compliance all require companies of over 100 employees to submit specific data on affirmative action and workforce composition. The availability of this information may lessen the impact of the SEC’s reversal of Cracker Barrel.

A growing trend that may also lessen the impact of the reversal has been the willingness of institutional investors to bargain with management directly. As noted by one commentator: "Several of the large public pension funds have adopted a regular program of delaying the announcement of the names of firms they have targeted for activism until talks could be held with the top management and/or directors to try to reach agreement on key issues." Using this approach, NYCERS, CalPERS, The Calvert Group, and other institutional investors have experienced some success: direct bargaining resulted in the withdrawal of twenty-five of fifty-four proposals during the 1995 proxy season.

---

199 See Business Wire, supra note 9. "The lead proponents of the Home Depot proxy resolution are Calvert Group, Franklin Research & Development, and United States Trust Company of Boston," as well as union sponsors, pension fund sponsors, and religious investors whose interests were coordinated by the Interfaith Center on Corporate Responsibility. Id.

200 See id. at *1.

201 See id. at *2.

202 Whitman, supra note 2, at *7 (including EEO, affirmative action, and "workforce demographics" as examples).

203 See id. See generally Lenz, supra note 173 (addressing liabilities that arise under federal and state employment laws).

204 See Dye & Hair, supra note 10, at 385.

205 Dye & Hair, supra note 10, at 385. See also Beth Duncan, Fewer Precatory Proposals Does Not Mean Less Shareholder Pressure, Experts Suggest, Sec. Law Daily (BNA), at *1 (Mar. 9, 1998) (stating that the Investor’s Rights Association of America “decided . . . to limit its focus on shareholder proposals and instead seek to negotiate, behind closed doors, with companies it feels are underperforming”).

206 "CalPERS" is the commonly used acronym for the California Public Employees’ Retirement System.

207 See Dye & Hair, supra note 10, at 385.
Management should welcome this informal approach as a less expensive alternative to a proxy fight and as an opportunity to keep abreast of issues that may become "socially significant." For better or worse, shareholders and management are parties to a marriage in a jurisdiction that does not permit divorce. Some commentators suggest that management implement a "shareholders' relation program." Whether structured formally or informally, more open communication and "behind-the-scenes resolution of shareholder concerns about corporate governance" may also lessen the impact of the SEC's recent reversal and at the same time enhance the ideals of corporate democracy.

Some commentators have called for the elimination of the ordinary business operations exception to Rule 14a-8 altogether. They feel that companies could filter out shareholder proposals that are not "proper subjects for shareholder action" under Rule 14a-8(i)(1). The elimination of the ordinary business operations exception may resolve some of the

209 See Adler, supra note 112, at 148-49 (discussing the "possibility that investor destabilizers will initiate a proxy fight").

210 See Whitman, supra note 2, at *5-*6.


212 Adler, supra note 112, at 148 (suggesting that "management could implement a shareholders' relation program designed to actively target institutional and activist investors, listen to their concerns and convince them that management has viable strategies to enhance value"). See also Roth, supra note 210, at 119-22 (advocating a shareholder relations department in publicly held companies to improve communication between shareholders and the corporation, as well as the formation of a special SEC office of corporate-shareholder relations).

213 Whitman, supra note 2, at *7.

214 See, e.g., Waite, supra note 43, at 1274-75 (suggesting that Rule 14a-8 be eliminated altogether due to the unnecessary confusion caused by the exception and the difficulty in applying it).

215 See id. at 1275.

17 C.F.R. § 240.14a-8(i)(1) (1999). Section (i) provides that a company may omit a proposal and any statement supporting it from its proxy statement if the proposal is not a "proper subject for action by shareholders under the laws of the jurisdiction of the company's organization." The note to paragraph (i)(1) indicates that some proposals are not considered proper under state law if they are written in binding, and not precatory, language. See Duncan, supra note 205, at *6 (reporting that "a drop in the number of precatory, or nonbinding proposals by shareholders at companies' annual meetings in 1998 compared with 1997 does not mean a decline in shareholder activism, a group of experts have [sic] suggested, citing moves to force binding changes in corporate bylaws"). See generally Lawrence A. Hamermesh, Corporate Democracy and Stockholder-Adopted By-Laws: Taking Back the Street?, 73 TUL. L. REV. 409, 413-14 (1998) (noting shareholders' use of their ability to adopt and amend bylaws without approval by board of directors as powerful mechanism to exert influence over corporate management).
confusion surrounding the SEC’s interpretation of it.\(^{216}\) More confusion, however, may be generated because state laws tend to be vague on what constitutes proper action for shareholders.\(^{217}\) Such an approach would merely swap one interpretive nightmare for another. Given the inherent tension between the positions of companies and shareholders in the proxy process, and the silence of many state laws on what definitively constitutes a "proper action by a shareholder,"\(^{218}\) the SEC will need to remain actively involved in the interpretation and application of the ordinary business operations exception.\(^{219}\) In fact, many of the commenters to the 1997 Proposed Amendments\(^ {220}\) "resisted the idea of significantly decreasing the role of the . . . [SEC] and its staff as informal arbiters through the administration of the no-action letter process."\(^ {221}\)

Early indications, of the SEC staff’s treatment of the ordinary business operations exception, found in no-action letters issued after the reversal of Cracker Barrel, reinforce the SEC’s discomfort with line-drawing.\(^ {222}\) In February 1998, before the 1998 Amendments became effective, the SEC staff issued a no-action letter to Chrysler Corporation that allowed the company to exclude an employment-related shareholder proposal.\(^ {223}\) In that letter, the SEC tried to offer some guidance by identifying which parts of the proposed resolution related to ordinary

\(^{216}\)See Waite, supra note 43, at 1275 ("The deletion of the ordinary business operations exception will eliminate the confusion created by the two-prong test . . . ").

\(^{217}\)See id.; see also discussion supra Part II.C.1 (discussing how state laws failed to give guidance on what specifically constitutes an ordinary business matter).

\(^{218}\)See LOSS & SELIGMAN, supra note 60, at 2010-11; see also 4 LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 457 (Aspen Law & Business, 1995) (noting that the common law created by the . . . [SEC] would likely "yield to a contrary decision of the particular state court; but it is perhaps equally likely to influence the state courts themselves when the rare cases come to them").

\(^{219}\)See 1998 Amendments, supra note 1, at 29,107-108.

\(^{220}\)See 1997 Proposed Amendments, supra note 55.

\(^{221}\)1998 Amendments, supra note 1, at 29,106. The role of the SEC as informal arbiter is not new. See Lewis S. Black, Jr. & A. Gilchrist Sparks III, The SEC as Referee—Shareholder Proposals and Rule 14a-8, 2 J. CORP. L. 1, 1 (1976) ("The role of the . . . [SEC] in interpreting and administering its shareholder proposal rule, Rule 14a-8, is analogous in many respects to that of a referee . . . ") (citations omitted).

\(^{222}\)See discussion supra Part II.C.3.

\(^{223}\)See CBS Corp. No-Action Letter, 1999 WL 80269 (Feb. 12, 1999).
business operations, but equivocated on the interpretation of paragraph six of the proposal.

Despite its purported reversal of its interpretation of Rule 14a-8(i)(7), the SEC staff apparently relied on the pre-Cracker Barrel standards articulated in Chrysler when it advised CBS Corporation — in a post-Cracker Barrel no-action letter — that CBS was required to include an employment-related shareholder proposal in its proxy materials. The staff apparently was swayed in its CBS decision by the argument of the proponents of inclusion: the employment-related proposal's provisions mirrored, in many respects, the paragraphs that the staff had found to be outside the scope of the ordinary business operations exception in Chrysler. The letter by the proponents of the proposal to the SEC stated that "[i]n a no-action letter issued last year [to Chrysler], the Staff provided guidance to the shareholder and corporate communities by specifying exactly which paragraphs, prior to the repeal of Cracker Barrel, of a proposal, which called for global business standards, pertained to ordinary business and

---

224 See id.
225 See id.
226 See Chrysler Corp. No-Action Letter, 1998 WL 77961, at *6 (Feb. 18, 1998) (stating "that although the balance of the proposal and supporting statement appears to address matters outside the scope of ordinary business, paragraph 5 of the resolution relates to ordinary business matters, and paragraph 6 is susceptible to a variety of interpretation, some of which could involve ordinary business matters") (emphasis added)). Parts of the shareholder proposal asked the company to review and report on the following:

1. A description of policies which are designed to protect human rights — civil, political, social and economic — consistent with respect for human dignity and international human rights standards.
2. A report of efforts to ensure that the company does not employ children under the age of fifteen, or younger than the age for completing compulsory education in the country of manufacture where such age is higher than fifteen.
3. A report of company policies ensuring that there is no use of forced labor, whether in the form of prison labor, indentured labor or bonded labor.
4. Establishment of consistent standards for workers' health and safety, practices for handling hazardous wastes and protecting the environment, as well as promoting a fair and dignified quality of life for workers and their communities.
5. Report on other categories, such as child care, training programs for workers, upgrading management and mechanical skills of employees, that the company believes are essential to its global operations.
6. Establishment of compliance procedures and development of independent monitoring in conjunction with local nongovernmental organizations to ensure credible code enforcement.
227 See CBS Corp. No-Action Letter, supra note 223.
228 See id. at *1.
which did not. Nonetheless, the SEC staff did not draw the line on whether proposals that resembled the language in paragraph six of the Chrysler proposal would be excluded.

The SEC staff is using its Chrysler precedent post-Cracker Barrel: the staff apparently relied on those same Chrysler paragraphs, which were quoted by the proposal proponents in a letter to the SEC, when it issued a no-action letter to R.R. Donnelley & Sons Company. Moreover, the SEC staff seems to be keeping its promise of evaluating shareholder proposals on a case-by-case basis. For example, prior to the Cracker Barrel reversal, a shareholder proposal relating to employment practices in a company's Northern Ireland operations was almost per se excludable from the company's proxy materials. In a May 1999 no-action letter to Toys "R" Us, Inc., however, the SEC staff advised the company that it could not exclude a shareholder proposal that addressed the issues of religious discrimination and poor working conditions in the company's Northern Ireland operations because those issues were important social policy issues. Consistency in the no-action process, however, is still a major concern. An examination of recent post-Cracker Barrel reversal no-action letters reveal contrary results on similar shareholder proposals.

The SEC staff advised Sears, Roebuck & Co. that a shareholder proposal seeking a report from the board of directors vendors' labor standards and compliance policies in foreign countries could not be excluded under Rule 14a-8(i)(7). Similarly, the SEC staff advised Lucent Technologies that it could not exclude a shareholder proposal relating to the

228Id. (emphasis added).
230See 1998 Amendment, supra note 1, at 29,116 ("Reversal of the [Cracker Barrel] position will result in a return to the case-by-case analysis that prevailed before the position was announced.").
company's policies on slave or forced labor in all dealings with China.\(^{234}\) Between the Sears and Lucent Technologies no-action letters, however, the SEC staff issued a no-action letter to the Warnaco Group, Inc. advising that it could exclude a proposal calling for a report that outlined the steps the company was taking to ensure that it was not purchasing from suppliers that used forced, child, or convict labor or disregarded laws protecting employee's rights.\(^{235}\) The SEC staff reached a similar result in a no-action letter issued to K-Mart Corporation on the same day the staff issued the Warnaco letter.\(^ {236}\)

The discrepancies in the above-mentioned no-action letters may be explained in part by the SEC staff's policy of not allowing revisions to proposed resolutions\(^{237}\) and in part by Chrysler.

If the shareholder proposal's content and format conform with the first four paragraphs discussed in Chrysler,\(^{238}\) it appears that the proposal will be deemed to be outside the ordinary business operations exception. If the proposal contains any language that is similar to paragraph five of Chrysler, the proposal will be found to relate to ordinary business operations. Consequently, the entire proposal may be excludable under Rule 14a-8(i)(7)\(^ {239}\) because of the SEC's no-revision policy. The SEC staff's equivocal position on paragraph six of Chrysler, however, lends no real guidance to shareholders and companies alike.

Thus, the SEC will continue to formulate its "common law"\(^ {240}\) definition of the scope of the ordinary business operations exception through no-action letters until state law is more definitive on the issue. It will take "several proxy seasons of experience before [shareholders or] public corporations can reasonably expect any ... degree of certainty" in the SEC's ad hoc application of the ordinary business operations exception to Rule 14a-8.\(^ {241}\)


\(^{237}\)See Chrysler Corp. No-Action Letter, supra note 225, at *6 (explaining that "it has not been the Division's practice to permit revisions under rule 14a-8(i)(7)").

\(^{238}\)See Chrysler Corp. No-Action Letter, supra note 225.

\(^{239}\)See, e.g., K-Mart Corp. No-Action Letter, supra note 236.

\(^{240}\)See discussion supra Part II.C.1 (chronicling the 1953 pedigree of the "ordinary business operations" exception).

\(^{241}\)See Whitman, supra note 2, at *8.
IV. CONCLUSION

The evolution of the ordinary business operations exception, Rule 14a-8(i)(7), has been a study in inconsistency and unpredictability. The SEC's 1998 reversal of its Cracker Barrel position, and its shift back to the standard that prompted the Cracker Barrel no-action letter in the first place, will only add to the interpretive difficulties. The 1998 reversal has not yet provided a meaningful standard for guidance in an increasingly important area of the law.

Until state law steps in to fill the void, the SEC will continue to judge whether an employment-related proposal should be excluded from a company's proxy materials on an ad-hoc basis. Barring any further interpretive reversals, it will take several years for any objective standards to emerge.

Patricia R. Uhlenbrock