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CASE COMMENTS

A JUDICIAL CHALLENGE TO THE SEC'S
SHAREHOLDER PROPOSAL RULE

The Securities and Exchange Commission's Rule 14a-8¹—the rule providing for inclusion in management's proxy solicitation material of shareholders' proposals for corporate action—has had an uneventful judiciary history. Despite adverse reaction by some commentators to what they have seen as unnecessary restrictions on shareholders' initiative,² the courts have rarely been called on to construe Rule 14a-8; and when the rule has come before them, the Commission has been given virtually a free hand in its construction.³ But the decision of the Court of Appeals for the District of Columbia Circuit in *Medical Committee for Human Rights v. SEC*⁴ suggests that this history of judicial deference to the agency's interpretation of its rule may be coming to an end. While the court remanded the case for further administrative proceedings without reaching the merits, it added several pages of dictum taking issue with the SEC's position in sufficiently vigorous language to place the future of Rule 14a-8 in considerable doubt.⁵

If the Commission's interpretation of the shareholder proposal rule is indeed overruled as a result of this litigation, it can be recorded as a casualty of the war in Vietnam. The case arose when the Medical Committee for Human Rights, the holder of five shares of Dow Chemical Company stock,⁶ requested Dow's management to include a proposal in its 1969 proxy statement. The proposed resolution urged the board of directors to consider the advisability of amending the company's

¹17 C.F.R. § 240.14a-8 (1970).

²E.g., Bayne, *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575 (1957); Bayne, Caplin, Emerson & Latham, *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387 (1954); Emerson, *Some Sociological and Legal Aspects of Institutional and Individual Participation Under the SEC's Shareholder Proposal Rule*, 34 U. DET. L.J. 528, 547 (1957).

³See, e.g., *Dyer v. SEC*, 290 F.2d 541 (8th Cir. 1961); *Dyer v. SEC*, 289 F.2d 242 (8th Cir. 1961); *Dyer v. SEC*, 287 F.2d 773 (8th Cir. 1961); *Dyer v. SEC*, 266 F.2d 33 (8th Cir. 1959); *Brooks v. Standard Oil Co.*, 308 F. Supp. 810 (S.D.N.Y. 1969); *Curtin v. American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D.N.Y. 1954); *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951).

⁴432 F.2d 659 (D.C. Cir. 1970).

⁵*Id.* at 676-82.

⁶These shares were transferred to the Medical Committee on March 22, 1968. Letter from William A. Groening, Jr. to Herbert H. Dow, January 29, 1970, attached to Respondent's Memorandum in Opposition to Petitioner's Motion to Dismiss with Oral Argument as Exhibit A.

certificate of incorporation to prevent the company from making napalm.⁷

Not surprisingly, management viewed this proposal unfavorably and notified the Commission of its intention to omit it from the proxy material. In support of this decision, the company filed a letter and memorandum opinion of counsel setting forth its objections to the proposal.⁸ The Commission's Division of Corporate Finance accepted Dow's reasoning, prompting a request from the Medical Committee for review of the Division's decision by the full Commission.⁹

The Commission, after filing of argument by both sides, informed the parties that it had approved the recommendation of the Division of Corporate Finance that no action be taken if the proposal were omitted by the company.¹⁰ The Medical Committee thereupon petitioned the court of appeals for review of the Commission's action under Section 25(a) of the Securities Exchange Act of 1934.¹¹

⁷432 F.2d at 633. The text of the proposed resolution was as follows:

RESOLVED, that the shareholders of the Dow Chemical Company request that the Board of Directors, in accordance with the laws [sic] of the Dow Chemical Company, consider the advisability of adopting a resolution setting forth an amendment to the composite certificate of incorporation of the Dow Chemical Company that the company shall not make napalm.

Id.

As originally submitted, the proposal would have forbidden Dow to *sell* napalm to any buyer who did not give assurance that the product would not be used against human beings. The change was made because a better case could be made for manufacture than for sale as a proper subject for shareholder action. *Id.* at 662-63. Both versions were cast in the form of requests, presumably in order to avoid the operation of the "proper subject exclusion." Notes 27 & 65 and accompanying text *infra*.

⁸This procedure is required by 17 C.F.R. § 240.14a-8(d) (1970). The proposal was objected to as dealing with general social and political matters, and also as relating to Dow's ordinary business operations. For discussion of these objections see notes 25-72 and accompanying text *infra*.

⁹The SEC's regulations provide for discretionary review by the Commission of an "informal" staff determination of the kind made here by the Division of Corporate Finance. 17 C.F.R. § 202.1(d) (1970). It has been held that a petitioner must exhaust his administrative remedies by seeking such review before bringing a private action to enforce Rule 14a-8. *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951).

¹⁰432 F.2d at 663.

¹¹15 U.S.C. § 78y(a) (1964). Section 25(a) of the Act provides that:

Any person aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person is a party may obtain a review of such order in the United States Court of Appeals within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order

In its briefs and oral argument before the circuit court, the Commission refused to discuss the merits of its decision not to compel inclusion of the contested proposal, but confined itself to a strong attack on the court's jurisdiction to review its action.¹² Circuit Judge Tamm, writing for the court, devoted the greater part of his opinion to an exhaustive analysis of the jurisdictional question. The Commission had contended that the procedures which it uses in deciding whether to compel inclusion of a given proposal are informal in nature¹³ and have been assumed not to be subject to judicial review.¹⁴ The court held, however, that the adversary background of the Commission's decision in this case was sufficient to differentiate it from the usual informal proceeding and make it reviewable.¹⁵ The SEC's contention that the decision whether to compel inclusion of a shareholder proposal is a matter within its prosecutorial function, and hence "committed to agency discretion by law,"¹⁶ was similarly rejected.¹⁷

Since the Commission had declined to articulate the reasoning which led it to dispose of the anti-napalm resolution as it did,¹⁸ the court remanded the case for construction of a record on the substantive points involved. "In aid of this consideration on remand," however, it confessed its "puzzlement" at the result reached by the agency¹⁹ and set out its *ex parte* interpretation of the two exclusions from the coverage of Rule 14a-8 relied on by Dow as justifying the omission of the proposal.²⁰

of the Commission be modified or set aside in whole or in part. . . .

[S]uch court shall have jurisdiction . . . to affirm, modify and enforce or set aside such order, in whole or in part.

¹²Brief for Respondent at 2. The Commission had originally raised the jurisdictional issue by a motion to dismiss, which was denied by the court on October 13, 1969, "without prejudice to renewal thereof in the briefs and at the argument on the merits." 432 F.2d at 663. (Circuit Judge Tamm, who wrote the opinion in the present case, voted to grant the motion. Brief for Petitioner at 13.) Including its petition for rehearing, the Commission filed six briefs and memoranda without ever discussing the merits. Petitioner's Response to Supplementary Memorandum of the SEC at 1.

¹³17 C.F.R. §§ 202.1-202.7 (1970).

¹⁴Clusserath, *The Amended Stockholder Proposal Rule: A Decade Later*, 40 NOTRE DAME LAW. 13, 17 (1964) [hereinafter cited as Clusserath].

¹⁵432 F.2d at 667-70.

¹⁶5 U.S.C. § 701(a)(2) (Supp. V 1965-69).

¹⁷The court said that this contention was meritorious, "but only in a limited sense; and the decisions of this court have never allowed the phrase 'prosecutorial discretion' to be treated as a magical incantation which automatically provides a shield for arbitrariness." 432 F.2d at 673. The court conceded that the Commission had discretion to allocate its limited resources of time and manpower as it saw fit, but held that where the agency based its decision not to prosecute on a conclusion of law, that conclusion was subject to review. *Id.* at 674-75.

¹⁸Note 12 *supra*.

¹⁹432 F.2d at 676.

²⁰*Id.* at 676-82.

Any attempt to assess the correctness of the court's interpretation of the shareholder proposal rule is handicapped by the fact that the Commission has seldom articulated the basis for its decisions in this area.²¹ As a former Commission attorney has said in criticizing this practice:

Often, management will throw the whole book of objections at a particular stockholder proposal, and later the staff's letter to both concerned parties will only inform them that the Division or Commission will raise no objection if management omits the stockholder proposal from its proxy material. . . . Such general, uninformative statements are often of no aid to the stockholder concerned. . . .²²

Presumably, the principles upon which the decision as to whether a given proposal meets the standards for inclusion are discussed within the agency; but the memoranda and minutes of Commission meetings which might reflect these discussions are considered "nonpublic" and are not normally made available to outsiders.²³

Nevertheless, published surveys of proposals which the SEC has permitted management to omit in the past, together with commentaries on the operation of the shareholder proposal rule written by employees and former employees of the Commission,²⁴ suggest some tentative conclusions regarding the interpretation placed on the rule by the agency. On the basis of this material, it would appear that the Commission can put forward a plausible argument that in light of its past construction of Rule 14a-8, Dow's objections to the Medical Committee proposal were sound.

The company had contended that the resolution could properly be omitted under either subparagraph (2) or subparagraph (5) of Rule 14a-8(c), the relevant portions of which are as follows:

. . . .

(c) Notwithstanding the foregoing, the management may

²¹Letter from Harvey L. Pitt, SEC Staff Attorney, to *Washington & Lee Law Review*, October 13, 1970.

²²Clusserath at 43.

²³17 C.F.R. § 200.80(c)(5) (1970). The Commission is presently considering a request that it make available minutes of all meetings since 1964 dealing with Rule 14a-8. Letter from Harvey L. Pitt, *supra* note 21.

²⁴E.g., 2 L. LOSS, SECURITIES REGULATION 900-15 (2d ed. 1961) (former Associate General Counsel); Heller, *Stockholder Proposals*, 4 VA. L. WEEKLY DIGTA Compilation 72 (1953) (then Assistant Director of the Division of Corporate Finance); Ledes, *A Review of Proper Subject Under the Proxy Rules*, 34 U. DET. L.J. 520 (1957) (then Legal Assistant to Commissioner James C. Sargent); Clusserath (former Staff Attorney). The Commission routinely disclaims responsibility for private publications by its employees but these comments are presumably entitled to some weight due to the authors' familiarity with Commission practice.

omit a proposal and any statement in support thereof from its proxy statement and form of proxy under any of the following circumstances:

. . . .

(2) If it clearly appears that the proposal is submitted by the security holder . . . primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes;²⁵ or

. . . .

(5) If the proposal consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer.²⁶

The court interpreted the political exclusion as little more than a gloss on the requirement that the proposal relate to a proper subject for action by security holders.²⁷ It read the word "general" in subparagraph (2) as ruling out attempts to secure a consensus of shareholder opinion on political issues whose resolution is not within the corporate power, and distinguished the Medical Committee's proposal as relating "solely to a matter that is completely within the accepted sphere of corporate activity and control."²⁸ This construction was supported by the decision of the Director of the Division of Corporate Finance, issued in 1945, which first introduced the political exclusion principle. Replying to a request for advice from an unidentified corporation,²⁹ the Director gave his opinion that resolutions opposing double taxation of dividend income, advocating revision of the antitrust laws, and calling for equality of representation for investors with farmers and workers could be omitted as failing to meet the proper subject requirement:

It was not the intent of [the shareholder proposal rule] to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or eco-

²⁵Hereinafter referred to as the political exclusion.

²⁶Hereinafter referred to as the ordinary business operations exclusion. 17 C.F.R. § 240.14a-8(c) (1970).

²⁷This requirement (hereinafter referred to as the proper subject exclusion) was contained in the original version of the shareholder proposal rule and was then the only limitation on management's duty to include a proposal. 17 C.F.R. § 240.14a-7 (Cum. Supp. 1943). The present language allows management to omit a proposal if it is "under the laws of the issuer's domicile, not a proper subject for action by security holders. . . ." 17 C.F.R. § 240.14a-8(c)(1) (1970).

²⁸432 F.2d at 681.

²⁹While an opinion of this type is not binding on the Commission, it "can be relied upon as representing the views" of the Division of Corporate Finance. 17 C.F.R. § 202.1(d) (1970).

nomic nature. *Other forums* exist for the presentation of such views.³⁰

Subsequent application of the political exclusion rule by the Commission staff suggests, however, that if this was its original construction, it has since been abandoned. In 1951, a proposal recommending that the Greyhound Corporation consider the advisability of abolishing segregated seating in the South was ruled out of order by the Division of Corporate Finance.³¹ This holding was explained by commentators on the grounds that the proposal did not show on its face that it was restricted to the company's busses,³² and that state laws, then thought valid with respect to intrastate transportation, required segregation.³³

It would seem, however, that these objections do not satisfactorily explain the result in the Greyhound case in view of the fact that the anti-segregation proposal could readily have been amended to eliminate them.³⁴ The decision is more easily justified if it is postulated that the test applied by the Division was whether the motive of the proponent was political or social in nature, rather than whether the proposal was germane to corporate affairs.³⁵ That this was in fact the reason for the exclusion of the proposal is suggested by the language used when the political exclusion was codified in the following year.³⁶ The codified rule bars proposals put forward "*for the purpose of promoting*" the designated causes,³⁷ a phrase which was not used in the original formulation³⁸ and whose significance the court in the present case seems to have overlooked.

³⁰432 F.2d at 677, citing Brief for Petitioner at Addendum 3. For an interpretation of the political exclusion consistent with that contained in the present opinion see Emerson & Latham, *The SEC Proxy Proposal Rule: The Corporate Gadfly*, 19 U. CHI. L. REV. 807, 834 (1952).

³¹The stockholder's suit in district court to enjoin Greyhound from mailing its proxy solicitations without the proposal was dismissed on the ground that plaintiff had failed to exhaust his administrative remedies. *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951); note 9 *supra*.

³²Emerson & Latham, *supra* note 30, at 833.

³³*Id.*; Note, *Rule X-14 A-8 of the SEC: Stockholder Participation in Corporate Affairs*, 47 NW. U.L. REV. 718, 719 (1952). The court in *Medical Committee* also cited these factors in distinguishing the Greyhound ruling. 432 F.2d at 678.

³⁴The Commission will normally permit minor amendments in order to render a shareholder proposal acceptable. Clusserath at 31; note 54 and accompanying text *infra*.

³⁵Note, *Corporate Political Affairs Programs*, 70 YALE L.J. 821, 846 (1961).

³⁶Sec. Ex. Act. Rel. 4775 (1952). The language adopted at that time was identical to the present Rule 14a-8(c)(2). Text accompanying note 25 *supra*.

³⁷Note 25 and accompanying text *supra* (emphasis added).

³⁸Note 30 and accompanying text *supra*.

This alternative interpretation is supported by other instances in which the political exclusion has been held to apply. In 1953, the Assistant Director of the Division of Corporate Finance, writing in his private capacity, referred to Commission exclusion of proposals that a corporation cease to invest in liquor stocks and that women be afforded the same pension benefits as men.³⁹ In explaining these decisions, the Assistant Director said that

Although the purposes appeared germane to the business of the company, on the facts the Commission determined that the primary motive of the stockholder was the advancement of the cause with which the stockholder had a close association, rather than the solution of a problem pertinent solely to the corporation itself.⁴⁰

Another source reports exclusion of proposals that RCA refrain from hiring Communists and former Communists and that "all employees be informed that it is to be [Standard Oil of New Jersey's] policy to hire all personnel without regard to race, religion or national origin."⁴¹ Whatever the merits of these proposals, it would seem that they were all as much "within the accepted sphere of corporate activity and control"⁴² as the Medical Committee's anti-napalm resolution. As applied by the Commission, then, the political exclusion would appear to bar any shareholder proposal, whatever its relevance to the affairs of the company, which is motivated by concern for social or political issues.

A recent decision by the full Commission suggests, however, that the scope of the political exclusion is not as broad in practice as might appear from the preceding discussion. This decision arose out of "Campaign GM," the recent effort by associates of consumer advocate Ralph Nader to compel General Motors, through shareholder action at the company's 1970 annual meeting, to be more responsive to social issues.⁴³ As part of this movement, Campaign GM submitted nine proposals for inclusion in GM's proxy statement,⁴⁴ all of which were objected to by

³⁹Heller, *Stockholder Proposals*, 4 VA. L. WEEKLY DICTA Compilation 72, 74 (1953).

⁴⁰*Id.* This explanation referred also to the Greyhound case, note 31-35 and accompanying text *supra*.

⁴¹Bayne, *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575, 599 (1957).

⁴²Note 28 *supra*.

⁴³*See, e.g.*, THE NEW YORKER, June 20, 1970, at 40; TIME, June 1, 1970, at 54-55.

⁴⁴Proposal number one directed an amendment to GM's certificate of incorporation to prevent the company from taking any action which would be illegal or detrimental to public health, safety, or welfare.

Proposal number two would have increased the size of the board of directors.

Proposal number three would have established a Shareholders Committee for

management on several grounds, including both the political and ordinary business operations exclusions.⁴⁵

If the motivation behind the proposals was considered, it would appear that all nine, regardless of their subject matter, should have been equally unacceptable in view of the avowed purpose of their proponents to bring about social change.⁴⁶ Both the Division of Corporate Finance and the Office of the General Counsel of the Commission were of the opinion, however, that proposal number two, which called for enlargement of the board of directors, did not fall under the political exclusion and should be included in the company's proxy statement.⁴⁷ The full Commission adopted this position.⁴⁸

The eight remaining Campaign GM proposals produced disagreement between the Division and the Office of the General Counsel. The Division felt that all eight could be omitted, based in part upon the political exclusion.⁴⁹ The General Counsel, while agreeing that proposal number one and numbers four through nine did not meet the standards for inclusion,⁵⁰ was evidently of the opinion that the political exclusion did not apply to *any* of the proposals.⁵¹ It recommended that proposal number three, which called for the establishment of a "Shareholders Committee for Corporate Responsibility" to study and report

Corporate Responsibility to study and report on GM's relationship to specified social problems.

Proposal number four called for a commitment by the company to an increased role for public mass transportation.

Proposal number five would have set specific crash-safety standards for GM automobiles.

Proposal number six directed commitment of corporate resources to control of vehicle emissions.

Proposal number seven called for greatly increased warranty coverage on the company's products.

Proposal number eight would have required controls on internal air pollution in GM plants.

Proposal number nine called for "immediate and effective action" to increase minority representation among franchise holders and skilled and managerial employees. Minute of a Meeting of the SEC, March 18, 1970, at 15-20 (hereinafter cited as Minute).

⁴⁵*Id.* at 10-11.

⁴⁶See sources cited in note 43 *supra*.

⁴⁷Minute at 11.

⁴⁸*Id.* at 14.

⁴⁹*Id.* at 11.

⁵⁰The basis of the Office of the General Counsel's objections does not appear in the Minute.

⁵¹The language of the Minute is ambiguous on this point: "Office [of the General Counsel] did not agree with GM or the Division that all of the proposals (except for the Division's position on proposal 2) might be omitted pursuant to Rule 14a-8(c)(2)." Minute at 12.

on GM's relation to specified social issues,⁵² be included in the management's proxy material. When the question came before the Commission, it voted, with one dissent, to compel inclusion of this proposal if it were revised to restrict the proposed Committee's budget to a reasonable sum and to prevent disclosure of trade secrets.⁵³ It determined that no action would be taken if GM omitted the remaining seven proposals, but did not state whether its holding rested on the political exclusion.⁵⁴

Neither the construction placed on the political exclusion by the court in the principal case⁵⁵ nor the straightforward test of motive apparently used by the Division of Corporate Finance in the past⁵⁶ seem adequate to explain the stand taken by the Division with regard to the Campaign GM proposals. The eight resolutions which the Division rejected were no less relevant to corporate concerns than the proposal to increase the size of the board. Nor is there anything to indicate that the motive of the approved proposal was any different from that of the others. Unlike the rejected proposals (and like the Medical Committee's resolution), the accepted proposal did not show its social motivation on its face, but such a distinction hardly seems adequate to account for the difference in treatment. Perhaps a better explanation for the Division's position is provided by the fact that the size of the board has in the past been considered an accepted subject for shareholder action.⁵⁷ The Division may have refrained from a rigorous inquiry into the motive underlying this proposal in order to avoid the appearance of pro-management bias.

On the other hand, the position taken by the Office of the General Counsel, and endorsed by the Commission at least with respect to proposal number three, may indicate a retreat from the test of motive and perhaps from the political exclusion itself.⁵⁸ The Commission's decision, that the proposal was not properly excludible, would seem fundamentally inconsistent with the position taken by the Division of Corporate Finance since the Greyhound ruling.⁵⁹ This holding suggests that perhaps the political exclusion is declining in significance, and that

⁵²*Id.* at 16-17.

⁵³*Id.* at 13-14.

⁵⁴*Id.* at 14.

⁵⁵Note 28 and accompanying text *supra*.

⁵⁶Notes 35-42 and accompanying text *supra*.

⁵⁷Clusserath at 48.

⁵⁸It should be noted that the majority of the decisions applying the stockholder proposal rule are made by the Division and not by the full Commission. 17 C.F.R. § 202.1(d) (1970); Clusserath, *supra* note 14, at 17.

⁵⁹Note 36 and accompanying text *supra*.

the Commission's rejection of the Medical Committee's proposal may have rested chiefly on the ordinary business operations exclusion.⁶⁰

The court in *Medical Committee*, on the contrary, had considerably less difficulty in dismissing the ordinary business operations exclusion than in dealing with the political exclusion. Referring to the law of Dow's state of incorporation,⁶¹ the circuit court found that since Delaware's General Corporation Law permits amendment of the certificate of incorporation to change the nature of the company's business, the anti-napalm resolution was clearly within the sphere of shareholder action.⁶² While this might be a valid conclusion with respect to the extent of the shareholder's power,⁶³ it does not appear to meet the question presented by the ordinary business operations exclusion.

Like the political exclusion, the ordinary business operations exclusion grew out of the interpretation of the original shareholder proposal rule, whose only limitation was that the proposal must relate to a proper subject for shareholder action.⁶⁴ Soon after the rule was adopted, the Commission developed the principle that while the shareholders could not demand that management act with regard to any matter which state law reserved for the directors, a *request* that the board *consider* taking action might be acceptable.⁶⁵ When the composition of the SEC changed following the election of President Eisenhower, the new Commission apparently felt that restrictions on shareholder proposals

⁶⁰Note 26 and accompanying text *supra*.

⁶¹As with the proper subject exclusion, state law governs as to whether a proposal relates to ordinary business operations. *Hearings on SEC Enforcement Problems Before a Subcommittee of the Senate Committee on Banking and Currency*, 85th Cong., 1st Sess., pt. 1 at 118 (1957). Professor Loss suggests, however, that state law is frequently inadequate to decide the question and that the Commission has developed a "common law" in this area. 2 L. LOSS, *SECURITIES REGULATION* 905-06 (2d ed. 1961).

⁶²432 F.2d 680. The court cited DEL. CODE ANN., tit. 8, § 242(a) (Supp. 1968):

(a) [A] corporation may amend its certificate of incorporation, from time to time, so as:

• • • •

(2) To change, substitute, enlarge or diminish the nature of its business or its corporate powers and purposes.

⁶³Note 65 *infra*.

⁶⁴Note 27 *supra*.

⁶⁵2 L. LOSS, *supra* note 61, at 908; CARY, *CORPORATIONS* 329-30 (4th ed. 1969). During the Commission's 1956 fiscal year, a stockholder of Interstate Department Stores, Inc. put forward a proposal calling for a two-for-one stock split. Such action would have required an amendment to the certificate of incorporation. Under the same Delaware statute that applied to the present case, the amendment had to be initiated by the directors and approved by the shareholders. The Commission staff took the position that the proposal would be proper if put in the form of a request. Ledes, *A Review of Proper Subject Under the Proxy Rules*, 34 U. DET. L.J. 520, 525-27 (1957).

should be tightened somewhat.⁶⁶ When in 1954 it amended Rule 14a-8 to provide these tighter controls,⁶⁷ it adopted the ordinary business operations exclusion as an absolute prohibition on shareholder initiative, however phrased, in the operational area of corporate activity.⁶⁸

The court's conclusion in *Medical Committee* that the shareholders have the power to recommend that Dow cease to manufacture napalm, thus fails to meet the objection raised by management to the Medical Committee's resolution. The point at issue is whether the decision to make napalm is a matter of "ordinary business operations." Unfortunately, the Commission has never provided a clear definition of this term.⁶⁹ However, the word "ordinary" apparently refers to the area of operations involved, barring any shareholder proposal in that area whatever the importance of the particular action advocated or challenged.⁷⁰ The field of production is seemingly such an area. In the Campaign GM case, an attempt by the dissident shareholders to exercise control over the specifications of the company's products⁷¹ was apparently rejected as falling within the ordinary business operations exclusion. This action was consistent with the result reached in an earlier attempt to restrict the size and speed of a corporation's products.⁷²

The Commission can thus make out a persuasive case with respect to both exclusions that it followed a consistent interpretation of its own rules in acquiescing in Dow's decision to omit the anti-napalm proposal. Furthermore, if the holding of the Supreme Court in *Bowles v. Seminole Rock & Sand Co.*⁷³ is taken at its face value, this consistency of interpretation would appear to dispose of the present case. In *Seminole*, the Office of Price Administration charged the defendant company with violating a price regulation. The company challenged the applicability

⁶⁶L. Loss, *supra* note 61 at 912.

⁶⁷See Bayne, Caplin, Emerson & Latcham, *supra* note 2.

⁶⁸In the words of an unidentified Commissioner, speaking at a Commission meeting in 1964, the adoption of the ordinary business operations exclusion represented

recognition of the view that proposals which would be considered improper as directives are proper in precatory form under paragraph (c)(1) and may be excluded from management's proxy material only if some other provision of the rule so requires.

CARY, *supra* note 65, at 330.

⁶⁹One commentator has suggested that the Commission uses the ordinary business operations exclusion as a "catch-all concept of omissibility." Note, *Corporate Political Affairs Programs*, 70 YALE L.J. 821, 848 (1961).

⁷⁰Clusserath at 36 (citing a decision of the Division of Corporate Finance).

⁷¹Note 44 *supra*.

⁷²Clusserath at 29.

⁷³325 U.S. 410 (1945).

of the regulation to the transaction involved. In rejecting the challenge, the Court held:

Since this involves an interpretation of an administrative regulation a court must necessarily look to the administrative construction of the regulation if the meaning of the words used is in doubt. The intention of Congress or the principles of the Constitution may be relevant in the first instance in choosing between various constructions. *But the ultimate criterion is the administrative interpretation, which becomes of controlling weight unless it is plainly erroneous or inconsistent with the regulation.*⁷⁴

This holding has been cited repeatedly by the Supreme Court⁷⁵ and by the lower federal courts.⁷⁶ The principle which it embodies has been applied with particular force to the SEC proxy rules.⁷⁷ Numerous private actions to enforce compliance with the rules have been unsuccessful largely because of the failure of the Commission to proceed against the alleged violator, not only where the agency has given full consideration to the case and found no infraction,⁷⁸ but also where it has merely taken no action with respect to the challenged material.⁷⁹

Nonetheless, this principle of construction, although often repeated, does not remove the courts' discretion to decline to follow the administrative interpretation in a case where the equities of the situation seem to urge a contrary result.⁸⁰ For example, in *M. Kraus & Bros. v. United*

⁷⁴*Id.* at 413-14 (emphasis added).

⁷⁵*E.g.*, *Immigration & Naturalization Serv. v. Stanisic*, 395 U.S. 62, 72 (1969); *Thorpe v. Housing Authority*, 393 U.S. 268, 276 (1969); *Udall v. Tallman*, 380 U.S. 1, 4 (1965).

⁷⁶*E.g.*, *Gray v. Johnson*, 395 F.2d 533 (10th Cir. 1968); *Jno. McCall Coal Co. v. United States*, 374 F.2d 689 (4th Cir. 1967); *Wright v. Paine*, 289 F.2d 766 (D.C. Cir. 1961); *L. Gillarde Co. v. Joseph Martinelli & Co.*, 169 F.2d 60 (1st Cir. 1948). In the *Jno. McCall Coal Co.* case the court stated:

Even though our views with regard to interpretation differ from those of the administrative agency we would not be authorized to substitute our views if it could be said that the administrative interpretation was a reasonable one.

374 F.2d at 692.

⁷⁷*Dyer v. SEC*, 290 F.2d 541 (8th Cir. 1961); *Dyer v. SEC*, 289 F.2d 242 (8th Cir. 1961); *Dyer v. SEC*, 287 F.2d 773 (8th Cir. 1961); *Dyer v. SEC*, 266 F.2d 33 (8th Cir. 1959).

⁷⁸*E.g.*, *Union Pac. R. Co. v. Chicago & N.W. Ry.*, 226 F. Supp. 400 (N.D. Ill. 1964); *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951).

⁷⁹*E.g.*, *Mack v. Mishkin*, 172 F. Supp. 885 (S.D.N.Y. 1959); *Weeks v. Alpert*, 131 F. Supp. 608 (D. Mass. 1955). This judicial reluctance to find a violation of the proxy rules where the Commission has found none was partially relied on by the court in the present case to support its holding that the Medical Committee was aggrieved by the agency's refusal to act against Dow. 432 F.2d at 667.

⁸⁰As one of the leading authorities on administrative law has said:

When the court agrees with the rule, that is, when it finds the rule

States,⁸¹ decided the year after *Seminole*, the Supreme Court simply ignored its holding in that case. Possibly influenced by the fact that to hold the administrative interpretation valid would have subjected the defendant to criminal penalties, it held that the language of the regulation in question did not clearly warrant the interpretation.⁸² In *Pike v. CAB*,⁸³ the circuit court refused to sustain the agency's revocation of a commercial pilot's license on the basis of a regulation found to be vague and confusing.⁸⁴

While it should be emphasized that the court in *Medical Committee* had heard only one side of the argument,⁸⁵ the strength of its disagreement with the Commission's presumed position suggests that the consistency of the agency's decision in this case with its prior construction of Rule 14a-8 would fail to convince the court that the anti-napalm resolution was properly excluded. Its evident unwillingness to be bound by the SEC's interpretation may stem in part from published criticism of the agency for alleged inconsistent administration, poor substantive law, and failure to provide adequate information as to the reasoning behind its application of the shareholder proposal rule.⁸⁶ The court seems also to have been impressed by the Medical Committee's argument that since Dow's management had arrived at its decision to go on manufacturing napalm, which it conceded might be damaging to the company, on political and moral grounds,⁸⁷ the result of the Commission's interpretation was a double standard as to the propriety of political activity by shareholders and management.⁸⁸

a sound interpretation of the statute or a proper determination under the statute, the court is likely to utter words that the regulation is controlling, that it has great weight, or that it must be given effect unless it is unreasonable or inconsistent with the statute. When the court disagrees, that is, when the court thinks the regulation is inconsistent with the statute or unauthorized by it, or when the policy embodied in the regulation is neither required nor prohibited by the statute and the court prefers a different policy, the court is likely to say that such a regulation is void and of no effect.

1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 5.05 (1958).

⁸¹327 U.S. 614 (1946).

⁸²*Id.* at 622; see 4 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 30.12 (1958).

⁸³303 F.2d 353 (8th Cir. 1962).

⁸⁴The court also distinguished *Seminole* on the ground that the precise point raised in *Pike* had never before been decided by the agency: "Administrative interpretation of *long standing* is thus not present." 303 F.2d at 357 (emphasis added).

⁸⁵Note 12 and accompanying text *supra*.

⁸⁶Clusserath at 39-42. The court cited this article in support of its assumption of jurisdiction. 432 F.2d at 674.

⁸⁷In its argument before the Commission, the Medical Committee had introduced in evidence a statement by Dow's president in the company magazine in which this admission was made. Record at 40a-43a.

⁸⁸432 F.2d at 681.

It appears likely that the SEC will be compelled to lower somewhat its barriers against politically or socially motivated attempts by shareholders to influence corporate decision-making concerning the nature of the products to be manufactured. Such a development would represent a more realistic appraisal of the role of the corporation in modern society than that which evidently underlies the political and ordinary business operations exclusions as they have been applied by the Commission.

The Commission's approach seemingly rests on the assumption that it is not only desirable but also necessary for a corporation to go about its operations in a political vacuum, without any concern for the effects of its activities beyond its balance sheet. If this view is accepted, any attempt by a shareholder to inject social considerations into corporate decision-making, or to interfere with the highly technical process of making money, becomes an evil to be avoided. The court in *Medical Committee*, on the other hand, has recognized that large corporations frequently use their enormous and concentrated power for political ends.⁸⁹ In light of this fact, a rule which allows management, but not shareholders, to dictate the employment of corporate resources "for the purpose of promoting general economic, political, racial, religious, social or similar causes"⁹⁰—as Dow's management had done in deciding to go on manufacturing napalm⁹¹—is manifestly inequitable.

The second position taken by Dow, and apparently endorsed by the Commission, that the decision as to what products the company shall make is wholly outside the legitimate area of shareholder concern,⁹² is similarly untenable. A strong case can certainly be made that this is a field in which management's expertise should, under normal circumstances, be unhampered by shareholder interference. But to derive from this an absolute prohibition on shareholder initiative in cases like the present one is to ignore the fact that the decision to manufacture napalm, charged as it is with moral considerations in the eyes of a large segment of society, is one which cannot be called "ordinary" in any realistic sense of the word.

It is not to be assumed that shareholders will take a more responsible position than management on social issues. Indeed, the reverse may well be true.⁹³ However, the very limited check on the power of management which would be provided by more liberal interpretation of

⁸⁹*Id.*

⁹⁰17 C.F.R. § 240.14a-8(c)(2) (1970).

⁹¹Note 87 *supra*.

⁹²432 F.2d at 679.

⁹³See Blumberg, *Corporate Responsibility and the Social Crisis*, 50 B.U.L. REV. 157, 177 n.118 (1970).