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THE ORDINARY BUSINESS OPERATIONS EXCEPTION TO THE SHAREHOLDER PROPOSAL RULE: A RETURN TO PREDICTABILITY

Kevin W. Waite

INTRODUCTION

The law firm of Smith & Jones is general counsel to MOW Corporation ("MOW"). On Friday afternoon at around 4:30 partner Joe Smith's phone rings (as it always seems to do at that time on Friday). The call is from Jon Adams, an officer of MOW. Adams is very angry and says he just faxed Smith a letter that he received. He wants Smith to take a look at it and call him right back. Smith retrieves the fax and begins reading it. It is a letter from a shareholder of MOW requesting that the following preambles and resolution be placed in MOW's proxy statement and form of proxy for the upcoming annual meeting of shareholders:

WHEREAS, the Corporation has for years maintained and practiced a policy of discrimination in employment; and

WHEREAS, said policy of discrimination is socially unacceptable and has a detrimental effect on the business operations of the Corporation;

NOW, THEREFORE, BE IT RESOLVED, that the Corporation shall discontinue its policy of discrimination and shall institute an affirmative action program; and

RESOLVED, that the Corporation shall prepare and furnish to the shareholders of the Corporation a report describing in reasonable detail the affirmative action program that has been instituted and shall thereafter from time to time furnish to the shareholders of the Corporation a report describing in reasonable detail the results of the affirmative action program that has been instituted.

After reviewing the fax, Smith calls Adams. Adams tells Smith that the Company is very upset by the proposal and does not want to include the resolution in its proxy material. He says that MOW does not discriminate in its hiring and does not want to enact a formal affirmative action program. He asks Smith to advise MOW whether the resolution must be included in the Corporation's proxy statement and form of proxy. He also requests that Smith prepare a letter on MOW's behalf to the Securities and Exchange Commission requesting a no-action letter.  

1. A no-action letter is an interpretation by the staff of the Securities and Exchange Commission provided in response to company inquiries asking whether the staff will recommend to the Commission that any enforcement action be taken. See
After hanging up, Smith calls his most trusted associate, Mary Miknora, into his office. He tells her what has transpired and asks her to do a little research and then draft the no-action request to the SEC. Mary leaves the office thinking that this project should be fairly easy. After all, she figures she just has to look at the proxy rules and some interpretive cases to come to a conclusion and prepare a no-action request. Little does she know, her assignment is not going to be as easy as she thinks.

The shareholder proposal rule\(^2\) was first enacted by the Securities and Exchange Commission (the "SEC" or the "Commission") in 1942 pursuant to authority granted to it by Congress under Section 14(a) of the Securities Exchange Act of 1934 ("1934 Act").\(^3\) The rule requires inclusion in management's proxy material of a shareholder proposal for action at a company's annual meeting if certain procedural\(^4\) and substantive\(^5\) requirements are met. One of these substantive requirements is that the shareholder proposal must not relate to the ordinary

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4. See 17 C.F.R. § 240.14a-8(a)-(b) (1995). Rule 14a-8(a)(1) requires that the shareholder submitting the proposal (the "proponent") own at least 1% or $1000 in market value of securities at the time that he submits the proposal and to have owned said amount of securities for at least one year prior to submitting the proposal. Id. § 240.14a-8(a)(1). Further, the proponent must continue to hold the required amount of securities through the date on which the meeting is held. Id.

Rule 14a-8(a)(2) provides that, when submitting the proposal, "a proponent shall provide the registrant in writing with his name, address, the number of the registrant's voting securities that he holds of record or beneficially, the dates upon which he acquired such securities, and documentary support for a claim of beneficial ownership." Id. § 240.14a-8(a)(2).

Rule 14a-8(a)(3) imposes certain time constraints within which a proponent must submit a shareholder proposal with respect to annual or other meetings. Id. § 240.14a-8(a)(3).

Rule 14a-8(a)(4) limits the number of shareholder proposals that a proponent may submit to one proposal. Id. § 240.14a-8(a)(4).

Rule 14a-8(b)(1) provides that the proponent shall include a statement in support of the proposal not to exceed 500 words that must be submitted at the time that the proposal is submitted. Id. § 240.14a-8(b)(1).

Rule 14a-8(b)(2) provides for identification of the proponent in the proxy statement. Id. § 240.14a-8(b)(2).

5. The substantive requirements are found in Rule 14a-8(c)(1)-(13). A registrant may omit a shareholder proposal and supporting statement from its proxy statement and form of proxy:

1) If the proposal is, under the laws of the registrant's domicile, not a proper subject for action by security holders . . . [;]

2) If the proposal, if implemented, would require the registrant to violate any state law or Federal law of the United States, or any law of any foreign jurisdiction to which the registrant is subject . . . [;]

3) If the proposal or the supporting statement is contrary to any of the Commission's proxy rules and regulations . . . ;
business operations of the issuer. This requirement is known as the ordinary business operations exception and is intended to make sure that everyday business decisions are made by management.

The ordinary business operations exception has been construed, until recently, as a two-part test. In 1976, the SEC issued a release (the "1976 Release") stating that for a registrant to rely on the exception to exclude a shareholder proposal from its proxy material, the proposal must not only relate to the ordinary business operations of the issuer, but must also not raise any substantial policy issues. If a substantial policy issue is raised by the proposal, the proposal must be included. The question therefore becomes: What constitutes a substantial policy issue?

The SEC staff, through the no-action process, has attempted to define "substantial policy issue" within the meaning of the ordinary business operations exception. Due to the subjectiveness of the exception, however, the SEC staff has on numerous occasions reversed

1. If the proposal relates to the redress of a personal claim or grievance . . . or if it is designed to result in a benefit to the proponent or to further a personal interest . . . ;
2. If the proposal relates to operations which account for less than 5 percent of the registrant's total assets . . . and for less than 5 percent of its net earnings and gross sales . . . and is not otherwise significantly related to the registrant's business;
3. If the proposal deals with a matter beyond the registrant's power to effectuate;
4. If the proposal deals with a matter relating to the conduct of the ordinary business operations of the registrant;
5. If the proposal relates to an election to office;
6. If the proposal is counter to a proposal to be submitted by the registrant at the meeting;
7. If the proposal has been rendered moot;
8. If the proposal is substantially duplicative of a proposal previously submitted to the registrant by another proponent, which proposal will be included in the registrant's proxy material for the meeting;
9. If the proposal deals with substantially the same subject matter as a prior proposal submitted to security holders in the registrant's proxy statement and form of proxy relating to any annual or special meeting held within the preceding five calendar years [and that prior proposal received little support]; or
10. If the proposal relates to specific amounts of cash or stock dividends.

6. Id. § 240.14a-8(c)(7).
7. See infra notes 108-32 and accompanying text.
9. Id. at 52,998.
10. The SEC staff issues no-action letters. These interpretations are not automatically reviewable by the SEC itself, although it may entertain an appeal if it chooses. See Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 884 n.8 (S.D.N.Y. 1993) (“Shareholders and management have no right to appeal staff advice to the Commission, although the Commission may, in its discretion, grant a party’s request for review.”).
its position as to what constitutes a substantial policy issue. Specifically, the staff has recently determined that proposals dealing with executive compensation, golden parachutes, plant closings, and tobacco products raise substantial policy issues and warrant inclusion in a registrant's proxy material. Previously, the staff had treated these types of proposals as excludable because they dealt with matters relating to the ordinary business operations of the issuer and raised no substantial policy issues.

Such reversals evidence the problems with the ordinary business operations exception when the two-prong test discussed in the 1976 Release is applied. Trying to define "substantial policy" is very difficult, if not impossible, to do. Which policies are substantial will change over time. Further, the point at which a policy issue becomes "substantial" is unclear. It is a subjective standard. The determination needs to be tied to an objective standard if the ordinary business operations exception is to be effective.

The ordinary business operations exception becomes further complicated when a registrant is involved in a business that on its face implicates substantial policy issues, such as weapons manufacturing. In such a case, under a literal application of the two-prong test, every shareholder proposal offered by a proponent would have to be included because all decisions, no matter how small, would in some way implicate a substantial policy issue. These companies should not be subject to the burden of always having to include a shareholder proposal that objects to what they are manufacturing. Investors should not be able to "regularly use their shareholder status as a bully pulpit." In 1992, recognizing the difficulty in making the substantial policy determination, the Commission revised its interpretation of the ordinary business operations exception with respect to affirmative action

11. The no-action letters issued by the SEC are non-binding, even on the parties to which the no-action letter is specifically addressed. For a discussion of the no-action process, see infra note 26 and accompanying text.

12. See infra notes 106-07 and accompanying text.

13. See infra notes 101-05 and accompanying text. A golden parachute provides benefits to executives of a company if they leave the company as a result of certain events, such as a merger.

14. See infra notes 85-94 and accompanying text.

15. See infra notes 95-99 and accompanying text.

16. See, e.g., Medical Comm. for Human Rights v. SEC, 432 F.2d 659 (D.C. Cir. 1970), vacated as moot, 404 U.S. 403 (1972) (holding that a shareholder proposal, submitted by Medical Committee, requesting the board of directors of Dow Chemical Company to amend its certificate of incorporation to bar the sale of napalm that was to be used in the Vietnam War unless the buyer gave reasonable assurance that the napalm would not be used on humans, could not be excluded based on the ordinary business operations exception).

17. New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 9 (2d Cir. 1995).
and equal employment opportunity proposals. In a no-action letter issued to Cracker Barrel Old Country Store, Inc., the SEC staff stated that even though a shareholder proposal dealing with equal employment opportunity for homosexuals was tied to a policy issue, it could be excluded based on the ordinary business operations exception because the staff could not draw the line between substantial and non-substantial policy issues. The proponent of the shareholder proposal sued. Although the district court held that the staff could not simply refuse to apply the two-part test from the 1976 Release, the Second Circuit reversed, holding that the staff could properly refuse.

While this litigation was pending, the SEC declined to issue any no-action letters to registrants pursuant to Rule 14a-8(c)(7). This left many companies and their counsel in a precarious position. Although an SEC no-action letter is not binding, it is granted great

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20. Id. at 77,287; see infra notes 119-20 and accompanying text.


22. See id. at 882.

23. See New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 14 (2d Cir. 1995).

24. See, e.g., Wal-Mart Stores, Inc., SEC No-Action Letter, 1994 SEC No-Act. LEXIS 299 (Feb. 8, 1994) (stating that "[i]n view of the pending [Cracker Barrel] litigation . . . , the Division has determined not to express any view with respect to the application of rule 14a-8(c)(7) to any shareholder proposal pending resolution of this matter on appeal"); see also Staff Ordinary Business Stance Leaves Counsel Over a Barrel in Proxy Season, 26 Sec. Reg. & L. Rep. (BNA) No. 17, at 637 (Apr. 29, 1994) (stating that the SEC staff declined to take any position in 11 requests for no-action letters pursuant to the ordinary business operations exception).


[T]he Commission and its Staff do not purport in any way to issue "rulings" or "decisions" on shareholder proposals which management indicates it intends to omit, and they do not adjudicate the merits of a management's posture concerning such a proposal. As a result, the informal advice and suggestions emanating from the Staff in this area are not binding on either managements or proponents. Further, nothing the SEC or its Staff does or omits to do in connection with such proposals affects the right of the proponent, or any shareholder, to institute a private action with respect to the management's intention to omit that proposal from its proxy materials. In summary, the sole purpose of staff review and comment with respect to proxy matters, including stockholder proposals, is to promote compliance
deference. Without a no-action letter from the SEC, many companies and their counsel had to decide on their own whether a given proposal was excludable under 14a-8(c)(7). The SEC's refusal to issue no-action letters with respect to 14a-8(c)(7) produced a great deal of uncertainty and created a greater threat of litigation by shareholders who wished to get their proposals into management's proxy statement.

Thus, the SEC has departed from using the two-prong test for shareholder proposals dealing with affirmative action and equal employment opportunity and the Second Circuit has upheld its choice to do so. The floodgates are now open for registrants to claim that a distinction cannot be drawn between substantial and non-substantial policy issues in areas other than affirmative action and equal employment opportunity. The ordinary business operations exception has therefore become a guessing game and its utility almost nonexistent. The position the staff will take with respect to any particular proposal is difficult to predict. The staff can always simply say that, based on Cracker Barrel, the line between a substantial and a non-substantial policy issue is too fine to draw and that the proposal can therefore be excluded. The staff can just as easily say that the issue is substantial and must be included. Moreover, it can change positions from one year to the next, as it has done numerous times in the past. This lack of predictability and confusion over the application of the ordinary business operations exception clearly presents the need for a change.

Part I of this Note will address the history of the ordinary business operations exception and will analyze the intent of the Commission in promulgating the exception. It will also discuss the origin of the substantial policy prong of the two-prong test created in the 1976 Release. Part II will present an overview of some recent SEC staff reversals as to what constitutes a substantial policy issue and therefore must be included in management's proxy material. Specifically, this part will review reversals with respect to shareholder proposals dealing with

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with the proxy rules and to assist both management and the Commission in avoiding the possibility of unnecessary litigation between them.

Id. at 86,602-03; see also New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 12 (2d Cir. 1995) (stating that no-action letters are interpretive and not legislative for purposes of the Administrative Procedure Act "because they do not impose or fix a legal relationship upon any of the parties"); Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 884 (S.D.N.Y. 1993) (stating that "the ad hoc nature of [no-action] letters means that courts cannot place them on a precedential par with formal rulemaking or adjudication").

28. See id. at 638.
30. New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 14 (2d Cir. 1995).
31. See infra notes 79-107 and accompanying text.
plant closings, tobacco products, and executive compensation. Part III will analyze the recent litigation over the operation of Rule 14a-8(c)(7) resulting from the staff’s refusal to apply the two-prong test for shareholder proposals regarding affirmative action programs and equal employment opportunity policies. Finally, in part IV, this Note suggests that, due to the unnecessary confusion caused by the ordinary business operations exception and the difficulty in applying the standard, the exception should be eliminated.

I. HISTORY OF THE ORDINARY BUSINESS OPERATIONS EXCEPTION

The system of proxy solicitation plays a vital role in the functioning of corporations and in determining how they will be governed. Proxy solicitation provides the means for obtaining the votes of the many shareholders who do not attend shareholder meetings. Without the proxy system, corporations would never be able to approve certain transactions that require shareholder approval due to the virtual impossibility of getting the needed number of shareholders in one place at one time. Finally, some shareholders would never be able to have a voice in corporate governance without the proxy mechanism. Thus, in a world filled with many large corporations with shareholders spread throughout the world, a workable set of proxy rules is essential.

With this in mind, in the 1934 Act, Congress granted the SEC the power to regulate corporate proxy solicitation to the extent "necessary or appropriate in the public interest or for the protection of investors." By enacting Section 14(a) of the 1934 Act, Congress intended to curb management abuse of the proxy solicitation process. It hoped to accomplish this by fostering disclosure and corpo-

32. See infra notes 85-94 and accompanying text.
33. See infra notes 95-99 and accompanying text.
34. See infra notes 100-07 and accompanying text.
35. See Louis Loss, Fundamentals of Securities Regulation 449 (2d ed. 1988); Solomon et al., supra note 1, at 558-59.
36. See Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 881 (S.D.N.Y. 1993) (stating that "[p]roxies have become an indispensable part of corporate governance because the realities of modern corporate life have all but gutted the myth that shareholders in large publicly held companies personally attend annual meetings" (quoting Stroud v. Grace, 606 Ai2d 75, 86 (Del. 1992))).
37. See Solomon et al., supra note 1, at 558.
38. See id.
39. See Loss, supra note 35, at 449 (noting that the "widespread distribution of corporate securities, with the concomitant separation of ownership and management, puts the entire concept of the stockholders' meeting at the mercy of the proxy instrument").
rate democracy.\textsuperscript{42} Although the role that Congress intended shareholders to play in corporate governance is not explicitly stated in Section 14(a),\textsuperscript{43} Congress apparently wanted to give shareholders some corporate decision-making power.\textsuperscript{44}

The shareholder proposal rule was first enacted in 1942\textsuperscript{45} and was amended frequently thereafter.\textsuperscript{46} The original rule did not include the ordinary business operations exception. The original rule simply required management to include in its proxy material any shareholder proposal that was "a proper subject for action by security holders."\textsuperscript{47} It was later made clear that a "proper subject" was to be determined

\textsuperscript{42} See id.; see also Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 676 (D.C. Cir. 1970) ("It is obvious to the point of banality to restate the proposition that Congress intended by its enactment of section 14 of the Securities Exchange Act of 1934 to give true vitality to the concept of corporate democracy."); Amalgamated Clothing and Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 881-82 (S.D.N.Y. 1993) ("Section 14(a) [of the 1934 Act] and the SEC's implementing regulations seek 'to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation.'" (citing J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964))); Proposed Amendments to Rule 14a-8, Exchange Act Release No. 12,598, 41 Fed. Reg. 29,982, 29,984 (1976) (proposed July 7, 1976) [hereinafter 1976 Proposal] ("[S]ection 14(a) of the Exchange Act... was enacted to promote corporate suffrage and to limit those situations in which public corporations are controlled by a small number of persons."); Solomon et al., supra note 1, at 559 (stating that "[t]he legislative history of SEC proxy regulations indicates that the Congressional concern was to provide 'fair corporate suffrage'"); Eric A. Welter, Note, The Shareholder Proposal Rule: A Change to Certainty, 60 Geo. Wash. L. Rev. 1980, 1990 (1992) ("The legislative history of Section 14(a) of the 1934 Act reveals the dual concerns of Congress: disclosure and shareholder democracy.").

\textsuperscript{43} See Patrick J. Ryan, Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy, 23 Ga. L. Rev. 97, 124 (1988) (stating that Section 14(a) does not "give on its face any hint of what the appropriate shareholder role might be in corporate governance"); Welter, supra note 42, at 1990 (stating that "section 14(a) of the 1934 Act itself fails to provide any explicit indication of the role of the shareholder in the affairs of the corporation").

\textsuperscript{44} Welter, supra note 42, at 1990 (asserting that "Congress apparently was concerned with providing shareholders a role in corporate decisionmaking").


\textsuperscript{46} See Liebeler, supra note 45, at 428 (stating that "[f]ollowing the [shareholder proposal] rule's adoption in 1942, the SEC continually revised the rule in an attempt to curb abuses by proponents and to determine what constitutes a 'proper subject' for proposals under state law").

by reference to the law of the state in which the company was incorporated.\textsuperscript{48} Today, the provision specifically states that a proposal is excludable if it is not a proper subject for security holder action “under the laws of the registrant’s domicile.”\textsuperscript{49}

Because little state law was developed discussing what was a proper subject for action by security holders,\textsuperscript{50} the SEC staff developed its own common law regarding what was a proper subject for shareholder action.\textsuperscript{51} While the SEC claimed to be relying on state law in determining what was a proper subject for shareholder action, the SEC more accurately appeared to be deciding what the state law was and influencing state courts in deciding the rare case that arose regarding what was a proper subject for shareholder action.\textsuperscript{52}

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\textsuperscript{48} The Director of the SEC stated in a 1945 opinion that:

Speaking generally, it is the purpose of Rule X-14A-7 to place stockholders in a position to bring before their fellow stockholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for the stockholders' action under the laws of the state under which it is organized. It was not the intent of Rule X-14A-7 to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or economic nature. Other forums exist for the presentation of such views.


\textsuperscript{50} Most corporation statutes simply provide that the business and affairs of every corporation shall be managed by a board of directors. See, e.g., Del. Code Ann. tit. 8, § 141(a) (1991) (stating that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors"); N.Y. Bus. Corp. Law § 701 (McKinney 1986) (stating that "the business of a corporation shall be managed under the direction of its board of directors").

\textsuperscript{51} See 4 Louis Loss & Joel Seligman, Securities Regulation 2012 (3d ed. 1990) ("Inevitably the Commission (normally its staff), while purporting to find and apply a generally nonexistent state law, has been building a ‘common law’ of its own as to what constitutes a ‘proper subject’ for shareholder action."); Welter, supra note 42, at 1983 ("The lack of state law ... led the SEC to interpret the ‘proper subject’ standard itself, eventually developing a type of ‘common law’ of its own."); see also Timothy L. Feagans, Comment, SEC Rule 14a-8: New Restrictions on Corporate Democracy?, 33 Buff. L. Rev. 225, 236 (1984) (noting that "[t]he paucity of state law, both statutory and decisional, compelled the SEC to develop its own administrative guidelines regarding when a proposal was a ‘proper subject for action by security holders’"); Note, Shareholder Proposals: The Experience of Rule 14a-8, 59 Geo. L.J. 1343, 1371 (1971) ("The evolution of the shareholder proposal rule from its simple genesis through the substantive amendments of 1954 and 1967 is evidence of a body of ‘common law’ directly resulting from the SEC’s administrative experience.").

\textsuperscript{52} See 4 Loss & Seligman, supra note 51, at 2012.
The ordinary business operations exception was first enacted as Section 14a-8(c)(5) in 1954. As originally enacted, the exception provided that management could "omit from its proxy material a proposal which is a recommendation or request with respect to the conduct of the ordinary business operations of the issuer." The Commission promulgated the ordinary business operations exception "in order to relieve the management of the necessity of including in its proxy material security holder proposals which relate to matters falling within the province of the management." Although a proposal dealing with the ordinary business operations of the issuer might be excludable under Rule 14a-8(c)(1) as an improper subject for shareholder action, the possibility remained that a proposal would be includable if framed in precatory, rather than mandatory, language. The Commission wanted to include explicitly the presumption that under state corporate law day-to-day business operations are left to management and the board of directors and thus are not proper subjects for shareholder action, regardless of whether or not a proposal is framed in mandatory or precatory language.

The next major event in the life of the ordinary business operations exception occurred in 1976. Because the exception was often used to exclude proposals that were of considerable importance to both the issuer and the security holder, and because the SEC did not believe that the ordinary business operations exception was fostering what it felt to be the proper level of corporate democracy, the Commission proposed two alternative changes to the ordinary business operations exception and requested comments on each.

The first proposed change was to enact a provision that would allow a shareholder proposal to be omitted only if it dealt with a "routine, day-to-day matter relating to the conduct of the ordinary business op-

54. Id. at 79,247.
56. Rule 14a-8(c)(1) allows an issuer to exclude a shareholder proposal if the proposal is not a proper subject for shareholder action under state law. See 17 C.F.R. § 240.14a-8(c)(1) (1995). Whether the proposal is proper under state law, however, may turn on whether the proposal is framed in mandatory or precatory language. See id. A precatory proposal is one that is framed as a recommendation to the board of directors rather than a mandate to the board that it take action. See id.
57. 17 C.F.R. § 240.14a-8(c)(1) (1995); see supra note 56.
58. See Welter, supra note 42, at 1985.
59. See 1976 Proposal, supra note 42, at 29,984. The SEC voiced concern over the possibility that, due to management's use of the shareholder proposal rule to exclude matters of concern to shareholders, the rule might not be operating "completely in accord with the purposes for which Section 14(a) of the Exchange Act was enacted." Id.
60. See 1976 Release, supra note 8, at 52,997.
The SEC stated that a company would not be able to rely upon this provision to exclude a shareholder proposal involving an important business matter, even if the proposal was related to the ordinary business operations of the company. The test that the Commission proposed to distinguish between routine and important business matters was: "Will it be necessary for the board of directors (or other governing body of the issuer, such as the board of trustees) to act on the matter involved in the proposal?"

The second proposal was an alternate proposal to the first (the "Second 1976 Proposal"). The Second 1976 Proposal was to allow omission of a shareholder proposal if it "deals with a matter that the governing body of the issuer (such as the Board of Directors) is not required to act upon pursuant to the applicable State law or issuer's governing instruments (such as the Charter or By-Laws)." The Second 1976 Proposal was proposed because "the Commission recognize[d] that proposed paragraph[ ] . . . (c)(7) [might] create interpretative difficulties that might not arise under the proposed alternative provision."

Many of the comments received by the Commission on the First 1976 Proposal stated that it would not be helpful because shareholders are not qualified to act on ordinary business matters of a complex nature, something they would be able to do if the First 1976 Proposal was promulgated as written. Further, many commentators claimed, the rule was too subjective and would cause interpretation problems.

The comments received by the Commission on the Second 1976 Proposal also stated that such a rule was not workable. Because many state statutes and corporate governing instruments do not specify when director action is required, but rather simply say that the corporation is to be managed by the board of directors, "the application of the proposed 'board-action' standard would turn upon the issues of delegation of authority and proper board practices." The Commission believed that resolution of these issues would be too complex, and therefore stated that the standard was not workable.

The Commission therefore decided to enact neither the First 1976 Proposal nor the Second 1976 Proposal, but rather to enact a modified

63. Id.
64. Id.
65. Id. at 29,985.
66. Id.
67. See 1976 Release, supra note 8, at 52,997.
68. Id.
69. See id. at 52,998.
70. Id.
71. Id.
version of the language already being used. This modified version of the ordinary business operations exception was not much of a departure from the language already existing, and is the exception that exists today. It states that a shareholder proposal is excludable if it "deals with a matter relating to the conduct of the ordinary business operations of the issuer." The reasons the Commission gave for not adopting the First 1976 Proposal or the Second 1976 Proposal were that (i) the difficulties caused by the proposed standards would outweigh any benefits either would provide, (ii) the standard already in effect was workable if interpreted in a more flexible manner, and (iii) no reasonable means were apparent to distinguish between routine and important business matters.

The Commission stated that, although the language of the exception had not greatly changed, a two-part test would thereafter be applicable to the new ordinary business operations exception. This new test would require inclusion of shareholder proposals that raised important policy issues and would, according to the SEC, "produce results that were more in accord with the concept of shareholder democracy underlying Section 14(a) of the Exchange Act." The two-part test enunciated by the Commission provided that, in order for a company to rely on the ordinary business operations exception to exclude a shareholder proposal, the proposal must first "involve business matters that are mundane in nature and [second, must] not involve any substantial policy or other considerations."

On its face, it may appear that a clear test would make Rule 14a-8(c)(7) easier to administer. As will be seen in parts II and III of this Note, however, this two-part test did not solve any problems and in fact served only to create confusion.

72. Id.
73. Id.
74. Id. at 52,997-98.
75. Id. at 52,998; see New York City Employees' Retirement Sys. v. SEC, 843 F. Supp. 858, 864 (S.D.N.Y. 1994), rev'd, 45 F.3d 7 (2d Cir. 1995). The District Court for the Southern District of New York stated:

The amendment that was adopted [in 1976] took the form of a facially insignificant change. . . . However, the SEC simultaneously explained that notwithstanding the similarity between the old and new rules, the amended rule was intended to signal an SEC shift in position and that it would henceforth prohibit exclusion of proposals involving substantial policy considerations, even if they otherwise could be said to deal with "ordinary business operations."

76. See 1976 Release, supra note 8, at 52,998.
77. Id. at 52,997.
78. Id. at 52,998.
II. Staff Reversals

The SEC and its staff, while attempting to apply the two-part test,\(^\text{79}\) has many times reversed its position on a given issue\(^\text{80}\) without giving any strong support for its choice to do so.\(^\text{81}\) These reversals evidence the subjectiveness of the substantial policy determination and show that the ordinary business operations exception cannot be applied consistently. Almost all proposals that deal with ordinary business also raise policy issues to some degree. Because policy issues change over time and because the determination as to when a policy issue becomes "substantial" is subjective, a lot of uncertainty exists each year as to whether a particular shareholder proposal will be excludable pursuant to the ordinary business operations exception.\(^\text{82}\) The degree of uncertainty has been exacerbated by the Second Circuit's decision\(^\text{83}\) to uphold the SEC's choice to abandon the two-prong test when deciding if an affirmative action or equal employment opportunity proposal can be excluded based on the ordinary business operations exception.\(^\text{84}\) Now, neither registrants nor shareholders will know if the staff will even attempt to apply the two-prong test or if it will just say that the determination is simply too difficult to make.

What follows are some examples of staff reversals of position under the ordinary business operations exception, all of which, at least in part, were based on increased legislative interest in the subject matter of the proposal in question. Even though the SEC staff attempts to substantiate each reversal of position by stating that there has been increased legislative interest in the particular area addressed by the proposal, it does not specify such interest. Further, although legislative interest may be some evidence of the presence of a substantial policy issue, legislative interest alone does not sufficiently define the contours of a substantial policy issue. The problem with equating "legislative interest" with "substantial policy issue" is that, even if we accept that legislative interest is evidence of a substantial policy issue, the question remains: When does it become a substantial policy issue? When a bill is introduced? When it is passed by the House? By the Senate? When it is signed into law? Staff reversals of position based on legislative interest in the subject matter therefore do not eliminate

\(^{79}\) See supra notes 75-78 and accompanying text for a discussion of the two-part test.

\(^{80}\) See infra notes 85-107 and accompanying text.

\(^{81}\) See Alan R. Palmiter, The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation, 45 Ala. L. Rev. 879, 908 (1994) (stating that "[e]ven more troubling than the number of policy shifts has been the agency's terse and desultory explanations for its new positions, often little more than a reference to an extant public debate on the question").


\(^{83}\) New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7 (2d Cir. 1995).

\(^{84}\) See id. at 12-14; infra part III.
any of the uncertainty inherent in the ordinary business operations exception due to the subjective determination of what constitutes a substantial policy issue.

### A. Plant Closing Proposals

On November 15, 1988, a shareholder of Pacific Telesis Group submitted a resolution for inclusion in Pacific's proxy statement and form of proxy relating to the upcoming annual shareholders meeting. This resolution stated as follows:

Resolved:

That Pacific Telesis in joint discussions with its labor partners, study the impact to communities of the closing or consolidation of Pacific Telesis facilities and be it further resolved that alternatives be developed that help mitigate those corporate decisions such as, but not limited to:

1. Locating new facilities where feasible within commutable range of old outdated offices.
2. Remodeling or rebuilding older offices into new more efficient work environments.
3. Reducing contract labor in those communities where office closures occur and make provisions for Pacific Telesis employees to perform such work.
4. Study other alternatives developed by officers of the company, there staff's, and other business partners.

Whereas this policy would seek to eliminate the burden of laid-off workers being placed on the community and encouraging corporate responsibility for the future of its work force.

In a letter dated December 14, 1988 to the SEC, senior counsel of Pacific Telesis requested a no-action letter from the SEC. He opined that the proposal could be excluded on the basis of Rule 14a-8(c)(7), the ordinary business operations exception. He pointed out that "[t]he proposal relates to the closing of Corporation facilities, and the Division of Corporation Finance of the Securities and Exchange Commission... has consistently allowed for the omission of share owner proposals dealing with the closing of company facilities under Rule 14a-8(c)(7)."

On February 2, 1989, however, the SEC staff issued a letter to Pacific Telesis Group rejecting their contention that the proposal could

86. Id. at *9-10.
87. Id. at *3.
88. Id. at *4-5.
89. Id. at *5 (citing General Electric Co., SEC No-Action Letter, 1988 SEC No-Act. LEXIS 129 (Jan. 29, 1988)).
be excluded based on the ordinary business operations exception.\textsuperscript{90} The letter stated:

In light of recent developments, including heightened state and federal interest in the social and economic implications of plant closings and relocation decisions, the staff has reconsidered its position with respect to the applicability of Rule 14a-8(c)(7) to proposals dealing generally with the broad social and economic impact of plant closings or relocations. It is the Division's view that such proposals... involve substantial corporate policy considerations that go beyond the conduct of the Company's ordinary business operations.\textsuperscript{91}

The Pacific Telesis letter thus reversed the position previously held by the SEC that shareholder proposals involving plant closings relate to the ordinary business operations of the registrant.\textsuperscript{92}

This staff reversal with respect to plant closings was claimed to be a response to increased legislative interest in the area. Although the letter did not specify, "Linda Quinn, the Division director... explained that the Division's change was in reaction to new federal legislation that required companies to give employees prior notice of plant closings."\textsuperscript{93} Unfortunately, as discussed previously,\textsuperscript{94} no registrant could predict that the staff would take such a position. Further, the change in position seems to be no more than a subjective judgment that the issue has suddenly become important enough to be included in a company's proxy statement. The economic ramifications of plant closings certainly was an issue for some time before Congress became involved. When Congress did become involved, the issue did not suddenly change and become any different than it had been in the past. Congress simply decided to get involved. Thus, the SEC's reversal appears to rest on no sound basis.

\textsuperscript{90} Id. at *1.
\textsuperscript{91} Id. at *1-2. The Pacific Telesis letter reversed the staff's position with respect to "proposals dealing generally with the broad social and economic impact of plant closings or relocations." Id. at *2. "The staff's revised position, however, [did] not apply to proposals concerning specific decisions regarding the closing or relocation of particular plant facilities." Id.

\textsuperscript{92} See, e.g., Sears, Roebuck & Co., SEC No-Action Letter, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,353, at 76,477 (Mar. 6, 1980) (holding that a shareholder proposal requesting the board of directors to take action with respect to the location of new Company facilities was a matter relating to the conduct of the ordinary business operations of the Company and was thus excludable under Rule 14a-8(c)(7)).


\textsuperscript{94} See supra notes 79-84 and accompanying text.
B. Tobacco Product Proposals

In February, 1990, the staff reversed, and the Commission upheld the reversal of, its long-held position that registrants could omit shareholder proposals dealing with tobacco and tobacco products. In a number of letters dated February 22, 1990, the SEC staff found that its "prior letters failed to reflect adequately the growing significance of the social and public policy issues attendant to operations involving the manufacture of tobacco related products." As one commentator put it, "Since when?"

Once again, the reversal of position was purportedly based upon increased legislative interest in the area. Nevertheless, the letters from the SEC did not mention this. Linda Quinn, the SEC Division Director, explained that the change in position was due to recent federal legislation on smoking in airplanes. Again, the mere existence of legislation tangentially related to the proposal's subject matter should not trigger a change in position. Smoking in airplanes on its face has little to do with the manufacture and distribution of tobacco related products and the staff failed to articulate any nexus between the two.

C. Executive Compensation Proposals

Executive compensation proposals have also traditionally been excludable under the ordinary business operations exception. Termi
nation contracts (i.e., golden parachutes) were treated the same as ordinary executive compensation, even during the mergers and acquisitions boom of the 1980's, and were therefore excludable based on the ordinary business operations exception.101

In 1989, a shareholder of Transamerica Corporation submitted a shareholder proposal that read as follows:

RESOLVED that the stockholders recommend that the board of directors adopt the following policy: "No compensation shall be paid to any director, officer, or employee of this corporation which is contingent upon the merger or acquisition of this corporation."102

Transamerica requested a no-action letter from the SEC based on the SEC's past no-action letters stating that executive compensation, including termination contracts, related to the ordinary business operations of the registrant.103

In a letter issued to Transamerica Corporation on January 10, 1990, however, the SEC staff stated that golden parachute arrangements raise substantial policy issues due to anti-takeover, tax, and legal implications, and could not be excluded from a registrant's proxy statement based on the ordinary business operations exception.104


RESOLVED that the stockholders recommend that the board of directors adopt the following policy: "To the extent possible and allowed by local, state and federal laws, no compensation shall be paid to any director, officer, or employee of this corporation which is contingent upon the merger or acquisition of this corporation."

Id. at 79,259.


104. Id. at 79,260.
staff limited its ruling to circumstances involving golden parachute payments.\textsuperscript{105} It stated that its "position regarding the applicability of rule 14a-8(c)(7) to proposals dealing with compensation arrangements not involving [golden parachute] payments . . . , as well as to those proposals relating to compensation arrangements in general, remains unchanged."\textsuperscript{106} Nevertheless, in February of 1992, just two years after announcing that its policy was unchanged with respect to executive compensation proposals not involving golden parachutes, the SEC announced that all executive compensation proposals would no longer be deemed matters relating to the ordinary business operations of the registrant.\textsuperscript{107}

III. DEPARTURE FROM THE 1976 RELEASE TWO-PART TEST

The two-part test enunciated in the 1976 Release was applied by the SEC, albeit inconsistently and perhaps arbitrarily,\textsuperscript{108} until 1992 when it stated in a no-action letter to Cracker Barrel Old Country Store, Inc. that it no longer mattered if substantial policy issues were raised in a shareholder proposal dealing with a registrant’s employment policies for the general workforce.\textsuperscript{109} Such proposals, stated the staff, were thereafter deemed to be excludable by registrants due to the employment-related nature of the proposals.\textsuperscript{110} This staff position was later upheld by the Commission.\textsuperscript{111}

105. Id.
106. Id.
108. See discussion supra part II.
109. Cracker Barrel No-Action Letter, supra note 18, at 77,287; see infra notes 117-20 and accompanying text.
110. Id.
In June, 1992, New York City Employees’ Retirement System (“NYCERS”) submitted a shareholder proposal to Cracker Barrel Old Country Store, Inc. that read as follows:

Whereas, in February, 1991 the management of Cracker Barrel Old Country Stores restaurants announced a policy of discrimination in employment against gay men and lesbians; and,

Whereas, although Cracker Barrel management asserts that this discrimination policy has been rescinded, the company has refused to rehire fired workers and media reports have indicated that gay and lesbian workers continue to be dismissed on the basis of their sexual orientation; and,

Whereas, employment discrimination on the basis of sexual preference may deprive corporations of the services of productive employees, leading to less efficient corporate operations which in turn can have a negative impact on shareholder value; and,

Whereas, public demonstrations, boycott campaigns and negative editorial and news coverage concerning discriminatory practices by the company can undermine consumer confidence and lead to a loss of business revenue;

RESOLVED, Shareholders request the Board of Directors to implement non-discriminatory policies relating to sexual orientation and to add explicit prohibitions against such discrimination to their corporate employment policy statement.\[113\]

On July 13, 1992, counsel to Cracker Barrel requested a no-action letter from the SEC.\[114\] This request stated that the “proposal is excludable pursuant to Rule 14a-8(c)(7) because it concerns employment practices and policies which relate to the ordinary business operations of the Company.”\[115\] The request cited previous no-action letters issued by the SEC with respect to similar proposals involving employment issues that stated that such proposals were excludable based on the ordinary business operations exception.\[116\]

On October 13, 1992, the SEC staff issued a no-action letter to Cracker Barrel\[117\] that gave rise to years of litigation\[118\] and threw the

\[112\] NYCERS is an institutional investor. Today, institutional investors are playing an ever larger role in corporate ownership.


\[114\] See Cracker Barrel No-Action Letter, supra note 18, at 77,284.

\[115\] Id. at 77,285.


\[117\] Id. at 77,287.

The staff stated in its no-action letter to Cracker Barrel that although, [a] general rule, the staff views proposals directed at a company's employment policies and practices with respect to its non-executive workforce to be uniquely matters relating to the conduct of the company's ordinary business operations . . . , the line between includable and excludable employment-related proposals based on social policy considerations has become increasingly difficult to draw [in recent years]. 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. . . .

. . . [T]he Division has [therefore] 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.119

The staff refused to apply the two-prong test from the 1976 Release because it was too difficult to make an appropriate determination of whether a substantial policy issue was raised.120 The staff thus abandoned its prior position that equal employment opportunity and affirmative action proposals could not be excluded pursuant to the ordinary business operations exception because they raised substantial policy issues.121 The justification given by the SEC for this abandonment, however, does not only apply to proposals dealing with equal employment opportunity and affirmative action. The difficulty in applying the test certainly applies to proposals in many other areas as well. The substantial policy prong of the two-prong test enunciated in the 1976 Release causes the same problems of tenuous distinctions122 in areas other than employment-related proposals.

Dissatisfied with the Commission's ruling that their proposal could be excluded by Cracker Barrel, NYCERS sued the SEC for failing to comply with the notice and comment procedures of the Administrative Procedure Act ("APA")123 when announcing a new rule.124 NYCERS also claimed that the position taken by the SEC in the

120. See id. (stating that "the line between includable and excludable employment-related proposals based on social policy considerations has become increasingly difficult to draw").
122. See Cracker Barrel No-Action Letter, supra note 18, at 77,287.
123. See New York City Employees' Retirement Sys. v. SEC, 843 F. Supp. 858, 863 (S.D.N.Y. 1994), rev'd, 45 F.3d 7 (2d Cir. 1995). An analysis of the notice and comment procedures of the APA, however, is beyond the scope of this Note. What is important for purposes of this Note is simply that the SEC staff refused to apply the
Cracker Barrel no-action letter was arbitrary, capricious, and unenforceable. The district court agreed with NYCERS' claim "that the Cracker Barrel position is a legislative rule that can be adopted only in a rule-making proceeding pursuant to public notice and comment." The district court did not reach NYCERS argument that the SEC position was arbitrary and capricious. Therefore, the court enjoined the SEC from issuing no-action letters pursuant to Rule 14a-8(c)(7) in which it "takes a position inconsistent with the understanding of the 'ordinary business operations' exception adopted by the SEC [in the 1976 Release], until such time as the SEC adopts a different position in rule making pursuant to notice and comment."

The SEC appealed this ruling and the Second Circuit recently stated that the SEC did not violate the APA through its refusal to apply the two-prong test from the 1976 Release. The Second Circuit also made two very important observations regarding shareholder proposals and the ordinary business operations exception. First, the Second Circuit showed its disdain for the abuse by institutional investors of the shareholder proposal process. It stated that "[a]fter investing in a company, [major institutional shareholders] regularly use their shareholder status as a bully pulpit to promote non-discriminatory policies in the workplace. [Their] powder and shot are proxy materials and shareholder proposals." Further, the Second Circuit showed the confusion abounding as to the proper application of the two-part test enunciated in the 1976 Release. The Second Circuit stated that Cracker Barrel was "[b]efuddled by the 1976 [Release]" and therefore wrote to the SEC to find out if the company could properly exclude the shareholder proposal from its proxy material.

IV. Suggestions For Reform

As described in the preceding parts of this Note, the ordinary business operations exception has undergone substantial changes in interpretation and application throughout its history. Despite these various changes, however, the exception has not become any easier to apply, nor has it achieved its stated purpose of "reliev[ing] the management of the necessity of including in its proxy material security

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124. See id. at 863.
125. Id.
126. Id.
127. Id.
128. Id. at 882.
129. New York City Employees' Retirement Sys. v. SEC, 45 F.3d 7, 14 (2d Cir. 1995).
130. Id. at 9.
131. Id. at 10.
132. Id.
holder proposals which relate to matters falling within the province of the management."\textsuperscript{133}

Due to the limited resources of the Commission, it cannot adequately enforce by itself the rules it promulgated pursuant to section 14(a) of the 1934 Act.\textsuperscript{134} Therefore, private enforcement is needed.\textsuperscript{135} In order for private enforcement to be effective, however, there must be predictability of outcome. As discussed in the preceding parts of this Note, a notable lack of predictability has resulted from the operation of the ordinary business operations exception, especially in recent years. The determination of what is a substantial public policy issue is too subjective and makes the no-action process unreliable. For these reasons, reform is needed.

If the ordinary business operations exception is going to be workable, it must be rewritten to provide a more objective approach that will alleviate the problems discussed in this Note. A more objective approach, however, is not possible within the current framework of the shareholder proposal rule and an even better solution is simply to eliminate the ordinary business operations exception. Once it is eliminated, Rule 14a-8(c)(1) can be relied upon by registrants to exclude from their proxy material proposals that are not proper subjects for shareholder action.\textsuperscript{136}

A determination under Rule 14a-8(c)(1) of whether a proposal must be included by management in its proxy material will in the first instance turn on whether the proposal is framed in mandatory or peremptory language. As one commentator noted:

\begin{quote}
Under (c)(1),... [i]f a resolution is mandatory and addresses a matter concerning which shareholders do not have authority to bind the directors or the corporation, it can be omitted as inconsistent with state law. If the resolution is cast as a recommendation, the Note to (c)(1)\textsuperscript{137} makes clear that it may be a "proper subject" under state
\end{quote}


\textsuperscript{135} Id. Private enforcement, for example, would consist of litigation brought by private parties.

\textsuperscript{136} Rule 14a-8(c)(1) provides that a shareholder proposal can be omitted by a registrant "[i]f the proposal is, under the laws of the registrant's domicile, not a proper subject for action by security holders." 17 C.F.R. § 240.14a-8(c)(1) (1995).

\textsuperscript{137} The following Note is part of 14a-8(c)(1):

\begin{quote}
Note: Whether a proposal is a proper subject for action by security holders will depend on the applicable state law. Under certain states' laws, a proposal that mandates certain action by the registrant's board of directors may not be a proper subject matter for shareholder action, while a proposal recommending or requesting such action of the board may be proper under such state laws.
\end{quote}

law. In such a case, the question of excludability will turn on the subject matter of the proposal.138

By eliminating the exception, shareholders will get their substantive voting rights directly from the state law pursuant to which the registrant was incorporated.139 Because the right of a shareholder to present a proposal for action at a meeting of shareholders turns upon state substantive law,140 the right to have a proposal placed in management’s proxy statement should also turn on state substantive law. The federal proxy rules should neither expand nor limit that right. Federal regulations should simply provide a mechanism for a shareholder to obtain the proxies of other shareholders with respect to any proposal that he or she would have a right under state law to present at the meeting itself.

The deletion of the ordinary business operations exception will eliminate the confusion created by the two-prong test from the 1976 Release. While there may still be some problems in interpreting what the state law actually is with respect to a particular proposal,141 the SEC should be less likely to reverse itself as it has in the past under the two-prong test from the 1976 Release. The staff will be interpreting state law rather than interpreting (or perhaps even ignoring) a standard that it promulgated.

This proposal provides more vitality to a shareholder’s right to take part in corporate governance. The elimination of the ordinary business operations exception may allow more shareholder proposals to get into management’s proxy material, but it should not be a great burden on registrants. Many other exceptions remain and as long as states define proper subject as not including ordinary business operations, a proposal dealing with ordinary business operations should still be excludable. All parties will gain due to increased predictability. Further, states will be able to define proper subjects for shareholder action if they choose. The SEC would then have to accept this definition of proper subject. This will further increase predictability. Corporations will then be able to take into account shareholder voting rights when choosing where to incorporate.

138. Solomon et al., supra note 1, at 615.
139. If a shareholder does not like the voting rights created by state corporation law, he can simply sell his shares (assuming there is a market for them) and buy shares of a corporation that is incorporated in a different state that will provide for voting rights that are more in accord with the desires of the shareholder. Similarly, a corporation can incorporate in the first instance or re-incorporate in a state that provides it with what it deems to be the most advantageous set of substantive voting rights.
140. See Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholder Proposals, Exchange Act Release No. 12,599, [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,635 (July 7, 1976); Solomon et al., supra note 1, at 612 (stating that “the shareholder proposal rule is a federal mechanism to enhance a state created right of the shareholder”).
141. See supra notes 50-52 and accompanying text.
Once the ordinary business operations exception is deleted, some measure of predictability will finally exist. Both shareholders and registrants will be better able to predict if any given proposal should be included or excluded. Some problems may arise in determining whether a subject is a proper subject under state law, but those problems are already present because even under the current regime, a determination is made as to whether the proposal in question is a proper subject for shareholder action. By deleting the ordinary business operations exception, at least one layer of confusion will be eliminated.

CONCLUSION

The results obtained by using the two-part test from the 1976 Release to determine whether a proposal must be included by management in its proxy material, or whether a proposal may be excluded based on the ordinary business operations exception, have been inconsistent at best. Recently, the SEC staff has determined that it will not always even attempt to apply the two-part test, and the Second Circuit has upheld this decision. Too much unpredictability now surrounds the exception for it to be of any value.

The ordinary business operations exception has undergone many changes throughout its lifetime, both in form and substance. The time has come to make one final change to the exception: it should be eliminated. Once eliminated, Rule 14a-8(c)(1) can be relied upon by a company to exclude from its proxy material a shareholder proposal that is not a proper subject under state law. While the determination of what is proper under state law is not without its difficulties, it is better than the truly ad hoc, arbitrary decisions, and inconsistent results that have become prevalent under the current regime.

To return to the advice sought by MOW, Mary Miknora's difficulties with application of the ordinary business operations exception are now clear. She will have to hurdle many obstacles to find an answer, and even then she will be unsure of her conclusion because she has no way of knowing if the two-prong test from the 1976 Release will be applied to her situation. If the ordinary business operations exception were eliminated she might still face some problems in determining what is a proper subject under state law, but she would not be subject to the inherent subjectiveness of the ordinary business operations exception or the possibility that the SEC will not even apply the two-part test that it promulgated. She will only have to look to see what the state law is with respect to shareholder voting rights. Mary Miknora would be much better off if the exception did not exist.

The deletion of the ordinary business operations exception will avoid the arbitrariness of the Commission, eliminate at least one layer

142. See supra notes 50-52 and accompanying text.
of confusion, and will send the issue back to state law where it rightfully belongs.