

4-1-1999

The SEC's Reversal of *Cracker Barrel*: A Return to Uncertainty

Shireen B. Rahnema

Follow this and additional works at: <http://repository.law.miami.edu/umblr>



Part of the [Law Commons](#)

Recommended Citation

Shireen B. Rahnema, *The SEC's Reversal of Cracker Barrel: A Return to Uncertainty*, 7 U. Miami Bus. L. Rev. 273 (1999)

Available at: <http://repository.law.miami.edu/umblr/vol7/iss2/4>

This Article is brought to you for free and open access by Institutional Repository. It has been accepted for inclusion in University of Miami Business Law Review by an authorized administrator of Institutional Repository. For more information, please contact library@law.miami.edu.

THE SEC'S REVERSAL OF *CRACKER BARREL*: A RETURN TO UNCERTAINTY

SHIREEN B. RAHNEMA*

I. INTRODUCTION	273
II. THE PROBLEM: UNADDRESSED DISCRIMINATION	277
A. <i>The Cracker Barrel Story: Discrimination Based on Sexual Orientation</i>	277
B. <i>Subtle Discrimination</i>	279
C. <i>A Potential Strategy</i>	280
III. BACKGROUND: SHAREHOLDER PROPOSALS AND THE REJECTED PACKAGE OF REFORMS	283
A. <i>Shareholder Proposals Defined</i>	283
B. <i>Employment Policy Proposals: The Wal-Mart and Cracker Barrel Controversies</i>	286
C. <i>The Rejected Package of Reforms</i>	291
IV. THE LIMITS OF THE REVERSAL OF THE CRACKER BARREL POSITION	293
A. <i>History of SEC Vacillation</i>	294
B. <i>Unaddressed Discrimination and the Corporate Forum</i>	298
1. PROFIT MAXIMIZATION	298
2. NO OTHER FORUM	302
C. <i>External or Internal Control: The Role of the Government</i> ...	304
V. CONCLUSION	306

I. INTRODUCTION

In a January 1991 press release, Cracker Barrel Old Country Store, Inc. ("Cracker Barrel") announced its new employment policy. William A. Bridges, Vice President of Human Resources, stated the following:

Cracker Barrel is founded upon a concept of traditional American values, quality in all we do, and a philosophy of 100% guest satisfaction. It is inconsistent with our concept and values, and is perceived to be inconsistent with those of our customer base, to continue to employ individuals in our operating units whose sexual preferences

* J.D. 1998, U.C.L.A. School of Law. I would like to thank Professors G. Mitu Gulati, William B. Rubenstein, and Gillian Lester for their guidance and encouragement. I would also like to thank Scott Abrahamson, Justine Meyers and Susanah Shaw for their helpful comments.

fail to demonstrate normal heterosexual values which have been the foundation of families in our society. Therefore, it is felt this business decision is in the best interests of the company.¹

Shortly after this press release, Cracker Barrel fired between eight and eleven employees because of their sexual orientation.² In response, protesters organized sit-ins, boycotts, and picket lines.³ In June 1991, demonstrations at Cracker Barrel restaurants resulted in nearly thirty arrests.⁴ Yet, the fired employees could not bring a lawsuit in either federal or state court because neither Title VII nor any of the applicable state statutes prohibited discrimination based on sexual orientation.

Because Cracker Barrel's discriminatory employment policy was immune to conventional civil rights litigation, one of its shareholders, New York City Employees Retirement Systems ("NYCERS"), found an alternative method to pressure Cracker Barrel into reconsidering the policy—the shareholder proposal. A shareholder proposal is a recommendation or requirement that the corporate managers take action; it is submitted to management to be mailed to all shareholders along with the manager's proxy material.⁵ Shareholders

¹ Cracker Barrel Old Country Store Inc., SEC No-Action Letter, 1992 SEC No-Act LEXIS 984 (Oct. 13, 1992) at 14 [hereinafter *Cracker Barrel No-Action Letter*].

² See, Ruth Ann Leach, *Movie Should Shame Cracker Barrel Officials*, NASHVILLE BANNER, Jan. 23, 1997, at A7 ("Summerville had been working in the kitchen at Cracker Barrel for 3½ years when the new policy was announced. . . . Summerville tells how she asked her supervisor to read her the new policy. She was told not to worry because 'we're really targeting effeminate men.' Summerville replied, 'if it applies to them, it applies to me.' She was fired that afternoon. Her termination papers state that the only reason for her dismissal: She 'is gay.'").

³ *Id.* See also, Beverly Shepard, *A Very Big Shock*, ATLANTA CONSTITUTION, Mar. 29, 1992, at D7 (Cracker Barrel officials would not comment on whether the protests have affected business and Cheryl Summerville was called the "Rosa Parks of the gay movement"); *Va Sit-In for Gay Rights*, WASHINGTON POST, Mar. 30, 1992, at D5 (gay-rights supporters staged a sit-in at Cracker-Barrel in Spotsylvania, Va., to protest the restaurant's firing of homosexual employees); Reed Johnson, *Cracker Barrel Reflects 'Bygone Era'*, DETROIT NEWS, Aug. 29, 1991; N.Y. TIMES, Feb. 28, 1991 at A22 (gay workers say they were fired from their jobs as a result of the policy adopted not to employ homosexuals); *Cracker Barrel No-Action Letter*, *supra* note 1, at 4 (quoting August 19, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Sue Ellen Dodell, Deputy Counsel on behalf of NYCERS).

⁴ Michael J. Connell, *Shareholder Proposals*, 799 PLI/Corp 631, 664 (1993) (quoting July 30, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Paula L. Chester, General Counsel to New York City Comptroller Elizabeth Holtzman).

⁵ See, 17 C.F.R. Section 240.14a-8. In order to be eligible to submit a proposal the shareholder must have continuously held at least \$2,000 in market value, or 10%, of the company's securities for at least one year. In effect, the shareholder proposal rules require the corporation to subsidize the costs of communication between shareholders. The rules attempt to distinguish proposals that managers are

or their proxies vote on the proposal at the next shareholders' meeting. Even when the proposals do not receive a majority vote, they are often effective because they attract the media attention that influences managers. The NYCERS proposal asked Cracker Barrel to implement nondiscriminatory policies and to add explicit prohibitions against discrimination based on sexual orientation to its employment policy statements.⁶ Cracker Barrel attempted to exclude this shareholder proposal from its proxy material and petitioned the Securities Exchange Commission (the "SEC") to evaluate the legality of excluding the proposal. The SEC approved Cracker Barrel's exclusion on the basis that the shareholder proposal involved "day-to-day" business and, thus, fell under the "ordinary business" exception.⁷ This SEC interpretation of the shareholder proposal rule, known as the "Cracker Barrel position," later became the subject of a celebrated legal dispute. In *NYCERS, et al., v. SEC*,⁸ the Second Circuit upheld the SEC's Cracker Barrel position and found that the no-action letter was not subject to notice and comment requirements because it was "interpretive," rather than legislative. Furthermore, the court held that it would not apply the arbitrary and capricious standard of review when the shareholders had an alternative private action against the corporation.

As a result of the SEC's Cracker Barrel position, managers were automatically able to exclude virtually all employment related shareholder proposals from their proxy material. However, on May 20, 1998, the SEC reversed itself, abandoned the Cracker Barrel bright-line rule, and returned to a case-by-case analysis of employment related shareholder proposals.⁹ Shareholder activists claimed the reversal of the Cracker Barrel position as a

required to include in proxy material from proposals that managers may decline to distribute. For a full explanation of shareholder proposals see Part III.

⁶ *Cracker Barrel No-Action Letter*, *supra* note 1 (quoting August 19, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Sue Ellen Dodell, Deputy Counsel on behalf of NYCERS).

⁷ *Cracker Barrel No-Action Letter*, *supra* note 1, at 4. Proposals relating to day-to-day business are generally excludable under the ordinary business exception. Before the SEC Cracker Barrel position, the SEC had the discretion to determine which employment related proposals could be excluded. Under the Cracker Barrel position, the SEC did not use discretion, but instead allowed the automatic exclusion of any employment related proposal. This included employment related proposals that addressed the policy of a corporation or affected a social policy issue. For a full explanation of the ordinary business exception see Part III of this Article.

⁸ 45 F. 3d 7 (2d Cir. 1995).

⁹ See, Final Rule: Amendments to Rules on Shareholder Proposals, 17 C.F.R. 240, Release No. 34-40018, File No. S7-25-97, May 21, 1998, 1998 SEC LEXIS 1001; *'Cracker Barrel' Policy Overturned by SEC*, NAT'L L.J., June 1, 1998 B2.

victory.¹⁰ Upon closer inspection, however, this seeming victory is of limited value.

Despite its apparent protection of discrimination related shareholder proposals, the reversal of the Cracker Barrel position returns discretion to the SEC, causing uncertainty for both shareholders and managers. By returning to SEC discretion without addressing its own history of vacillation, the SEC has merely replaced an unpopular rule with an ambiguous one. Moreover, the SEC's reversal does nothing to ensure discussion in the corporate forum about discrimination issues. In part, it is because these discrimination issues are not addressed in other forums that shareholders must be given the opportunity to raise them in the corporate forum. Finally, the mere reversal of the Cracker Barrel position places undue value on external control, as opposed to internal policy reform. As a result, the SEC will be overburdened, corporations will be discouraged from reforming themselves, and what appears to be a short term gain may turn out to be a long term loss. Rather than reversing its Cracker Barrel position, the SEC should clarify its policy by creating a presumption in favor of the inclusion of discrimination related shareholder proposals.

Part II of this article describes the problem of unaddressed discrimination by focusing on discrimination against lesbians and gay men, and more subtle forms of discrimination based on gender and race. Part II also demonstrates how the shareholder proposal can be used to confront this unaddressed discrimination. Part III provides background on proxy solicitations and shareholder proposals. It also explains the package of reforms that the SEC recently rejected. Part IV analyzes the reversal of the Cracker Barrel position in light of numerous policy questions about SEC discretion, appropriateness of corporate forums, and sources of control. It considers how the SEC and various courts have interpreted the shareholder proposal rule and tracks the SEC's history of vacillating and inconsistent no-action letters.¹¹ The conclusion briefly suggests alternatives to the SEC rule that would more adequately protect discrimination related proposals and create clarity for both shareholders and managers.

¹⁰ *Vote Favors Social Proposals*, *NEWSDAY*, May 21, 1998 at A70; Mary Gordon, *SEC Broadens Shareholder's Voice*, *Associated Press*, May 20, 1998.

¹¹ After a shareholder proposal is submitted, the management may write to the SEC requesting a statement that the SEC will take 'no-action' if the management excludes the proposal from its proxy material. The SEC statement is the 'no-action letter.' For a full explanation of no-action letters see Part III.

II. THE PROBLEM: UNADDRESSED DISCRIMINATION

A. *The Cracker Barrel Story: Discrimination Based on Sexual Orientation*

Based in Lebanon, Tennessee, Cracker Barrel is a moderately priced restaurant and gift shop chain.¹² The gift shops sell Americana such as porcelain figures, Coca-Cola paraphernalia, and fluted glassware.¹³ The restaurants' menus stress old-fashioned American cooking including hamburgers, catfish, country-fried steak, Smores, and Coca Cola Cake.¹⁴ In 1997, Cracker Barrel's fiscal first-quarter profits rose 26% to \$23.7 million.¹⁵ For the fiscal year that ended August 1, 1997, Cracker Barrel reported sales of \$1.124 billion.¹⁶ In 1992, Cracker Barrel had over 14,000 employees across the country.¹⁷

In 1991, NYCERS was New York City's largest employee pension fund with assets of \$19 billion.¹⁸ In 1992, NYCERS had 81,104 of Cracker Barrel common stock, which it had owned for over a year.¹⁹ NYCERS asserted that soon after the Cracker Barrel press release at least eleven Cracker Barrel employees were fired solely because they were lesbians or gay men.²⁰ Cracker Barrel disagreed only about the number of employees fired, stating that eight gay employees were terminated in January of 1991 and that in February a

¹² Jody Rathgeb, *Cracker Barrel Offers Fare That's Hearty, Simple*, RICHMOND TIMES-DISPATCH, Dec. 25, 1997, at D14.

¹³ *Id.* at D14.

¹⁴ Michael Muckian, *Cracker Barrel Satisfying, Overall*, CAPITAL TIMES, Jan. 3, 1993, at 4D.

¹⁵ *Business Brief: Cracker Barrel Old Country Store*, WALL ST. J., Nov. 20, 1997, at B6.

¹⁶ Jack Hayes, *After Free Fall Cracker Barrel Rolls as a Top Contender in Family Segment*, NATION'S RESTAURANT NEWS, Nov. 17, 1997, at 1.

¹⁷ *Cracker Barrel No-Action Letter*, *supra* note 1, at 11 (quoting August 11, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Robert G. McCullough, representative of Cracker Barrel).

¹⁸ *Cracker Barrel's Policy on Gays Faces Action By New York Fund*, WALL ST. J., Oct. 31, 1991.

¹⁹ *Cracker Barrel No-Action Letter*, *supra* note 1, at 43 (Attachment 2) (quoting June 12, 1992 letter to Dan Evins, President Cracker Barrel Old Country Store, from Elizabeth Holtzman, custodian of NYCERS, and June 8, 1992 letter from Citibank, N.A.).

²⁰ *Cracker Barrel No-Action Letter*, *supra* note 1, at 14 (quoting July 30, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Paula L. Chester, General Counsel to New York City Comptroller Elizabeth Holtzman). Footnote 2 of the letter referred to "Separation Notices" and "Disciplinary & Termination Reports" as examples of termination notices received by lesbian and gay workers in January and February of 1991. According to the letter, the notices and reports stated that the employees were terminated because they violated Cracker Barrel's policy against employing homosexuals.

ninth employee was terminated when she confronted her store manager with the fact that she was a lesbian.²¹ Cracker Barrel later claimed that it had publicly apologized for these incidents and did not fire any other employees based on sexual orientation.²² However, Cracker Barrel did not rescind the policy, reinstate dismissed workers, or offer them compensation for wrongful discharge.²³

NYCERS responded to the firings with a shareholder proposal requesting that Cracker Barrel change its policy of discrimination.²⁴ In light of the fact that more conventional litigation strategies were unavailable, the shareholder proposal seemed to provide the best method to bring the discrimination to the attention of a larger audience.²⁵ While the proposal did not guarantee that particular employees would be reinstated or recover damages, it exposed the discrimination, created dialogue between shareholders and managers, and raised the issue for public debate. Furthermore, the shareholder proposal drew the attention of the media and, thus, had the potential to influence managers.²⁶

In a no-action letter to Cracker Barrel, the SEC stated that Cracker Barrel was not required to include the employment discrimination shareholder proposal in its proxy material to be sent out to all shareholders.²⁷ In this letter, the SEC changed its position from one that allowed some employment related proposals to a position that automatically excluded all employment related proposals. In other words, the Cracker Barrel position meant that all employment related proposals fell under the ordinary business exception.²⁸ Although the position was controversial, it did have one significant benefit; it was a

²¹ Ruth Ann Leach, *supra* note 2; *Cracker Barrel No-Action Letter*, *supra* note 1, at 10 (quoting August 11, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Robert G. McCullough, legal representative of Cracker Barrel).

²² *Cracker Barrel No-Action Letter*, *supra* note 1, at 10 (stating that in 1993 Cracker Barrel declared that it was an equal opportunity employer that adheres to the letter and the spirit of the law regarding equal treatment in the workplace). *See also*, *14% of Cracker Barrel Investors Back First Shareholders Resolution for Gay Rights*, L.A. TIMES, Nov. 24, 1993 at D3.

²³ *Cracker Barrel No-Action Letter*, *supra* note 1, at 16 (quoting July 30, 1992 letter to William E. Morley, Esq., Chief Counsel Securities and Exchange Commission Division of Corporate Finance, from Paula L. Chester, General Counsel to New York City Comptroller Elizabeth Holtzman).

²⁴ *Cracker Barrel No-Action Letter*, *supra* note 1, at 11 (quoting original letter from NYCERS to the SEC).

²⁵ By 'conventional litigation strategies' I mean litigation based on Title VII or a state statute.

²⁶ *Cracker Barrel's Policy on Gays Faces Action By New York Fund*, WALL ST. J., Oct. 31, 1991.

²⁷ *Cracker Barrel No-Action Letter*, *supra* note 1 (allowing exclusion of proposal that the corporation implement no discriminatory employment policies related to sexual orientation because day-to-day issues concerning hiring and other personnel matters are properly left to the company management).

²⁸ Ordinary business is not considered to be under the authority of shareholders and, thus, proposals regarding ordinary business can be excluded. For a complete discussion of the ordinary business exception see Part III.

bright-line rule that put an end to the history of SEC discretion and vacillation. However, the Cracker Barrel position created certainty at the price of shareholder suffrage, anti-discrimination principles, and lesbian and gay men.

The SEC's recent reversal of the Cracker Barrel position means that shareholder proposals which raise employment policy issues will no longer be automatically labeled ordinary business and, thus, barred from a shareholder vote. A coalition of 340 activist, religious and labor groups "declared victory" after the agency voted to adopt the revised rules.²⁹ The shareholder proposal is an important tool to address discrimination based on sexual orientation because there are so few avenues to confront this type of discrimination. Title VII and many state statutes do not prohibit discrimination based on sexual orientation, and even in jurisdictions where individuals can bring a state law claim, juries are not always receptive to claims based on sexual orientation. Thus, the shareholder proposal and accompanying media attention present an alternative strategy in the face of pervasive prejudice against lesbians and gay men.³⁰ However, the reversal of the Cracker Barrel position returns shareholders and managers to the uncertainty of the pre-Cracker Barrel position and does nothing to ensure that proposals addressing sexual orientation will be included in the future.

B. *Subtle Discrimination*

The problem of unaddressed employment discrimination is not confined to discrimination against lesbians and gay men. Empirical research demonstrates that when whites evaluate blacks, they frequently attribute negative acts "to personal disposition, while positive acts are discounted as the product of luck or special circumstances."³¹ This type of subtle discrimination based

²⁹ Mary Gordon, *SEC Broadens Shareholder's Voice*, ASSOCIATED PRESS, May 20, 1998. The coalition included the Social Investment Forum, the AFL-CIO, the Episcopal Church, several Catholic, Jewish and Baptist groups, the National Organization for Women, civil rights groups, environmentalist's organizations, children's advocates, the YWCA, and several corporations and financial firms such as the Burrito Brothers and the U.S. Trust Co. of Boston, Inc.

³⁰ Raymond J. Babin, *Letters to the Editor: Fighting for Our Lives and Livelihoods*, WALL ST. J., Jan. 16, 1995, at A15. Lesbians and gay men experience overt discrimination (examples include the "don't ask, don't tell" policy of the armed services, and the custody battle where Sharon Bottom was denied custody of her child based on her homosexuality) and violence (examples include death threats against the owners of Camp Sister Spirit and the murder of Matthew Shepard). Less-overt discrimination occurs in the form of denials of job promotions, salary increases, medical care, credit, and housing.

³¹ Michael Selmi, *Testing for Equality: Merit, Efficiency, and the Affirmative Action Debate*, 42 UCLA L. REV. 1251, 1283-85 (1995) ("When the discrimination is subtle or unconscious, even a non-discriminating employer may not be able to identify and correct the resulting inefficiencies . . . Stereotypes stem from the inability of individuals to internalize the social norms to which they openly ascribe so that while individuals proclaim they are not prejudiced their actions often indicate otherwise."). See also, James

on race or gender often goes unaddressed.³² Furthermore, it is not clear that corporations maintaining employment policies that disadvantage African-American workers will necessarily be driven from the market.³³ Moreover, Title VII remedies are not appropriate in all cases of subtle discrimination³⁴ and statutes like Title VII are difficult to apply to many jobs because judgments about the best candidate are inherently subjective.³⁵ Finally, institutional practices are not likely to be denounced under disparate impact analysis because changing these practices would involve fundamental restructuring of the way corporate firms do business.³⁶

Thus, non-conventional civil rights strategies may be more a more realistic means of addressing subtle discrimination where managers or juries are skeptical that discrimination exists. Similarly, promoting internal change within a corporation is probably a more effective method of curbing subtle forms of race and gender discrimination, as well as discrimination based on sexual orientation. Shareholder proposals provide an alternative strategy to foster internal change and address these subtle forms of discrimination.

C. A Potential Strategy

Both the Cracker Barrel policy of discrimination and the prevalence of more subtle forms of discrimination demonstrate a need to curb otherwise unaddressed discrimination. In the past, shareholder proposals have been

Jones, *Piercing the Veil: Bi-cultural Strategies for Coping with Prejudice and Racism* in *OPENING DOORS: PERSPECTIVES ON RACE RELATIONS IN CONTEMPORARY AMERICA*, 179, 195 (Harry J. Knopke et al. eds., 1991) ("the basic tendency for human beings [is] to make social categorical judgments leading to an in group preference").

³² For example, state and federal statutes do not require corporations to adopt affirmative action programs that would address this kind of subtle discrimination. *See also*, Barbara R. Bergmann, *The Corporation Faces Issues of Race and Gender*, in *THE AMERICAN CORPORATION TODAY* 269, 271-84 (Carl Kaysen ed., 1996) (including statistical evidence of continued work place discrimination against minorities and women).

³³ David B. Wilkins and G. Mitu Gulati, *Why Are There So Few Black Lawyers in Corporate Law Firms? An Institutional Analysis*, 84 CAL. L. REV. 493, 557 (1996) (rejecting the traditional economic assumption that firms that maintain employment policies that disadvantage black workers will necessarily be driven from the market).

³⁴ *Id.* at 585 (citing Barbara J. Flagg, *Fashioning a Title VII Remedy for Transparently White Subjective Decision Making*, 104 YALE L.J. 2009 (1995); S. Elizabeth Foster, *Comment, The Glass Ceiling in the Legal Profession: Why Do Law Firms Have So Few Female Partners*, 42 UCLA L. REV. 1631, 1668 (1995)).

³⁵ Wilkins and Gulati, *supra* note 33, at 586 ("At the hiring stage, the inherently subjective and provisional character of judgments about the quality of a given candidate would make it difficult for firms to develop a set of objective criteria capable of credibly determining which candidates are in fact better qualified.").

³⁶ *Id.* at 586.

effective in addressing discrimination. However, the effectiveness is usually indirect. In most cases, a shareholder proposal does not receive a majority of the vote and even when it does, the corporation is often not required to adopt the proposal.³⁷ In most states, even when a majority of the shareholders vote for a proposal, the proposal can only serve to advise the management.³⁸ Thus, shareholder proposals often have no direct effect on the decisions of managers.

However, the indirect effects of shareholder proposals can be significant. Even when formal changes are not made, symbolic messages have consequences.³⁹ Furthermore, a proposal influences management even if it fails to receive a majority vote.⁴⁰ Unlike a public election, anything less than a near-unanimous vote of confidence sends a message and may generate enough bad press and uneasy feelings to elicit action.⁴¹ For example, in 1970, "Campaign GM" submitted nine proposals, which addressed policies on mass transportation, air pollution, auto safety, and minority employment, for inclusion in the managers' proxy materials.⁴² Seven of the proposals were deemed excludable by the SEC⁴³ and the two shareholder proposals that were included received less than 3% of the shareholder votes.⁴⁴ However, the sponsors claimed success because the campaign focused public attention on issues of corporate responsibility and pressured General Motors's managers to make various changes including the appointment of an African-American to the board of

³⁷ Robert N. Leavell, *Corporate Social-Reform, The Business Judgment Rule and Other Considerations*, 20 GA. L. REV. 565 (1986) (discussing whether shareholder proposals should be advisory or mandatory).

³⁸ *Id.* While federal law determines which proposals must be included in management's proxy solicitations, state law determines the effect of the shareholder proposal.

³⁹ Joseph A. Grunfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 866 (1993) (arguing that "just vote no" campaigns do not oust incumbent directors but that they do have significant consequences); Ricki Fulman, *Shareholder Activism: Pension Funds Led Corporate Governance Revolution: Not Just for Gadflies Anymore, Investor Activism Gets Results*, Feb. 9, 1998, PENSIONS AND INVESTMENTS (for a brief history of effective proposals regarding financial performance and board accountability).

⁴⁰ John C. Wilcox, *Making the Best of Shareholder Resolutions*, 922 PLI/Corp 201, 203-205 (1995). Bob Monks, a proponent of shareholder activism through his LENS Fund, regards the proposal process and an "invaluable" tool for shareholders and states that "it almost doesn't matter what the subject of the proposal is," because the process has become so effective in attracting the attention of corporate executives and mobilizing shareholder support. *Id.*

⁴¹ Richard H. Koppes, *Institutional Investors, Now in Control of More than Half the Shares of US Corporations, Demand More Accountability*, NAT'L L.J., April 14, 1997, at B5.

⁴² Leavell, *supra* note 37, at 583.

⁴³ *Id.* at 583.

⁴⁴ Wilcox, *supra* note 40, at 344 (citing Schwartz, *Proxy Power & Social Goals: How Campaign GM Succeeded*, 45 ST. JOHN'S L. REV. 764 (1971)).

directors.⁴⁵ The success of the shareholder proposal depends on the goals of the proponents. A successful shareholder proposal may not be defined as a proposal receiving a majority vote, but rather as one that fosters a media campaign that has a practical effect on management decision making.

The shareholder proposals that influenced corporate behavior in South Africa also exemplify the potential effectiveness of proposals.⁴⁶ Many American corporations signed an agreement to honor the Sullivan principles, designed to promote equality in South Africa, in part, because of the influence of shareholder proposals.⁴⁷ The greatest amount of shareholder support was at Tinoca, Inc. where only 24.4% of the shareholder voting authority was in favor of the Sullivan Principles.⁴⁸ While these shareholder proposals won far less than a majority of the votes, they publicized the discriminatory policies of apartheid and indirectly influenced managers to take action.⁴⁹

Proposals by institutional shareholders are especially likely to command the attention of managers⁵⁰ and are often used to increase bargaining power when negotiating with managers.⁵¹ Even if it is not put to a vote, a proposal may prompt management to make concessions in return for the withdrawal of a proposal.⁵² Some commentators concede that these institutional proposals can be effective, but insist that they are inefficient; rather than attempting to alter management's behavior, institutional shareholders should abide by the "Wall Street Rule."⁵³ The Wall Street Rule requires shareholders to express their discontent by selling their stock when they are dissatisfied. However,

⁴⁵ *Id.* at 344.

⁴⁶ Virginia J. Harnisch, *Rule 14a-8 After Reagan: Does it Protect Social Responsibility Shareholder Proposals?*, 6 J.L. & POL. 415, 441 (1990).

⁴⁷ *Id.* at 441; Elizabeth Glass Geltman and Andrew E. Skroback, *Environmental Activism and the Ethical Investor*, 22 J. CORP. L. 465 (1997).

⁴⁸ Harnisch *supra* note 46, at 441 (citing *Shareholder Proposals On Governance, Social Responsibility Gain Support, Study Indicates*, Daily Report on Executives (BNA) No. 122, at A-4 (June 26, 1987)).

⁴⁹ *Id.* at 441.

⁵⁰ Robert N. Leavell, *supra* note 37.

⁵¹ Geltman and Skroback, *supra* note 47, at 469 n.31 (stating that the shareholders will meet with management, reach a compromise, and the proposal is withdrawn from the proxy process); Stewart J. Schwab and Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1023 (1998) (distinguishing union-shareholder initiatives designed to further union's traditional organizing and collective bargaining goals from those that enhance union's role in corporate decision-making).

⁵² Proposed Rule: Amendments to Rules on Shareholder Proposals, Securities and Exchange Commission, 17 CFR Part 240, at 35 Release No. 34-39093, File No. S7-25-97, [hereinafter *Proposed Rule*].

⁵³ Susan W. Liebler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425, 447 (1984).

this argument for selling stock does not incorporate the shareholders' preference for pressuring managers to address the particular source of their dissatisfaction. Furthermore, large investment funds often have so much stock in a corporation that they can only sell their shares to a limited number of other institutions.⁵⁴ Finally, many institutions use "indexing" so that their portfolios are shaped to match an index such as the S&P 500.⁵⁵ Once a fund is indexed, there is little opportunity or desire to change positions in the indexed portion of the portfolio.⁵⁶ In these situations, the shareholder proposal is both an effective and efficient way to communicate with management and confront otherwise unaddressed discrimination.

III. BACKGROUND: SHAREHOLDER PROPOSALS AND THE REJECTED PACKAGE OF REFORMS

A. *Shareholder Proposals Defined*

Corporations hold annual shareholder meetings in order to elect directors and vote on a variety of issues including: mergers, liquidations, sales of substantial assets, and amendments to the articles of incorporation.⁵⁷ Few shareholders actually attend these meetings, in part, because most shareholders do not own enough stock to affect the outcome.⁵⁸ Because few shareholders attend, shareholders may appoint an agent to attend the meeting and vote on their behalf. The agent is the shareholder's "proxy" and the document by which the shareholder appoints the agent is also called the "proxy."⁵⁹ Because the outcome of the meeting depends on the number of votes cast, the agent with the most proxies wins. The managers of the corporation solicit proxies from the shareholders directly.⁶⁰ If the shareholder signs and returns the managers' proxy card, then the shareholder authorizes the managers to vote on his or her behalf.⁶¹

⁵⁴ Warren F. Grienberger, *Institutional Investors and Corporate Governance*, 970 PLI/Corp 371, 374 (1997).

⁵⁵ *Id.* at 374.

⁵⁶ *Id.* at 374.

⁵⁷ See generally, WILLIAM A. KLEIN & J. MARK RAMSEYER, *BUSINESS ASSOCIATIONS: AGENCY, PARTNERSHIPS, AND CORPORATIONS* 484-526 (1997).

⁵⁸ *Id.* at 484.

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* at 485.

Congress delegated the task of regulating proxy solicitations to the SEC.⁶² The Securities Exchange Act of 1934 renders unlawful the solicitation of proxies in violation of the SEC's rules; these rules are now codified at 17 C.F.R. Section 240.14a ("Rule 14a"). They seek "to prevent management or others from obtaining authorization of corporate action by means of deceptive or inadequate disclosure in proxy solicitation."⁶³ The SEC interprets Rule 14a-9 to require management to provide shareholders with the opportunity to submit proposals to management for inclusion in management's proxy material.⁶⁴ This interpretation is intended to ensure that the contents of the proxy statement accurately reflect all the issues that will arise at the annual meeting.⁶⁵ Corporations are required to inform shareholders of these proposals so that shareholders can take into account the proposals that will be voted on when they choose who will be their proxy.⁶⁶

Between 300 and 400 companies typically receive a total of about 900 shareholder proposals each year.⁶⁷ A majority of the proposals focus on corporate governance and compensation matters.⁶⁸ However, a significant number of proposals also address social policy issues.⁶⁹ There is a history of shareholder proposals regarding issues such as divestment from South Africa, adoption of the MacBride principles (addressing discrimination in Northern Ireland), withdrawal from the production of napalm, disclosure of environmental information, and policies regarding affirmative action and employment discrimination.⁷⁰

⁶² *Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc.*, 821 F.Supp. 877, 881 (S.D.N.Y. 1993). In contrast, shareholder proposals that are presented by a shareholder in attendance at the annual meeting are regulated by state law.

⁶³ *Wal-Mart*, 821 F.Supp. at 881 (citing *J.I. Case Co. v. Borak*, 377 U.S. 426, 431, (1964)); 1934 Securities Exchange Act, 41 Fed. Reg. 52.

⁶⁴ *Id.* at 882.

⁶⁵ *Id.*

⁶⁶ *New York City Employee's Retirement System v. American Brands, Inc.*, 634 F.Supp. 1382, 1386 (S.D.N.Y. 1986) ("Since a shareholder may present a proposal at the annual meeting regardless of whether the proposal is included in a proxy solicitation, the corporate circulation of proxy materials which fail to make reference to a shareholder's intention to present a proper proposal at the annual meeting renders the solicitation inherently misleading.").

⁶⁷ *Proposed Rule*, *supra* note 52.

⁶⁸ *Id.*

⁶⁹ *Proposed Rule*, *supra* note 52. 'Social policy' proposals address a wide variety of topics such as: the environment, the manufacture of tobacco products, divestment from South Africa, employment discrimination, child labor, etc.

⁷⁰ Geltman and Skroback, *supra* note 47 (tracing the history of shareholder proposals); Kevin W. Waite, Note: *The Ordinary Business Operations Exception to the Shareholder Proposal Rule: A Return to Predictability*, 64 *FORDAM L. REV.* 1253 (1995); Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance* 85 *CAL. L. REV.* 1 (1997).

Without management's subsidy of shareholder proposals through the distribution of proxy materials, reform initiatives would be rare.⁷¹ If a proposal is unsuccessful, state law provides no mechanism for reimbursement from the corporation.⁷² Even if a proposal is successful in raising the value of the stock, the proponent would only gain in proportion to his or her share holdings.⁷³ Other shareholders would benefit from the proposal without having to contribute to the costs of the proposal. Without Rule 14a-8, requiring management to bear the cost of distribution, the financial disincentives to shareholder proposals would be great. The subsidized distribution alleviates the collective action and free-rider problems that shareholders must overcome.⁷⁴

Rule 14a-8(c)(7) generally requires management to include shareholder proposals. However, an exception to the rule permits management to omit a shareholder proposal if "the proposal deals with a matter relating to the conduct of the ordinary business operations."⁷⁵ The policy underlying the ordinary business exception is to confine the resolution of everyday problems to the managers since it is impractical for shareholders to decide how to solve such problems.⁷⁶ The ordinary business exception excludes proposals that shareholders, as a group, would not be qualified to judge due to a lack of business expertise and intimate knowledge of the company.⁷⁷ A shareholder proposal about ordinary business operations would also be improper if raised at an annual meeting because most states, including Delaware, maintain that ordinary business operations are under the authority of the directors and not the shareholders.⁷⁸ Thus, when the SEC applies the ordinary business exception, it does so to save management the cost of including a proposal that would be improper if raised by a shareholder at the annual meeting.⁷⁹

Managers who wish to omit shareholder proposals from their proxy statement must file with the SEC and may request that the SEC issue a "no-action" letter.⁸⁰ In a no-action letter the SEC staff informs the company whether or not the SEC will "act" if management omits the proposal.⁸¹

⁷¹ Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879, 895 (1994).

⁷² *Id.* at 896.

⁷³ *Id.*

⁷⁴ *Id.* at 895.

⁷⁵ 17 C.F.R. Section 240.14a-8.

⁷⁶ *Proposed Rule*, *supra* note 52, at 12; *Financial Services Alert*, BUSINESS MONITOR, June 30, 1998.

⁷⁷ *Proposed Rule*, *supra* note 52, at 12 (citing Exchange Act Release No. 12999 (Nov. 22, 1976)).

⁷⁸ *Wal-Mart*, 821 F.Supp. at 883.

⁷⁹ *Id.* at 883.

⁸⁰ *Id.*

⁸¹ *Id.*

Management must demonstrate that it would be improper to include a particular shareholder proposal in its proxy materials.⁸² These no-action letters have historically been inconsistent and confusing. The SEC issued the 1976 Interpretive Release to try to clarify its position on the ordinary business exception:

The term "ordinary business operations" has been deemed on occasion to include certain matters which have significant policy, economic or other implications inherent in them. For instance, a proposal that a utility company not construct a proposed nuclear power plant has in the past been considered excludable. In retrospect, however, it seems apparent that the economic and safety considerations attendant to nuclear power plants are of such magnitude that a determination whether to construct one is not an "ordinary" business matter. Accordingly, proposals of that nature as well as others having major implications [will] be considered beyond the realm of an issuer's ordinary business operations, and future interpretive letters of the Commission's staff will reflect that view. . . . Thus, where proposals involve business matters that are mundane in nature and do not involve any substantial policy or other considerations, the subparagraph may be relied upon to omit them.⁸³

Despite this attempt to clarify, the SEC's application of the ordinary business exception has continued to vacillate.⁸⁴

B. *Employment Policy Proposals: The Wal-Mart and Cracker Barrel Controversies*

Since 1983, the SEC has determined whether employment policy proposals may be excluded under the ordinary business exception by asking if the proposal relates to day-to-day employment matters rather than significant policy considerations.⁸⁵ Day-to-day employment matters that may be omitted from management's proxy material include: employee health benefits, general compensation issues not focused on senior executives,

⁸² *Id.* (citing Adoption of Amendments to Proxy Rules, Securities Exchange Act Release No. 4979, 1954 SEC LEXIS 38 *3 (Jan. 6, 1954)).

⁸³ *Id.* (citing Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12999, 41 Fed. Reg. 52 (Dec. 3, 1976)).

⁸⁴ *Id.* at 886.

⁸⁵ *Id.*

management of the work place, employee supervision, labor-management relations, employee hiring and firing, conditions of employment, and employee training.⁸⁶ Before 1992, the SEC found that proposals regarding equal employment and affirmative action raised policy concerns above and beyond day-to-day employment matters.⁸⁷ Thus, these types of proposals could not be excluded under the ordinary business exception.⁸⁸

Yet, in 1992, the SEC reversed this position, stating that Cracker Barrel could omit the shareholder proposal that asked the corporation to discontinue discrimination based on sexual orientation.⁸⁹ In the 1992 no-action letter to Cracker Barrel, the SEC wrote the following:

⁸⁶ *Id.* at 887 (citing United Technologies Co., SEC No-Action Letter, 1993 SEC No-Act. LEXIS 288 (Feb. 19, 1993)); *Proposed Rule*, *supra* note 52 (stating that in 1997 the SEC received approximately 30 submissions implicating the Cracker Barrel position on employment-related proposals).

⁸⁷ American Telephone and Telegraph Company, SEC No-Action Letter, SEC No-Act. LEXIS 1716 (Dec. 21, 1988) (stating that the non-discrimination and affirmative action shareholder proposal involved policy issues and, thus, could not be omitted from AT&T's proxy material under the ordinary business exception); Dayton Hudson Corporation, SEC No-Action Letter, SEC No-Act. LEXIS 428 (March 8, 1991) (stating that the shareholder proposals requesting progress reports on the areas of equal employment opportunity and affirmative action could not be excluded under the ordinary business exception).

⁸⁸ *Id.* Although the ordinary business exception may not apply, the SEC rules contain other potential exceptions. For example, proposals can be omitted if the proposal is based on a personal grievance, the proposal is not relevant to the business of the corporation, or the proposal is beyond the power of the corporation to effectuate. 17 C.F.R. Section 240.14.

⁸⁹ *Cracker Barrel No-Action Letter*, *supra* note 1, at *43. The fact that the SEC conclusively changed its policy in a situation that involved discrimination against lesbians and gay men should not be ignored. Some may argue that the SEC changed its position because this shareholder proposal dealt with lesbians and gay men. Lesbians and gay men have little formal protection and one could assert that it is not coincidental that the SEC viewed this as an appropriate time to shift its policy. Yet, to counter this suggestion it is relevant to note that in 1991 (a year before the Cracker Barrel no-action letter) the commission hinted at the shift in policy in a no-action letter that had nothing to do with lesbians and gay men. The SEC no-action letter issued to Capital Cities/ABC found that the affirmative action proposal could be excluded from the management's proxy material. More specifically, it stated that the shareholder proposal was excludable because it requested detailed information on the composition of the company's work force, employment practices and policies. *Wal-Mart*, 821 F.Supp. at 888 (citing *Wal-Mart Stores Inc.*, SEC No-Action Letter, 1991 SEC No-Act. LEXIS 572 (Apr. 10, 1991)). This statement seemed to imply that a shareholder proposal was excludable if it related to 'employment practices and policies.' The Capital Cities/ABC proposal also requested a summary of timetables to implement affirmative action programs. *Wal-Mart*, 821 F.Supp. at 887. Thus, it is unclear if the SEC intended to shift its position in the Capital Cities no-action letter so that any employment related proposal was now excludable or if the SEC meant to merely make proposals requesting timetables excludable. In any case, the Capital Cities decision was vacated, at the request of the parties, in order to facilitate settlement. *Wal-Mart*, 821 F.Supp. at 888 (citations omitted). While the Capital Cities/ABC no-action letter was not conclusive, it did hint at the upcoming Cracker Barrel position. Thus, it counters the assertion that the SEC changed its position because the Cracker Barrel proposal addressed sexual orientation.

Notwithstanding the general view that employment matters concerning the workforce of the company are excludable as matters involving the conduct of day-to-day business, exceptions have been made in some cases where a proponent based an employment-related proposal on "social policy" concerns. In recent years, however, the line between includable and excludable employment-related proposals based on social policy considerations has become increasingly difficult to draw. The distinctions recognized by the staff are characterized by many as tenuous, without substance and effectively nullifying the application of the ordinary business exclusion to employment-related proposals.

The Division has reconsidered the application of Rule 14a-8(c)(7) to employment-related proposals in light of these concerns and the staff's experience with these proposals in recent years. As 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.*⁹⁰

With this statement, the SEC changed its position; employment related proposals focusing on significant social policy issues could automatically be excluded under the ordinary business exception.⁹¹ In response to this change in position, NYCERS sued the SEC and argued that the court should not defer to the SEC's Cracker Barrel position. Generally, when a court reviews an administrative regulation such as the SEC's rules, the court must look to the agency's interpretation, which is controlling unless that interpretation is "plainly erroneous or inconsistent with the regulations."⁹² Although the court need not defer to an individual no-action letter, courts have historically relied on the consistency or lack of consistency of the SEC's position in determining whether a proposal deemed excludable by the SEC staff should really be

⁹⁰ *Cracker Barrel No-Action Letter*, *supra* note 1, at *2-*3 (emphasis added).

⁹¹ *Proposed Rule*, *supra* note 52, at 12.

⁹² *Wal-Mart*, 821 F.Supp. at 883 (citing *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)).

omitted.⁹³ In *NYCERS v. SEC*,⁹⁴ the Second Circuit deferred to the SEC's Cracker Barrel position that allowed all employment related proposals to be excluded under the ordinary business exception.

In striking contrast to the *NYCERS v. SEC* decision, the district court in *Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores Inc.*,⁹⁵ did not defer to the SEC. Instead the *Wal-Mart* court held that the employment practices of Wal-Mart involved significant policy issues (rather than ordinary business) and, thus, required Wal-Mart's management to include the shareholder's proposal in its proxy solicitation.⁹⁶ This holding makes a significant statement about who holds control over employment discrimination policies in a corporation. The *Wal-Mart* court interpreted the 1934 Securities Exchange Act and held that policies regarding equal employment opportunities and affirmative action were subject to a shareholder vote.⁹⁷

In *Wal-Mart*, the district court did not defer to the SEC's Cracker Barrel position primarily because the SEC failed to apply both parts of the 1976

⁹³ *Wal-Mart*, 821 F.Supp. at 885 (declining to defer to the SEC and relying on cases which find that an agency interpretation that conflicts with earlier interpretations or shifts rationale is entitled to considerably less deference than a consistently held agency position) (citations omitted).

⁹⁴ 45 F.3d 7 (2d Cir. 1995).

⁹⁵ 821 F.Supp. 877 (S.D.N.Y. 1993) (affirmed by *Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc.*, 54 F.3d 69 (2d Cir. 1995)).

⁹⁶ 1993 Wal-Mart Shareholder Proposal, reprinted in *Wal-Mart*, 821 F.Supp. at 880. The proposal requested that Wal-Mart's board of directors prepare reports addressing the following:

- 1) A chart identifying employees according to their sex and race in each of the nine major EEOC defined job categories for 1990, 1991, and 1992 listing either numbers or percentages in each category.
- 2) A summary description of affirmative action programs to improve performance especially in job categories where women and minorities are under utilized and a description of major problems in meeting the company's goals and objectives in this area.
- 3) A description of steps taken to increase the number of managers who are qualified females and ethnic minorities.
- 4) A description of ways in which Wal-Mart publicizes our company's policies to merchandise suppliers and service providers to encourage forward action on their part as well.
- 5) A description of Wal-Mart's efforts to purchase goods and services from minority and female owned business enterprises. . . .

The proposal also stated:

We believe the vast majority of Wal-Mart's customers are either women or members of a racial minority group.

We believe it makes good business sense for Wal-Mart to describe and publicize its employment standards which relate to its core customer groups and potential employees. By publicizing its standards, Wal-Mart will be an example to companies with whom it does business.

The *Wal-Mart* district court held that the proposal could not be omitted as long as requests for information regarding day-to-day business affairs were deleted from the proposal.

⁹⁷ The 1934 Securities Exchange Act, 41 Fed. Reg. 52. The Act asserts that shareholders have a voice in significant policy decisions made by a corporation.

Interpretive Release previously discussed.⁹⁸ The release states that a proposal relating to day-to-day business affairs is only excludable if it also does not raise any substantial policy considerations.⁹⁹ However, the Cracker Barrel position created a bright-line rule that all employment related proposals were excludable under the ordinary business exception because they related to day-to-day business affairs, regardless of whether the proposal also involved a substantial policy consideration.¹⁰⁰ Thus, the Cracker Barrel position flatly disregarded the requirement that the proposal must be free of substantial policy considerations in order to be omitted.¹⁰¹ The *Wal-Mart* district court refused to defer to the SEC's Cracker Barrel position because it contradicted the 1976 Interpretive Release.¹⁰²

The shareholder proposal in *Wal-Mart* sought to identify corporate policy regarding equal employment and to promote such policies among suppliers.¹⁰³ The proposal also requested information about every "step" Wal-Mart management took to increase the number of female and minority managers, and asked the corporation to state the "ways" Wal-Mart publicized its equal employment opportunity and affirmative action policies.¹⁰⁴ The *Wal-Mart* district court found that a request for the corporation to state the "ways" Wal-Mart publicized was excludable because it involved the mundane matters of Wal-Mart's day-to-day business.¹⁰⁵ Thus, the court held that the proposal had to be included in management's proxy material, provided the shareholders agreed to delete the parts of the proposal that involved these mundane matters.¹⁰⁶

⁹⁸ *Wal-Mart*, 821 F.Supp. at 889.

⁹⁹ *Id.* at 890 (citing 1976 Interpretive Release, 41 Fed. Reg. 52).

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² *Id.*

¹⁰³ *Wal-Mart*, 821 F.Supp. 877 (affirmed by *Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc.* 54 F.3d 69 (2d Cir. 1995)). Very few courts have reviewed exclusions of employment related proposals under the ordinary business exception. See generally, *New York City Employees Retirement Systems v. American Brands*, 634 F.Supp. 1382 (D.C.N.Y. 1986) (requiring the corporation to include the shareholder proposal requesting adoption of the MacBride Principles, which set equal employment guidelines in Northern Ireland, because otherwise shareholders would be irreparably harmed).

¹⁰⁴ *Wal-Mart*, 821 F.Supp. at 891.

¹⁰⁵ *Id.* at 891.

¹⁰⁶ *Id.* at 892; Klein, *supra* note 57, at 517 (stating that about 90% of the votes cast in the Wal-Mart meeting were opposed to the proposal considered in the above case); *Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc.* 54 F.3d 69, 70 (2d Cir. 1995) (requiring Wal-Mart to pay plaintiff's attorney fees of \$54,140.00).

C. *The Rejected Package of Reforms*

Before the recent reversal of the Cracker Barrel position, the SEC proposed a package of reforms. The package of reforms included reversal of the Cracker Barrel position, a 3% override provision, an increase in the resubmittance threshold, a change in the relevancy exclusion, and a modification of the personal grievance exclusion.

The proposed package created so much debate that the SEC extended its public comment period.¹⁰⁷ While many were pleased with the proposed reversal of the Cracker Barrel position,¹⁰⁸ others argued that the package of reforms would curtail access to the shareholder proposal process.¹⁰⁹ A coalition of shareholder activists, including the California Public Employee's Retirement System, representing more than \$1 trillion in pension assets, argued that if the proposed rule changes had been instituted previously, shareholder advocacy campaigns addressing apartheid in South Africa and the sale of tobacco to American youths would have been virtually impossible.¹¹⁰ Jesse Jackson, president of Rainbow/PUSH Coalition, called the proposed reforms "a grand insult to the intelligence of people who are shareholders."¹¹¹

¹⁰⁷ Steve Bailey and Steven Syre, *Silencing the Shareholders, SEC Reform Proposals End Up Reining in Resolutions Too Much*, BOSTON GLOBE, Dec. 11, 1997, at A42.

¹⁰⁸ SEC home page: www.sec.gov/rules/proposed/s72597/any25972.txt [hereinafter *Individuals' E-mail*]. Individuals e-mailed Chairman Arthur Levitt at the SEC to express their support of the proposed rule change. The letters were posted on the SEC home page: "I am writing to urge your continued support of the Securities and Exchange Commission's proposal for change in the rules governing shareholders' rights regarding company policy—particularly as it impacts job discrimination on the basis of sexual orientation. . . . You have collaborated in barring eligible—but less privileged—voters from the ballot box. (That puts you in company with the likes of many Southern small town white sheriffs in the 1960's.) I am glad that you—like George Wallace—finally repented." Daniel C. Barcus, 416 West Briar Place, Chicago, IL 60657, barcus@attmail.com; "I myself, will not knowingly do business with an establishment which is know to be prejudice, whether it be for the color of one's skin, the person's gender, the person's sexual orientation, or for one's age. . . . I have not, nor would, nor will perpetrate nor perpetuate discrimination in any shape, way, or form. Neither should you, nor other government employees, especially in the course of their duties to the U.S. public." L.H. Kinder, 11200 SEE C-42, Unit C, Summerfield, FL 34491. These individuals would have considered the SEC proposed rule change to be a victory for shareholders in general and more specifically, for shareholder proposals that seek to curb discrimination. The e-mail letters hold the SEC responsible for allowing the exclusion of these anti-discrimination proposals and incorrectly assume that the proposals will automatically be included if the SEC reverses its Cracker Barrel position.

¹⁰⁹ Mary Gordon, *SEC Broadens Shareholder's Voice*, ASSOCIATED PRESS, May 20, 1998 ("Agency staff members said they didn't recommend adoption of some of the earlier proposals because of strong opposition expressed in letters by more than 2,000 individuals and organizations.").

¹¹⁰ Rachel Witmer, *Proxies: Jesse Jackson Joins Shareholder's Groups Spurning SEC's Shareholder Proposal Plan*, BNA, Securities Regulations and Law, Vol. 29, at 1518, 1519 (1997).

¹¹¹ *Id.* at 1518.

Nell Minow of LENS, Inc., a fund with \$100 million, explained that "[c]orporations try to cut off questions, try to cut off embarrassment," even though it is in the corporation's financial interest to deal with diversity and environmental issues.¹¹²

Particularly controversial was the 3% override provision; the provision would have allowed 3% of share ownership to override a management decision and force management to include proposals about ordinary business matters.¹¹³ Elizabeth Elliott McGeveran, managing director of Co-op America, objected to this 3% override provision.¹¹⁴ McGeveran argued that the override level should be lowered to 0.25%, rather than 3%, as that would be a "reasonable indicator of massive shareholder concern."¹¹⁵ Securities and Exchange Commissioner, Steven Wallman, also doubted the effectiveness of the 3% override. He wrote that "[w]hile theoretically proponents of a social proposal could be helped by the availability of a shareholder override—a threshold set at the high level of 3 percent—combined with the practical difficulties of soliciting or doing a major publicity campaign—will constrain its practical effectiveness."¹¹⁶

The rejected package would have also increased the resubmission thresholds, thus, making it harder to present proposals receiving a small percentage of the votes cast on an earlier submission.¹¹⁷ Currently, under rule 14a-8(c)(12), if a proposal fails to receive a specified level of support, then proposals addressing substantially the same subject matter can be excluded for a three year period. In order to avoid future exclusion, a proposal must receive at least 3% of the vote on its first submission, 6% on the second, and 10% on the third. The rejected rule sought to increase the resubmission threshold to 6% on the first submission, 15% on the second submission, and 30% on the third. The coalition of shareholder activists also criticized this increased threshold requirement. Tom Flanagan, President of Investors Rights Association of America, asserted that, "most decent proposals only get 25% of the votes."¹¹⁸ He concluded that the 30% threshold in the third year "will knock out almost all proposals."¹¹⁹

¹¹² *Id.*

¹¹³ *Proposed Rule*, *supra* note 52, at 14-17.

¹¹⁴ Witmer, *supra* note 110, at 1519.

¹¹⁵ *Id.* at 1519.

¹¹⁶ Bailey and Syre, *supra* note 107. *See also*, Michael Schroeder, *Groups Unite to Oppose SEC's Efforts to Shift Stance on Shareholder Issues*, WALL ST. J., Oct. 23, 1997, at A8.

¹¹⁷ *Proposed Rule*, *supra* note 52, at 13.

¹¹⁸ Witmer, *supra* note 110, at 1519.

¹¹⁹ *Id.* at 1519.

The current rule also permits management to exclude proposals relating to a personal claim or grievance.¹²⁰ This management decision can then be reviewed by the SEC staff to determine whether or not the exclusion applies. Under the rejected package, the SEC would have expressed "no view" on the exclusion of a proposal if the proposal, on its face, related to a personal grievance.¹²¹ The coalition also criticized this personal grievance provision and argued that almost anything can be characterized as a personal grievance. Minow demonstrated the problem by pointing out that she does not resort to submitting a shareholder proposal until she has had some difficulty dealing with the managers of the corporation.¹²² In other words, any shareholder proposal, by its very nature, can be characterized by the managers as a personal grievance.¹²³ Because of overwhelming criticism of these provisions, the SEC rejected the proposed package of reforms and merely reversed its Cracker Barrel position.¹²⁴ Shareholder activists celebrated this reversal as a victory.

IV. THE LIMITS OF THE REVERSAL OF THE CRACKER BARREL POSITION

At first glance, the reversal of the Cracker Barrel position appears to be a major achievement for advocates of discrimination related shareholder proposals.¹²⁵ Proposals designed to address employment discrimination are once again eligible for shareholder review. However, the reversal of the

¹²⁰ *Proposed Rule*, *supra* note 52, at 7.

¹²¹ *Id.* at 8.

¹²² Witmer, *supra* note 110, at 1519.

¹²³ Currently, Rule 14-8(c)(5) also allows shareholder proposals to be excluded if they are not "relevant." The rule permits managers to exclude a proposal relating to operations that involve less than 5% of the corporation's assets, if not "otherwise significantly related to the corporation's business." *Proposed Rule*, *supra* note 52, at 8. The rejected rule would have made this relevancy exception into a purely economic test that would not have considered whether or not the proposal is "otherwise significantly related to the corporation's business." *Proposed Rule*, *supra* note 52, at 8.

¹²⁴ Mary Gordon, *SEC Broadens Shareholder's Voice*, Associated Press, May 20, 1998; *Leader in Socially Responsible Investing Responds to Proposed Shareholder Rules by SEC*; *Calvert Seeks Greater Access to Information on Employment Practices for Shareholders*, BUSINESS WIRE, Dec. 8, 1997 (the Calvert Group submitted formal comments to the SEC stating that the proposed amendments would be un-supportive and stifling to shareholder democracy); Bailey and Syre, *supra* note 107 (former SEC commissioner Steven M.H. Wallman stated, "While Cracker Barrel may be reversed in form if the proposals are adopted, it is unclear . . . whether it will be reversed in substance."); Steve Goldstein, *Governance Gurus Lean Toward Investors in Shareholder Proposal Fight*, Institutional Investors, Inc., CORP. FIN. WEEK, Jan. 5, 1998; Dominic Bencivenga, *Finding Middle Ground, Two Experts Craft SEC Compromise Proposal*, NEW YORK L.J., Jan 29, 1998; Cornish F. Hitchcock, *SEC Moves to Silence Shareholders*, NEW JERSEY L.J., Jan 5, 1998 at 20 (criticizing the package of reforms and pointing out that to use the 3% override provision at a large corporation such as General Electric, shareholders would need \$2 billion in GE stock).

¹²⁵ *Individuals' E-mail*, *supra* note 108.

Cracker Barrel position exchanges a bright-line rule for the discretion of the SEC, and returns shareholders, managers, and the courts to the vacillation and uncertainty that existed before the Cracker Barrel position.

A. History of SEC Vacillation

The reversal of Cracker Barrel's bright-line approach is a return to the case-by-case analysis¹²⁶ that produced contradictory and confusing no-action letters. This vacillation by the SEC creates inconsistent case law and frustrates the efforts of both shareholders and managers. Indeed, it was this very confusion and frustration that lead to the Cracker Barrel bright-line rule in 1992.¹²⁷ The history of SEC vacillation about the ordinary business exception leaves the discrimination related proposal on shaky ground.

Matters once treated as excludable ordinary business are later considered "significant issues of public policy." Examples include the following: senior executive compensation;¹²⁸ director compensation;¹²⁹ tobacco manufacturing and production;¹³⁰ plant closings;¹³¹ and golden parachutes.¹³² At the same

¹²⁶ SEC Proposes Reform of Shareholder Proposal Process, Corporate Secretary's Guide: Corporate Directions 149, Issue No. 229, Oct. 7, 1987.

¹²⁷ *Cracker Barrel No-Action Letter*, supra note 1. See generally, Waite supra note 70 (arguing that the ordinary business exception should be eliminated because of the confusion and uncertainty it causes); Andrew J. Frackman and Achilles M. Perry, *ACTWU v. Wal-Mart: Is this the Cost of Corporate Democracy?*, 9 INSIGHTS 2, 3 (Aug. 1995) (stating that the uncertainty reflected in the Cracker Barrel no-action letter undermines the utility of the shareholder proposal rule and exceptions).

¹²⁸ Compare Reebok Intl. Ltd., SEC No-Action Letter, 1991-1992 Transfer Binder Fed.Sec.L.Rep. (CCH) Para. 76,131, at 79,337 (Mar. 16, 1992) (stating that proposals relating to senior executive compensation can not be omitted because such proposals "no longer can be considered matters relating to a registrant's business") with General Electric Co., SEC No-Action Letter, 1990 SEC No-Act LEXIS 136 (Jan. 31, 1990) (allowing exclusion of proposal regarding incentive compensation since it deals with a matter of ordinary business, namely employee compensation). See generally, Eric A. Welter *The Shareholder Proposal Rule: A Change to Certainty*, 60 GEO. WASH. L. REV. 1980, 2004 (1992).

¹²⁹ Compare Black Hills Corp., SEC No-Action Letter, 1992 SEC No-Act LEXIS 212 (Feb. 13, 1992) (stating that management must include a proposal relating to retirement plans for outside directors because proposals relating to "director compensation no longer can be considered matters relating to a registrant's business") with North Fork Bancorporation, SEC No-Action Letter, 1991 SEC No-Act LEXIS 409 (Mar. 5, 1991) (stating that management may exclude a proposal requiring directors to waive their fees until the stock price reached a specified level because the proposal relates to "ordinary business operations").

¹³⁰ Compare Philip Morris Companies, Inc., SEC No-Action Letter, 1990 SEC No-Act LEXIS 335 (Feb. 13, 1990) (stating that management must include a proposal forbidding the company from doing business in tobacco products after December 31, 1999) with Philip Morris Companies, Inc., SEC No-Action Letter, 1990 SEC No-Act LEXIS 96 (Jan. 18, 1990) (stating that management may exclude a very similar proposal). See generally, Welter supra note 128 at 2004.

¹³¹ Compare Pacific Telesis Group, SEC No-Action Letter, 1989 SEC No-Act LEXIS 104 (Feb. 2,

time, matters once considered "significant policy issues" are later treated as excludable "ordinary business." The following are examples: corporate charitable contributions;¹³³ the manufacture of tobacco-related products;¹³⁴ and affirmative action and equal employment policies.¹³⁵ The SEC's reversals of its own staff position add to this inconsistency.¹³⁶ For example, in a no-action letter to Capital Cities/ABC¹³⁷ the SEC staff first issued a no-action letter

1989) (stating that management must include a proposal for study on impact of plant closings and announcing staff position to allow inclusion of proposals that "deal generally with the broad social and economic impact of plant closings or relocations") with Centennial Group, Inc., SEC No-Action Letter, 1989 SEC No-Act LEXIS 955 (Sept. 7, 1989) (stating that management may exclude a proposal to reverse decision to close a particular plant because closing of facilities is a matter of "ordinary business operations"). *See generally*, Welter, *supra* note 128 at 2004.

¹³² Compare Transamerica Corp., SEC No-Action Letter, 1989-1990 Transfer Binder Fed.Sec.L.Rep. (CCH) Para. 78,338, at 79,260 (Jan. 10, 1990) (stating that management must include a proposal on golden parachutes and reversing staff position by citing to changes in the tax code and an increasing "public debate concerning potential anti-takeover, tax and legal implication of golden parachute[s]") with Centennial Group, Inc., SEC No-Action Letter, 1989 SEC No-Act LEXIS 955 (Sept. 7, 1989) (stating that management may exclude a proposal to limit golden parachute payments to two executives because proposal relates to "ordinary business operations"). *See generally*, Welter, *supra* note 128 at 2004.

¹³³ Compare Exxon Corp., SEC No-Action Letter, 1992 SEC No-Act LEXIS 209 (Feb. 19, 1992) (stating that management may exclude a proposal that company refrain from giving money to pro-abortion groups) with American Telephone and Telegraph Co., SEC No-Action Letter, 1991 SEC No-Act LEXIS 76 (Jan. 16, 1991) (stating that management must include proposals that company contribute to teenage pregnancy prevention programs on the ground that management decisions on charitable expenditures involve issues "beyond matters of the Company's ordinary business operations").

¹³⁴ Compare Mobil Corp., SEC No-Action Letter, 1991 SEC No-Act LEXIS 344 (Feb. 28, 1991) (stating that management may exclude a proposal to stop manufacture of plastic film used in cigarette packaging) with Kimberley-Clark Corp., SEC No-Action Letter, 1990 SEC No-Act LEXIS 330 (Feb. 22, 1990) (stating that management must include a proposal to cease production of cigarette paper by Dec. 31, 1999, because of "growing significance of the social and public policy issues attendant to the operations of involving the manufacture of tobacco related products").

¹³⁵ Compare Cracker Barrel Old Country Store, Inc., SEC No-Action Letter, SEC No-Act LEXIS 984 (Oct. 13, 1992) (stating that management may exclude a proposal that company implement no-discriminatory employment policies related to sexual orientation because day-to-day issues concerning hiring and other personnel matters are properly left to the company management) with Dayton Hudson Corp., SEC No-Action Letter, SEC No-Act LEXIS 428 (Mar. 8, 1991) (stating that management must include a proposal for report on the progress of equal employment opportunity and affirmative action because such questions "involve policy decisions beyond those personnel matters that constitute the company's ordinary business").

¹³⁶ Palmiter, *supra* note 71, at 908.

¹³⁷ *Wal-Mart*, 821 F.Supp. at 887 (citing Capital Cities/ABC, Inc., SEC No-Action Letter, SEC No-Act LEXIS 525, at *1 (Apr. 4, 1991); Def. Ex. P at 1 [Letter from Secretary of SEC to General Counsel of Capital Cities/ABC] Apr. 4 1991). *See also*, Wal-Mart Stores, Inc., SEC No-Action Letter, SEC No-Act LEXIS 572 (Apr. 10, 1991) (reversing staff position and allowing exclusion of a proposal to establish a program to provide affirmative action information to shareholders); Texaco Inc., SEC No-Action Letter, SEC No-Act LEXIS 498 (Mar. 31, 1992) (reversing staff position and allowing exclusion of proposal

requiring inclusion of a shareholder proposal calling for annual reports on the company's affirmative action programs. Upon the request of the management, the SEC reviewed its no-action letter, reversed its own staff's position, and stated that the proposal was excludable under the ordinary business exception.¹³⁸ The SEC's recent reversal of the Cracker Barrel position fails to clarify which shareholder proposals should be excludable under the ordinary business exception. Instead, it merely returns discretion to the SEC,¹³⁹ allowing more inconsistent and contradictory no-action letters.¹⁴⁰

Although the SEC's Cracker Barrel position failed to establish a fair and reasonable rule about which sorts of proposals should have been excluded, the position was successful in that it created a clear rule that shareholders and managers relied on when making decisions about shareholder proposals.¹⁴¹ However, the recent reversal of the Cracker Barrel position does not provide any guarantees that employment discrimination related proposals will be included because the SEC still has the authority to declare all discrimination related proposal excludable under the ordinary business exception.¹⁴² The varying viewpoints of the SEC leadership and their historical tendency to

requesting the company to reject any taxpayer-guaranteed loans in its overseas operations).

¹³⁸ *Id.*

¹³⁹ *Proposed Rule, supra* note 52.

¹⁴⁰ Because the SEC must, once again, determine which discrimination related proposals fall into the ordinary business exception, it is important to point out the ways in which discrimination policies are not ordinary business. A policy to discriminate based on sexual orientation is very different from issues of management in the work place, employee supervision, and hiring and firing, in part, because it is so controversial. It is the controversy raised by explicit discrimination that makes it far from ordinary. Thus, a proposal involving controversial discrimination policies should not fall under the ordinary business exception. *See generally*, Steven M. H. Wallman, *Equality Is More Than 'Ordinary Business'*, N.Y. TIMES, Mar. 30, 1997, at section 3, page 12. If the SEC returns to a position of discretion, it should distinguish controversial employment discrimination proposals from more ordinary and mundane employment proposals. *Id.*

¹⁴¹ *See generally*, Connell *supra* note 4 (arguing that the Cracker Barrel position was a "line drawn wrong").

¹⁴² "Although social policy proposals related to employment will no longer be automatically excludable, neither will they be automatically included. The return to subjective line-drawing by the staff, coupled with the shift to purely economic test under the relevance exclusion, leaves open the possibility of continued attempts to exclude many social proposals (whether related to employment or not)." Proposed Rule Supplement: Concurrence of Commissioner Steven M.H. Wallman (S7-25-97) (www.sec.gov/rules/proposed/s72597cn.htm) [hereinafter *Concurrence of Commissioner Wallman*]; SEC *Proposes Reform of Shareholder Proposal Process*, Corporate Secretary's Guide: Corporate Directions, Issue No. 229, October 7, 1987, at 149; Connell, *supra* note 4, at 426 ("Moreover, we would just be waiting for the day when there is the next Cracker Barrel—the next position taken that excludes matters that many believe should be included.").

vacillate about which proposals fall under the ordinary business exception should provide no comfort for advocates of the shareholder proposal.¹⁴³

The return to SEC discretion creates uncertainty and promotes inefficiency for shareholders, managers, and the courts.¹⁴⁴ More specifically, the return to fluctuating and contradictory no-action letters will encourage lawsuits against the SEC because displeased shareholders and managers will want the SEC's inconsistent no-action letters reviewed by the courts. However, when a court reviews a no-action letter it will be faced with confusion about the level of deference owed to the SEC. Deference to the SEC is based, in part, on the consistency or lack of consistency of the SEC's no-action letters.¹⁴⁵ On the one hand, some fluctuation in SEC policies should be acceptable in order to accommodate for changing conditions and circumstances.¹⁴⁶ Yet, at the same time, the SEC's no-action letters deserve less deference when the SEC's reasoning and findings are varied and inconsistent.¹⁴⁷ Without the SEC's no-action letters as a guidepost, different courts will come to different conclusions about which employment related proposals are excludable. Once again, this inconsistency will lead to confusion and inefficiency for all parties involved. Furthermore, confusion and inefficiency will do little to create a forum for discussion and dialogue about unaddressed discrimination.¹⁴⁸ In order for the SEC no-action letters to

¹⁴³ See, Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulations*, 46 VAND. L. REV. 1129, 1130 (1993) (arguing that the SEC's vacillation stems from a uncertainty about its rulemaking authority in regards to the solicitation of proxies and that the history of the SEC's rulemaking has reflected political compromise between the pressures of various interest groups); *Concurrence of Commissioner Wallman*, *supra* note 142, at 2. See generally, *Wal-Mart*, 821 F.Supp. at 886 (demonstrating the history of SEC vacillation).

¹⁴⁴ See generally, Waite *supra* note 70 (arguing that the ordinary business exception should be eliminated because of the confusion and uncertainty it causes); Andrew J. Frackman and Achilles M. Perry, *ACTWU v. Wal-Mart: Is this the Cost of Corporate Democracy?*, 9 No.8 INSIGHTS 2, 3 (August 1995) (stating that the uncertainty reflected in the Cracker Barrel no-action letter undermines the utility of the shareholder proposal rule and exceptions).

¹⁴⁵ *Wal-Mart*, 821 F.Supp. 877.

¹⁴⁶ *Id.* at 885 ("In determining whether to defer to a position drawn from a series of no-action letters, courts must recognize that a change in SEC position does not necessarily reveal capricious action by the agency; changes in conditions and public perceptions justify changes in the SEC's construction of the 'ordinary business operation' exception.").

¹⁴⁷ *Id.* at 885 (refusing to defer to the SEC, in part, because an agency interpretation that conflicts with the agency's earlier interpretation is entitled to considerably less deference than a consistently held agency view) (citations omitted).

¹⁴⁸ Dominic Bencivenga, *Finding Middle Ground: Two Experts Craft SEC Compromise Proposals*, NEW YORK L.J., Jan 29, 1998. "It's very ironic for a government agency to want to get out of regulating something, and for all the parties to say 'No, you're doing a great job, stay,'" said Brian J. Lane, the SEC director of the corporation finance division. *Id.* This comment does not recognize that before Cracker Barrel the SEC was not doing a 'great job,' but instead produced vacillating and confusing no-action letters.

be useful to participants, the SEC must provide consistency in its decisions.¹⁴⁹ A presumption in favor of inclusion, rather than a codification of SEC discretion, would promote this consistency.¹⁵⁰

B. Unaddressed Discrimination and the Corporate Forum

1. PROFIT MAXIMIZATION

Although many would agree that discrimination issues deserve to be debated, the determination of an appropriate forum for this debate is very controversial. Business leaders often insist that discrimination issues should be addressed in a setting other than the corporate forum.¹⁵¹ Some argue that the corporation is an improper forum because the purpose of a corporation is profit maximization.¹⁵²

However, a presumption in favor of shareholder proposals that confront discrimination would not conflict with the profit maximizing goals of corporations. Proponents demonstrate that confronting discrimination through socially responsible investing can actually increase the profit margin in certain political situations.¹⁵³ For example, unresolved discrimination disputes lead to negative media coverage and expensive law suits that deplete corporate profits.¹⁵⁴ By averting such complications, profit maximization can be attained

¹⁴⁹ See Welter, *supra* note 128, at 2013-14.

¹⁵⁰ A presumption in favor of inclusion would not deprive the SEC of all discretion. SEC discretion can allow for consideration of unique facts and, thus, may lead to more sophisticated results. Thus, a presumption should allow SEC discretion to exclude proposals in extreme situations.

¹⁵¹ Witmer, *supra* note 110, at 1518 (paraphrasing Steve Viederman who asserts that the Business Round Table has suggested that social workplace issues should be dealt with in other forums).

¹⁵² *Id.* at 1518.

¹⁵³ Maria O'Brien Hylton, *Socially Responsible Investing: Doing Good Versus Doing Well in an Inefficient Market*, 42 AM. U. L. REV. 1 (1992) (arguing: i) socially responsible investing is a form of consumption; ii) ethical investing is a way of avoiding high risk investments; and iii) income can be maximized by ethical investing because in certain political situations companies with socially responsible business practices will outperform other companies).

¹⁵⁴ *Natural Resources Defense Council, Inc. v. SEC*, 432 F.Supp. 1190, 1210 (D.C. Cir. 1979); Robert Whitman, *Including Employment Practice Data In Proxy Statements*, NEW YORK L.J., Nov. 6, 1997, Section: Outside Counsel at 1 (proponents of resolutions that would force companies to reveal employment information argue that shareholders have a right to such information because employment litigation has a real effect on the bottom line). Recent examples of employment litigation include the following: in the face of publicity and a consumer boycott Texaco settled for \$172 million; Mitsubishi was hit with negative publicity surrounding charges of sexual harassment and a suit brought by the Equal Employment Opportunity Commission; Home Depot reportedly agreed to pay more than \$85 million to settle sex discrimination in west coast stores; and Shoney's settled a race discrimination class action in 1992 for \$103 million and saw earnings drop. *Id.*

through political and social shareholder proposals.¹⁵⁵ Resolution of discrimination issues contributes to, rather than conflicts with, profitability.

Arguments that socially responsible investing can increase the profit margin are often helpful to the shareholder activist. At the same time, the arguments avoid important questions about the current conception of corporate purpose.¹⁵⁶ Many commentators assert that the regulation of corporations first became dominant in the latter half of the 20th century.¹⁵⁷ They insist that it was not until the 1960's that corporations became political actors in order to face consumer, environmental, and civil rights laws that were passed to constrain the freedom of corporate management.¹⁵⁸ Other commentators argue that it was only in the 1990's that corporate managers began to feel pressure to take on "social responsibilities," based on a growing sense that business had a positive duty to advance moral and economic aims.¹⁵⁹

In fact, an expanded conception of corporate purpose, one that melds profit maximization goals with other social aims, is as old as the corporation itself. For example, the British East India Company, chartered in 1600, was the first important joint-stock enterprise in an English speaking country.¹⁶⁰ It was not only a profit-making organization, but it was also an instrument of the British Crown, endowed with monopoly status in its business and quasi-governmental power to pursue its assigned mission.¹⁶¹ Similarly, the founders of the United States (Jefferson, Madison, Jackson) embraced private

¹⁵⁵ *Id.* See also, Palmiter, *supra* note 71, at 923 (arguing that there is nothing wrong with a corporation opting for different models of profit-maximization such as combining environmental responsibility and profits).

¹⁵⁶ See generally, Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899 (1993) (relational feminism that emphasizes connection and community rather than the narrow pursuit of self-interest can contribute to this debate about corporate purpose); Palmiter, *supra* note 71, at 923 (arguing that there is nothing wrong with a corporation opting for different models of profit-maximization such as combining environmental responsibility and profits).

¹⁵⁷ James Q. Wilson, *The Corporation as a Political Actor*, in THE AMERICAN CORPORATION TODAY 418 (Carl Kaysen ed., 1996) (presuming that the regulation of the corporate process is new and criticizing the strong state model).

¹⁵⁸ *Id.* at 414-15.

¹⁵⁹ George David Smith and Davis Dyer, *The Rise and Transformation of the American Corporation*, in THE AMERICAN CORPORATION TODAY 28, 29, 57 (Carl Kaysen ed., 1996) (arguing that the claims of owners have a particularly heavy influence in the United States).

¹⁶⁰ Thomas K. McCraw, *The Evolution of the Corporation in the United States*, in THE U.S. BUSINESS CORPORATION: AN INSTITUTION IN TRANSITION 3 (John R. Meyer and James M. Gustafson eds., 1988).

¹⁶¹ *Id.* at 3. This wider conception of corporate purpose also applied to the Massachusetts Bay Company, the London Virginia Company, the Hudson's Bay Company, and the Royal African Company.

ownership where the corporation's conduct would be subject to public review and control through extensive disclosure of corporate information, supervision by government regulators, and potential legislative intervention.¹⁶² The corporation was "private property infused with public purpose, sanctified by public approval, disciplined by public authority, answerable to public scrutiny."¹⁶³

In the late 18th and early 19th centuries U.S. business corporations were created to perform public functions such as providing education and urban services, as well as, building the country's infrastructure.¹⁶⁴ Governments gave these corporations privileges such as monopoly rights, eminent domain, and exemption from liability because of the public need for their services.¹⁶⁵ In the early years of the American industrial revolution, many new corporations formed, seemingly because of the desire of the government to use the corporate device for a public purpose.¹⁶⁶ A corporation operated for the public good because "the community, not the capitalists, marked out its sphere of activity."¹⁶⁷ It was not until the second industrial revolution (1850 to 1950) that the corporation changed from a construct with public functions into an autonomous organization that was separate from government.¹⁶⁸ However, the relationship between corporations and the government remains contested ground.

In *Wal-Mart*,¹⁶⁹ the court implicitly raised questions of corporate purpose and profit maximization. By forcing Wal-Mart to consider employment

¹⁶² Paul H. Weaver, *After Social Responsibility*, in THE U.S. BUSINESS CORPORATION: AN INSTITUTION IN TRANSITION 134, 138 (John R. Meyer and James M. Gustafson eds., 1988).

¹⁶³ *Id.* at 138. George Perkins said, "The larger the corporation becomes, the greater its responsibilities to the entire community." *Id.* at 138 (citing George W. Perkins, *The Modern Corporation*, pamphlet of an address given at the Columbia University, New York, N.Y. February 7, 1908 at 16). These arguments were sometimes veiled attempts to obtain government subsidies. *Id.* at 139. For example, the Illinois Central argued that their North/South railroad would help save the union and get the railroad federal subsidies. Similarly, AT&T argued for the state governments to give AT&T the status of a regulated monopoly because people deserved cheaper, high quality phone service. *Id.* (citing Carter Goodrich, *Government Promotion of American Canals and Railroads, 1800-1890*, at 171 (1960) and John Brooks, *Telephone: The First Hundred Years*, at 142-45 (1976)). These examples merely demonstrate that today's assumption that wealth maximization is the only legitimate purpose of a corporation was, historically, a question for debate.

¹⁶⁴ WILLIAM G. ROY, *SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA* 16 (1997).

¹⁶⁵ *Id.* at 16.

¹⁶⁶ McCraw, *supra* note 160, at 4.

¹⁶⁷ *Id.* at 4 (citing Oscar Handlin and Mary F. Handlin, *Origins of the American Business Corporation*, *Journal of Economic History* 5, 22-23 (May 1945)).

¹⁶⁸ *Id.* at 7.

¹⁶⁹ *Wal-Mart*, 821 F.Supp. 877.

discrimination issues, the shareholder proposal questioned the assumption that the corporation's solitary purpose was profit maximization. By ruling that affirmative action policies were not excludable under the ordinary business exception, the *Wal-Mart* court expanded conceptions of corporate purpose and acknowledged the need for corporations to address discrimination. In effect, the *Wal-Mart* decision requires corporations to include issues of employment discrimination in their conception of corporate purpose.

In contrast to this expanded notion of corporate purpose, other courts maintain a narrower conception. For example, in *Natural Resources Defense Council, Inc. v. SEC*,¹⁷⁰ the plaintiff sought to force a corporation to disclose information about its environmental impact and employment policies. The court required further SEC rule-making and argued that employment information was unique because it was more likely than environmental information to affect the profits of the corporation.¹⁷¹ Instead of arguing that the employment discrimination was especially unjust or harmful to employees, the court focused on the fact that employment discrimination could result in future liability for the corporation.¹⁷² Thus, in contrast to the *Wal-Mart* court, this court justified its holding by using a more narrow profit maximization model.

These examples demonstrate the controversy surrounding corporate purpose and profit maximization principles. Goals of profit maximization have always had to operate in the midst of constraints; the constraints created by the *Wal-Mart* holding are consistent with the types of constraints placed on corporations since their inception. For example, government already limits the ability of corporations to maximize profits by creating wage and safety regulations. Although these regulations may diminish corporate profits, our current cultural and political values require such standards for the public good. Similarly, the impact of unaddressed discrimination justifies the inclusion of discrimination related proposals. Furthermore, our current conception of corporate purpose need not be conceived so narrowly as to exclude discrimination related proposals.

¹⁷⁰ 432 F.Supp. 1190 (D.C. Cir. 1979).

¹⁷¹ *Id.* at 1210.

¹⁷² *Id.* at 1210 ("Even a cursory examination of the 'over 100' matters deemed equivalent to equal employment opportunity reveals that most, perhaps even all, of these other matters of social concern are substantially less likely than equal employment opportunity to result in significant future financial liabilities to registrants.").

2. NO OTHER FORUM

Unaddressed discrimination, by definition, does not have an alternative forum. An individual can not bring a claim of discrimination unless a statute, law, or constitutional amendment has addressed that form of discrimination. However, our cultural and political values rest on the assumption that many types of discrimination are unjust and, thus, deserve to be addressed in some sort of forum. If one forum is unavailable, then an alternative forum must be found. If one starts with the assumption that discrimination against lesbians and gay men, for example, is unjust, then it follows that such discrimination is deserving of a forum. It is precisely because this discrimination is unaddressed in the more conventional forums, that our cultural and political values require the inclusion of these proposals in the alternative forum.¹⁷³

In *NYCERS v. American Brands, Inc.*,¹⁷⁴ the court stated that "[t]he shareholder proposal rule is perhaps the only means by which a shareholder has any realistic chance of being taken seriously by the management of a large, publicly-held corporation, or of exercising, along with his fellow shareholders, any meaningful corporate suffrage."¹⁷⁵ This statement emphasizes shareholder participation in a case where the proposal specifically addressed discrimination. Similarly, in *Lovenheim v. Iroquois Brands, Ltd.*,¹⁷⁶ the district court emphasized shareholder participation when it granted an

¹⁷³ The concern for an appropriate forum raises questions of corporate governance. There is much academic debate about the benefits and risks of shareholder activism and shareholder passivity. See generally, John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 CARDOZO L. REV. 837 (1994) (arguing that deregulation will not necessarily lead to shareholder activism and that the fear of shareholder activism is not based in reality); William W. Bratton and Joseph A. McCahery, *Regulatory Competition, Regulatory Capture, and Corporate Self-Regulation*, 73 N.C. L. REV. 1861 (1995) (argument for corporate self-regulation through institutional shareholder participation); Jayne W. Barnard, *Shareholder Access To The Proxy Revisited*, 40 CATH. U. L. REV. 37 (1990) (arguing for shareholder voting). Compare, Thomas A. Smith, *Institutions and Entrepreneurs in American Corporate Finance*, 85 CAL. L. REV. 1 (1997) (critiquing shareholder activism and arguing that shareholder passivity is a direct product of the risk managing role of institutional investors); Roberta Romano, *Public Pension Fund Activism In Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993) (arguing that public pension funds have geographic-based conflicts of interest that will limit shareholder activism); Park McGinty, *The Twilight Of Fiduciary Duties: On The Need For Shareholder Self-Help In An Age Of Formalistic Proceduralism*, 46 EMORY L. J. 163 (1997) (arguing that the interests of proponents of shareholder proposals diverge from the interests of shareholders).

¹⁷⁴ 634 F.Supp. 1382 (S.D.N.Y. 1986).

¹⁷⁵ *Id.* at 1387. The court held that American Brands must include the proposed adoption of the MacBride Principles in its proxy material. The MacBride Principles sought to curb employment discrimination against the Catholic minority in Northern Ireland. The shareholder proposal was meant to apply to American Brand's subsidiary in Northern Ireland. *Id.* at 1384.

¹⁷⁶ 618 F.Supp. 554, 561 (D.D.C. 1985).

injunction requiring the inclusion of a shareholder proposal related to the treatment of animals. The court reasoned that the shareholder would be irreparably harmed if he lost the "opportunity to communicate his concern with those shareholders not attending the upcoming shareholder meeting." Furthermore, the district court found that "public interest" was served by allowing all shareholders to make an informed vote on the proposal.¹⁷⁷ Shareholder participation should also be emphasized when the subject matter of the proposal has no other forum. Steve Viederman, President of the Jessie Smith Noyes Foundation which has \$73 billion in assets, responded to the argument that environmental and social workplace issues should be dealt with in other forums by stating the following: "There are no other forums. . . . The shareholder process is *the* forum."¹⁷⁸

In part, there is no alternative forum for issues of discrimination based on sexual orientation because the courts have concluded that lesbians and gay men do not need special protection. One of the roles of the courts is to protect the interests of minorities that do not have access to the legislative process.¹⁷⁹ However, courts have found that equal protection claims by lesbians and gay men do not warrant heightened judicial scrutiny.¹⁸⁰ Many courts have argued against heightened scrutiny for lesbians and gay men, in contrast to racial minorities, by stating that lesbians and gay men do not lack political power¹⁸¹

¹⁷⁷ *Id.* at 562.

¹⁷⁸ Witmer, *supra* note 110, at 1518.

¹⁷⁹ *United States v. Carolene Products Co.*, 304 U.S. 144, 152 n.4 (1938). See generally, JOHN HART ELY, *DEMOCRACY AND DISTRUST: A THEORY OF JUDICIAL REVIEW*, (1980) (arguing that courts should facilitate the representation of minorities and eliminate malfunctions in the democratic process); Richard A. Posner, *Democracy and Distrust Revisited*, 77 VA. L. REV. 641 (1991) (arguing Ely's book is not convincing).

¹⁸⁰ *Romer v. Evans*, 116 S.Ct. 1620 (1996) (finding that Amendment II violates the Fourteenth Amendment even under rational basis review); *High Tech Gays v. Defense Indus. Sec. Clearance Office*, 895 F.2d 563, 574 (9th Cir. 1990) (holding that *Hardwick* compels the conclusion that classifications based on sexual orientation deserve no more than rational basis review); *Ben-Shalom v. Marsh*, 881 F.2d 454, 466 n.9 (7th Cir. 1989) *cert. denied* 494 U.S. 1004, 110 S.Ct. 1296 (1990) (ruling that *Hardwick* foreclosed heightened judicial scrutiny for discrimination based on sexual orientation, and that the military's policy was rationally related to a legitimate governmental interest); *Padula v. Webster*, 822 F.2d 97, 102 (D.C. Cir. 1987) (denying the equal protection challenge and stating that it would be anomalous to declare that a status defined by conduct which may be criminalized (sodomy), is deserving of strict scrutiny); *Woodward v. United States*, 871 F.2d 1068 (Fed. Cir. 1989) *cert. denied* 494 U.S. 1003, 110 S.Ct. 1295 (ruling that homosexuality's non-immutability blocked any claims to suspect classification status); *Equality Foundation of Greater Cincinnati, Inc. v. City of Cincinnati*, 54 F.3d 261 (6th Cir. 1995). The Supreme Court has also held that the constitutional right to privacy does not protect homosexual conduct. *Bowers v. Hardwick*, 478 U.S. 186 (1986).

¹⁸¹ See, *High Tech Gays*, 895 F.2d at 574 ("... legislatures have addressed and continue to address the discrimination suffered by homosexuals on account of their sexual orientation through passage of antidiscrimination legislation. Thus, homosexuals are not without political power. . . ."); *Ben-Shalom v.*

sufficient to constitute a "discrete and insular minority."¹⁸² In other words, courts decline to create protections because they conclude that lesbians and gay men have the political and economic power needed to protect themselves.

The Supreme Court, in the landmark case *Romer v. Evans*,¹⁸³ found that Colorado's constitutional amendment prohibiting protection of lesbians and gay men was unconstitutional as a per se equal protection violation and lacked a rational relationship to a legitimate governmental interest.¹⁸⁴ Colorado's Amendment II prohibited all legislative, executive, and judicial action that was designed to protect lesbians or gay men.¹⁸⁵ By ruling against Amendment II, the Court allowed lesbians and gay men to use the political and economic power that other courts have relied on when denying heightened scrutiny. If it is correct that lesbians and gay men have influence and power (and, thus, do not constitute a discrete and insular minority) then courts, in order to be consistent, must allow lesbians and gay men to exercise their political and financial power to change the policies of corporations. More generally, when courts and legislatures decline to protect a minority group because of the group's power, it follows that the minority group should be permitted to exercise this power in the private realm. Just as the *Romer* Court fostered political debate and voting by ruling against Amendment II, the SEC should promote debate and voting by creating a presumption in favor of inclusion of discrimination proposals.

C. *External or Internal Control: The Role of the Government*

The SEC can avoid external regulation of business (new anti-discrimination laws) and instead foster debate in the private sphere with a relatively neutral type of regulation—shareholder proposal rules.¹⁸⁶ Values arising from within an organization are likely to be more effective than external regulations.¹⁸⁷ For example, the communicative value of shareholder votes favoring

Marsh, 881 F.2d at 466 n.9 ("Homosexuals are not without political power"); *Dahl v. Secretary of U.S. Navy*, 830 F.Supp. 1319, 1324 n.7 (E.D. Cal. 1993) ("the recent Congressional and executive dialogue concerning homosexuals' ability to serve in the military demonstrates that . . . homosexuals have a significant ability to attract Congress' attention.").

¹⁸² *Watkins v. United States Army*, 875 F.2d 699 (9th Cir. 1989) (en banc), cert. denied, 498 U.S. 957 (1990). See generally, WILLIAM B. RUBENSTEIN, *SEXUAL ORIENTATION AND THE LAW* 666 (1997).

¹⁸³ 116 S.Ct. 1620 (1996).

¹⁸⁴ *Romer*, supra note 180, at 1620.

¹⁸⁵ *Id.*

¹⁸⁶ Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 102 (1988) (arguing that the shareholder proposal rule is a "relatively neutral" regulatory device).

¹⁸⁷ Palmiter, supra note 71, at 899.

adoption of the Valdez Principles¹⁸⁸ would be superior to a mandate by the Environmental Protection Agency.¹⁸⁹ However, the reversal of the Cracker Barrel position does not ensure this internal dialogue and voting. Instead, it guarantees debate only within the SEC by forcing the SEC staff to decide which proposals should be included in the proxy material. Rather than returning to SEC discretion, the shareholder rules should promote a forum for internal debate by creating a presumption in favor of inclusion. Because of the benefits of internal decision-making, the SEC's rules should explicitly include a commitment to shareholder dialogue about undecided discrimination issues.

Some critics may insist that it is not the role of the government to regulate shareholder proposals. For example, contractarians argue that because a corporation is a "nexus of contracts," the government should avoid external regulation and instead allow for internal bargaining between the contracting parties (owners, management, and labor) in a corporation.¹⁹⁰ In contrast, progressive scholars argue that the corporation's constituencies cannot realistically bargain and that external intervention is required to protect the worker's voice.¹⁹¹ The reversal of the Cracker Barrel position, by returning discretion to the SEC, effectively sides with the progressives and increases external regulation.

Instead, the SEC should create a presumption in favor of inclusion and, thus, promote shareholder debate about these undecided discrimination issues. By creating a presumption in favor of internal debate and voting the SEC takes a middle position between the contractarians and the progressive scholars. Although this presumption is a form of external governmental regulation, it merely requires dialogue and voting between contracting parties. A requirement to debate and vote is much less intrusive than an external regulation that either gives discretion to a government agency or creates external discrimination laws that apply to all corporations. A presumption in favor of dialogue and voting would address the progressives' concern that parties cannot realistically bargain and, at the same time, would respond to the

¹⁸⁸ Geltman, *supra* note 47. The Valdez Principles require corporations to adopt a comprehensive code of environmental ethics.

¹⁸⁹ Palmiter, *supra* note 71, at 899.

¹⁹⁰ *Id.* at 862. Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 862 (1997) (reviewing PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995)). See also, JOHN RAWLS, A THEORY OF JUSTICE, reprinted in JOHN ARTHUR AND WILLIAM H. SHAW, JUSTICE AND ECONOMIC DISTRIBUTION 13 (1991). John Rawls articulates a liberal conception of justice that requires basic protection by the state but leaves other ethical issues up to the individual.

¹⁹¹ O'Connor, *supra* note 156; Bainbridge, *supra* note 190.

contractarians' insistence that government limit external control and allow parties to bargain with each other.

When the court in *NYCERS v. SEC*¹⁹² focused on the authority of the SEC to make and alter rules regarding shareholder proposals, it raised questions about internal and external control.¹⁹³ By ruling in favor of the SEC, the appellate court gave the SEC authority to further regulate corporations. The SEC used this authority to impose an external rule allowing employment related shareholder proposals to be automatically excluded. This choice to limit shareholder power is an external ruling on how a corporation should be governed. The SEC's reversal of the Cracker Barrel position also promotes external control by granting discretion to an external government agency. However, a presumption that promotes internal voting and dialogue would provide a better balance between the benefits and drawbacks of both external regulation and internal decision-making.

V. CONCLUSION

Rather than codifying SEC discretion, Rule 14a should establish a presumption in favor of the shareholder's ability to raise issues of unaddressed discrimination. For example, the rule could simply state that a proposal addressing discrimination policies does not normally fall under the ordinary business exception. At a minimum, the rule should include a discrimination related proposal in its list of examples in order to demonstrate that proposals confronting unaddressed discrimination are generally includable in the management's proxy material. This presumption would not overrule the ordinary business exception and, thus, proposals about day-to-day employment matters would still be excludable. Furthermore, the presumption could be overcome where the proposal is frivolous, based on a personal grievance, or falls under another exclusionary provision.

The shareholder proposal process is an appropriate forum to raise these discrimination issues, in part, because discrimination related proposals do not conflict with profit maximization principles. Furthermore, the lack of an

¹⁹² 45 F.3d 7 (2d Cir. 1995).

¹⁹³ *NYCERS v. SEC*, 843 F.Supp. 858 (S.D.N.Y. 1994) (*reversed and vacated in part, and dismissed in part* in *NYCERS v. SEC*, 45 F.3d 7 (2d Cir. 1995)). The lower court found that the SEC had changed a legislative rule without prior notice and comment. In responding to Cracker Barrel's no-action request, the SEC found that the proposal raised substantial policy considerations, but was nonetheless excludable. The lower court argued that this finding constituted a change in a legislative rule without prior notice or comment. Thus, the lower court enjoined the SEC from issuing letters that indicated a change in the SEC position without officially changing the legislative rule and abiding by the proper procedure. In contrast, the appellate court found that the SEC altered an interpretive rule and, thus, there were no notice and comment requirements.

alternative forum supports a presumption that these types of proposals should not be omitted under the ordinary business exception. Because courts reason that lesbians and gay men have adequate influence and, thus, do not need special protections, consistency requires that this minority group be allowed to exercise this influence in the corporate forum. Finally, a presumption in favor of internal debate and voting would require internal decision-making without imposing new discrimination laws from external sources.

The reversal of the SEC's Cracker Barrel position is a limited victory because it returns the shareholder proposal to the discretion and vacillation of the SEC staff. Shareholders and managers need a stable position to bring about efficiency; activists need a clear position to bring about debate and dialogue. A presumption in favor of inclusion would be a first step toward this more certain position.

