

## THE UNDERGROUND RULIFICATION OF THE ORDINARY BUSINESS OPERATIONS EXCLUSION

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*In its landmark Cracker Barrel no-action letter, the SEC staff announced a bright-line rule permitting exclusion of any shareholder proposal pertaining to a company's management of its general workforce, even if focused on a significant social policy issue such as employment discrimination, under the "ordinary business operations" exclusion. The SEC reversed Cracker Barrel in 1998, returning to a case-specific approach to determining whether proposals fall under the exclusion. This Note examines 250 no-action letters from the 2015 proxy season and finds evidence indicating that the staff has, contrary to official SEC policy, returned to a rule-like approach to the ordinary business operations exclusion. Normatively, this de facto rulemaking by the staff is problematic when evaluated according to the rules' democratic legitimacy, transparency, or inclusivity. To address these concerns, this Note proposes two solutions. First, the SEC should recast the ordinary business operations exclusion as a "catalog" and create mechanisms to ensure that there is adequate public participation in updates to that catalog. Second, the SEC should replace the social policy exception's "significance" requirement with a numerical cap on proposals and a standard rooted in corporations' purpose clauses, which would allow for some private ordering. These changes would enhance the exclusion's democratic legitimacy, shine light on the opaque process through which the staff determines excludability, and remove the staff from its uneasy role as social policy censor.*

### INTRODUCTION

In early January 1991, restaurant chain Cracker Barrel Old Country Store adopted an explicitly discriminatory employment policy targeting employees "whose sexual preferences fail to demonstrate normal heterosexual values."<sup>1</sup> Individual restaurant managers subsequently began conducting one-on-one interviews with employees and firing those suspected of having lesbian, gay, or bisexual sexual orientations.<sup>2</sup> In one official termination notice, the employee's manager explained, "This employee is

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1. John Howard, *The Cracker Barrel Restaurants*, in *Understanding and Managing Diversity: Readings, Cases, and Exercises* 166, 167 (Carol P. Harvey & M. June Allard eds., 2015).

2. See *id.*

being terminated due to violation of company policy. The employee is gay.”<sup>3</sup>

The following year, Cracker Barrel shareholders submitted a resolution under the federal shareholder proposal rule requesting that the board implement nondiscriminatory employment practices regarding sexual orientation.<sup>4</sup> Agreeing with the company’s request to exclude the proposal from its proxy statement, the staff of the Securities and Exchange Commission (SEC) issued a sweeping proclamation stating that it would view any shareholder proposal pertaining to a company’s management of its “general workforce,” even if focused on significant social policy issues, as excludable for relating to the company’s “ordinary business operations.”<sup>5</sup> Although the SEC later reversed course on this bright-line rule,<sup>6</sup> the *Cracker Barrel* opinion has continuing significance today in light of recent decisions that similarly rely on categorical rules to exclude proposals<sup>7</sup>—a return to *Cracker Barrel*.

Under Exchange Act Rule 14a-8, a public corporation must include in its annual proxy statement qualifying proposals from shareholders who meet certain procedural and minimum-ownership requirements.<sup>8</sup> But if one of several substantive bases for exclusion applies, management may omit that proposal.<sup>9</sup> One of the substantive bases that corporations most frequently use is the ordinary business operations exclusion (Rule 14a-8(i)(7) or (i)(7)),<sup>10</sup> which allows a company to exclude any proposal that “deals with a matter relating to the company’s ordinary business operations.”<sup>11</sup> This exclusion has long been the object of criticism—not only by scholars but also by practitioners, federal appellate judges, Congress, and SEC Commissioners and Chairpersons from both parties.<sup>12</sup>

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3. *Id.*

4. See *id.* at 169; see also *Cracker Barrel Old Country Store, Inc.*, SEC No-Action Letter, 1992 WL 289095, at \*2 (Oct. 13, 1993).

5. *Cracker Barrel Old Country Store, Inc.*, *supra* note 4, at \*1; see also *infra* section I.C.4.

6. See *infra* section I.C.5.

7. See *infra* Part II.

8. 17 C.F.R. § 240.14a-8 (2016).

9. *Id.* § 240.14a-8(i).

10. See *infra* Appendix at Figure A.1.

11. 17 C.F.R. § 240.14a-8(i)(7).

12. See, e.g., *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 351 (3d Cir. 2015) (criticizing the “hard-to-define” exclusion); Oversight of the SEC’s Division of Corporation Finance: Hearing Before the Subcomm. on Capital Mkts. & Gov’t Sponsored Enters. of the H. Comm. on Fin. Servs., 113th Cong. 11–12 (2014) (statements of Reps. Scott Garrett & Carolyn B. Maloney, Members, H. Comm. on Fin. Servs.) (criticizing the SEC’s administration of the exclusion); Thomas M. Clusserath, *The Amended Stockholder Proposal Rule: A Decade Later*, 40 *Notre Dame L. Rev.* 13, 39 (1964) (same); H. Rodgin Cohen & Glen T. Schleyer, *Shareholder vs. Director Control over Social Policy Matters: Conflicting Trends in Corporate Governance*, 26 *Notre Dame J.L. Ethics & Pub. Pol’y* 81, 121–22 (2012) (same); Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 *Ala. L. Rev.* 879, 918 (1994) (proposing elimination of

One problem with the exclusion stems from the tension between its design as an open-ended standard<sup>13</sup> and the SEC staff's role in defining its contours. While standards frequently become more rule-like through precedent, the precedent that has "rulified" the ordinary business operations exclusion consists almost entirely of nonbinding, informal SEC staff opinions called "no-action letters."<sup>14</sup> Unlike the judicial opinions that comprise the common law in other contexts, no-action letters typically contain minimal explanation of the staff's reasoning, and appellate review is difficult to obtain.<sup>15</sup> This has created profound confusion about the exclusion's scope, as the divergent opinions related to the recent Third Circuit case *Trinity Wall Street v. Wal-Mart Stores, Inc.*<sup>16</sup> illustrate. *Trinity* resulted in three significantly different views of the exclusion: first, the narrow view of its reach championed by the district court and amici law professors; second, the expansive court of appeals majority opinion, which drew a rule-like test out of a series of no-action letters; and third, the middle-ground approach of the SEC staff and concurring judge, who agreed with the majority's judgment but rested their opinions on a more nimble, standard-like analytical framework.<sup>17</sup> Meanwhile, despite the Third Circuit's appeal for "fresh interpretive guidance" from the SEC,<sup>18</sup> the full Commission has not weighed in since 1998.<sup>19</sup> In short, the exclusion is in a state of chaos.<sup>20</sup>

This Note seeks to contribute to the literature by examining the ordinary business operations exclusion in light of its shifting place in the rules-standards continuum and documenting the exclusion's "rulifica-

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the exclusion); Mary L. Schapiro, Letter to the Editor, Shareholders Should Have a Soapbox, *Wall St. J.*, Mar. 9, 1993, at A19 (criticizing the "case-by-case decision making that shifts with the political and corporate governance views of the staff and individual commissioners"); Bevis Longstreth, Comm'r, Sec. & Exch. Comm'n, The SEC and Shareholder Proposals: Simplification in Regulation 10 (Dec. 11, 1981), <http://www.sec.gov/news/speech/1981/121181longstreth.pdf> [<http://perma.cc/6JBL-EZCP>] (criticizing the power given to the staff to "decide complex issues of law, fact and policy without any real possibility of outside, objective appellate review"); Harvey L. Pitt, Chairman, Sec. & Exch. Comm'n, Remarks Before the Council of Institutional Investors' Fall Conference (Sept. 23, 2002), <http://www.sec.gov/news/speech/spch582.htm> [<http://perma.cc/7THG-CXQP>] (expressing hope that the SEC would eliminate the exclusion).

13. See Louis Kaplow, Rules Versus Standards: An Economic Analysis, 42 *Duke L.J.* 557, 559-60 (1992) (defining rules and standards); *infra* section I.C (describing the exclusion's design).

14. See *infra* section I.A (explaining the role of no-action letters); *infra* section II.B (presenting evidence of the exclusion's "rulification" through no-action letters).

15. See *infra* section I.A.

16. 792 F.3d 323.

17. See *infra* section II.A.

18. *Trinity*, 792 F.3d at 351.

19. See *infra* section I.C.

20. Cf. Palmiter, *supra* note 12, at 882 (contending in the early 1990s that the shareholder proposal rule was "in chaos").

tion”<sup>21</sup> through an empirical analysis of all Rule 14a-8 no-action letters issued to Fortune 500 companies during the 2015 proxy season.<sup>22</sup> It finds that of those proposals on which the SEC staff offered an opinion as to Rule 14a-8(i)(7) excludability, the staff placed 86% of those proposals into a specific category such as “employee policy,” and the category into which the staff placed a proposal was perfectly predictive of whether the staff would find the proposal excludable.<sup>23</sup> After examining this trend, the Note argues that although some rulification of the exclusion may be desirable, this particular form of staff rulemaking is problematic. Specifically, the rulemaking is neither transparent nor democratically legitimate, creating inefficiencies and raising concerns about regulatory capture.<sup>24</sup> Additionally, the rules have produced erroneous results, including the unwarranted exclusion of proposals that focus on significant social policy issues, which is reminiscent of *Cracker Barrel* and conflicts with the most recent test for analyzing social policy proposals that the SEC adopted after notice and comment.<sup>25</sup>

Two changes to Rule 14a-8 would help to address these issues.<sup>26</sup> First, the SEC should recast the ordinary business operations exclusion as a “catalog,” which would provide clearer guidance to those interpreting the exclusion, and create mechanisms to ensure that updates to the cata-

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21. Professor Frederick Schauer brought attention to the “rulification” phenomenon in Frederick Schauer, *The Tyranny of Choice and the Rulification of Standards*, 14 J. Contemp. Legal Issues 803 (2005) [hereinafter Schauer, *Rulification*], although others had previously used the term, see, e.g., Mark D. Rosen, *Multiple Authoritative Interpreters of Quasi-Constitutional Federal Law: Of Tribal Courts and the Indian Civil Rights Act*, 69 Fordham L. Rev. 479, 491 (2000).

22. See *infra* section II.B.

23. See *infra* section II.B.2.

24. See *infra* section II.C. These problems fit within a broader pattern of agency avoidance of rulemaking procedures. See Connor Raso, *Agency Avoidance of Rulemaking Procedures*, 67 Admin. L. Rev. 65, 85–93 (2015); cf. Robert A. Anthony, *Interpretive Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them to Bind the Public?*, 41 Duke L.J. 1311, 1363–65 (1992) (noting the tendency of agency staff to treat informal guidance documents as rules, effectively binding private parties); Kristen E. Hickman, *Coloring Outside the Lines: Examining Treasury’s (Lack Of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1759–73 (2007) (criticizing the Treasury Department’s use of interpretive rules to circumvent notice and comment); James T. Hamilton & Christopher H. Schroeder, *Strategic Regulators and the Choice of Rulemaking Procedures: The Selection of Formal vs. Informal Rules in Regulating Hazardous Waste*, Law & Contemp. Probs., Spring 1994, at 111, 120–22 (examining EPA policymaking through guidance documents and interpretive rules). This Note presents a case study of one type of such avoidance by an agency of vital importance: the SEC. Although the optimal regulatory regime may vary by agency, the economic significance of the SEC and recent developments related to Rule 14a-8, see *infra* section II.A, make an SEC-focused study valuable in its own right.

25. See *infra* section II.C.

26. See *infra* Part III.

log adhere to notice-and-comment procedures.<sup>27</sup> Second, the SEC should replace the “significance” requirement of the social policy exception with a numerical limit on proposals and a new exclusion that tracks corporate-charter purpose clauses, taking the staff out of its awkward role as social policy censor.<sup>28</sup> Although the corporate-purpose clause no longer occupies the prominent place in corporate law that it once did, a slight revitalization in this narrow context would be desirable despite the difficulties that might arise.<sup>29</sup>

Part I of this Note explains the regulatory framework governing the shareholder proposal rule and the ordinary business operations exclusion. Part II discusses recent confusion over the exclusion’s scope, chronicles its rulification through an empirical study of SEC no-action letters, and identifies problems with this rulification. Part III offers solutions to the problems described in Part II.

#### I. THE REGULATORY FRAMEWORK GOVERNING SHAREHOLDER PROPOSALS AND THE ORDINARY BUSINESS OPERATIONS EXCLUSION

This Part provides an overview of the regulatory framework governing shareholder proposals and the ordinary business operations exclusion. Section I.A discusses shareholder proposals generally, including the no-action letter process. Section I.B, recognizing the influence of administrative interpretations of Rule 14a-8, discusses the weight courts have accorded these authorities when determining the exclusion’s scope. Finally, section I.C delves into the ordinary business operations exclusion itself, tracing its history and the SEC’s interpretation of its scope.

##### A. *Rule 14a-8 and the No-Action Letter Process*

Acting under the authority of section 14(a) of the Securities Exchange Act of 1934 (’34 Act),<sup>30</sup> the SEC promulgated the predecessor

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27. See *infra* section III.A. A “catalog” is an alternative type of legal directive, distinct from rules and standards. As Professors Gideon Parchomovsky and Alex Stein define the term, a catalog contains a list of enumerated items with a general provision empowering the decisionmaker to proscribe (or permit) other similar items. Gideon Parchomovsky & Alex Stein, *Catalogs*, 115 *Colum. L. Rev.* 165, 168 (2015); see also *infra* section III.A.1.

28. See *infra* section III.B.

29. See *infra* section III.B.

30. 15 U.S.C. § 78n(a) (2012). Congress appears to have enacted section 14(a) for the purpose of both preventing abuse of the proxy system by management and giving shareholders a greater voice in corporate decisionmaking. See Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 *Ga. L. Rev.* 97, 146 (1988) (examining Rule 14a-8’s legislative history); cf. *J.I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964) (noting that congressional belief in the importance of “fair corporate suffrage” animated the passage of section 14(a) (internal quotation marks omitted) (quoting H.R. Rep. No. 73-1383, at 13 (1934))). But see Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 *Vand. L. Rev.* 1129, 1174–84 (1993) (noting dissenting views).

to Rule 14a-8<sup>31</sup> in 1942 to, in the words of one commentator, “catalyze what many hoped would be a functional ‘corporate democracy.’”<sup>32</sup> In its current form, the rule requires public corporations to include in their annual proxy statements, at company expense, qualifying proposals by shareholders who satisfy the rule’s eligibility and procedural requirements.<sup>33</sup> However, a company may omit a proposal if one of thirteen substantive bases for exclusion applies.<sup>34</sup> These substantive exclusions prohibit a range of proposals, such as proposals containing false or misleading statements, proposals motivated by the proponent’s personal grievance, and proposals relating to the company’s ordinary business operations.<sup>35</sup> If a company wishes to omit a proposal from its proxy statement, it must, no later than eighty days before it files its proxy materials with the SEC, send its reasons for omitting the proposal to both the SEC and the shareholder proponent.<sup>36</sup> The company bears the burden of showing its entitlement to exclude the proposal.<sup>37</sup>

Virtually every company that wishes to omit a proposal requests a no-action letter (NAL) concurrently with its required submission to the SEC.<sup>38</sup> An NAL is an informal SEC staff opinion that “describe[s] the request, analyze[s] the particular facts and circumstances involved, discuss[es] applicable laws and rules, and, if the staff grants the request for no action, concludes that the SEC staff would not recommend that the Commission take enforcement action against the requester.”<sup>39</sup> These let-

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31. The SEC originally promulgated the rule as Rule X-14A-7. See *Solicitation of Proxies Under the Act*, Exchange Act Release No. 34-3347, 7 Fed. Reg. 10,655, 10,656 (Dec. 22, 1942) (codified at 17 C.F.R. pt. 240).

32. Palmiter, *supra* note 12, at 879 (quoting Report of the SEC, Proposal to Safeguard Investors in Unregistered Securities, H.R. Doc. No. 79-672, at 18 (1946)); see also Ryan, *supra* note 30, at 112–13 (discussing Rule 14a-8’s history).

33. See 17 C.F.R. § 240.14a-8 (2016) (outlining the rule); *id.* § 240.14a-8(b)(1) (requiring the proponent to continuously hold at least \$2,000, or 1% of the company’s voting stock for at least one year before the proposal’s submission date). Although state law does not restrict shareholders’ freedom to propose precatory resolutions at shareholder meetings, see, e.g., *Auer v. Dressel*, 118 N.E.2d 590, 593 (N.Y. 1954) (according shareholders the power to pass precatory resolutions even when they could not directly effect change); Palmiter, *supra* note 12, at 894 (noting that state law “uniformly” permits advisory resolutions), this freedom is now largely moot in public corporations, in which voting is largely by proxy, see Ryan, *supra* note 30, at 105, and proxy contests cost millions of dollars, see Palmiter, *supra* note 12, at 896 n.71.

34. See 17 C.F.R. § 240.14a-8(i).

35. See *id.*

36. *Id.* § 240.14a-8(j)(1).

37. *Id.* § 240.14a-8(g).

38. Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 *Cornell L. Rev.* 921, 939 (1998) [hereinafter Nagy, NALs].

39. No-Action Letters, U.S. Sec. & Exch. Comm’n, <http://www.sec.gov/answers/noaction.htm> [<http://perma.cc/Q2P6-TUNU>] (last updated Sept. 21, 2012). Strangely, the term “no-action letter” refers to the staff response regardless of whether it is favorable

ters are typically very short—often only two paragraphs—and contain little explanation of the staff’s reasoning.<sup>40</sup> The end result has no legal effect—it simply informs the company of whether the staff will recommend enforcement if the company omits the proposal.<sup>41</sup>

Because NALs are not legally binding,<sup>42</sup> it is not technically possible to “appeal” any “judgment.” Nevertheless, there are two ways to obtain review of the staff’s position. First, an aggrieved party may seek a declaratory judgment in a federal district court as to whether the company may omit the proposal from its proxy statement.<sup>43</sup> Although it is unclear when exactly a company has standing to bring such an action,<sup>44</sup> courts have agreed that shareholder proponents have this remedy available once a company states its intention to omit a proposal.<sup>45</sup> Second, a party may seek review of the staff position by the full Commission, although the Commission rarely grants such requests.<sup>46</sup> Courts have generally held that direct judicial review of no-action letters is unavailable.<sup>47</sup>

Despite the parties’ rights to bring an action in federal court, though, the NAL is usually the end of the matter. Perhaps due to the high cost of litigation and relatively limited benefit from a victory in

to the requester. Nagy, NALs, *supra* note 38, at 937. NALs are usually issued after multiple rounds of brief-like submissions from the company and shareholder. *Id.* at 939.

40. See, e.g., Wal-Mart Stores, Inc., SEC No-Action Letter, 2014 WL 409085, at \*1 (Mar. 20, 2014).

41. See, e.g., Bank of America Corp., SEC No-Action Letter, 2015 WL 81899, at \*2 (Mar. 17, 2015) (noting NALs’ lack of legal effect).

42. See, e.g., *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 427 n.19 (D.C. Cir. 1992); Nagy, NALs, *supra* note 38, at 923–24, 942–43.

43. See, e.g., *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 75 F. Supp. 3d 617, 628 (D. Del. 2014) (holding that the shareholder plaintiff could bring an action for declaratory judgment), *rev’d on other grounds*, 792 F.3d 323 (3d Cir. 2015); see also *Roosevelt*, 958 F.2d at 425 (same).

44. Compare *EMC Corp. v. Chevedden*, 4 F. Supp. 3d 330, 342 (D. Mass. 2014) (dismissing an action by a company for lack of standing), *Chipotle Mexican Grill, Inc. v. Chevedden*, No. 14-cv-0018-WJM-KMT, 2014 WL 1004529, at \*3 (D. Colo. Mar. 14, 2014) (same), and *Omnicom Grp., Inc. v. Chevedden*, No. 14 Civ. 0386(LLS), 2014 WL 969801, at \*1–2 (S.D.N.Y. Mar. 11, 2014) (same), with *Waste Connections, Inc. v. Chevedden*, 554 F. App’x 334, 334–36 (5th Cir. 2014) (*per curiam*) (finding the company plaintiff had standing).

45. See, e.g., *Roosevelt*, 958 F.2d at 425; *Trinity*, 75 F. Supp. 3d at 628.

46. See Nagy, NALs, *supra* note 38, at 943–44; see also Courtney Bartkus, Comment, *Appealing No-Action Responses Under Rule 14a-8: Informal Procedures of the SEC and the Availability of Meaningful Review*, 93 U. Denv. L. Rev. Online 199, 208 (2016), [http://static1.l.sqspcdn.com/static/f/276323/26976608/1460932207277/Courtney+Bartkus\\_14a8.pdf](http://static1.l.sqspcdn.com/static/f/276323/26976608/1460932207277/Courtney+Bartkus_14a8.pdf) [<http://perma.cc/8BGD-A5DQ>].

47. See, e.g., *Kixmiller v. SEC*, 492 F.2d 641, 643–44 (D.C. Cir. 1974); Nagy, NALs, *supra* note 38, at 945. There is a decades-old circuit split over whether *Commission reviews* of NALs are subject to judicial review. Compare *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 672–73 (D.C. Cir. 1970) (answering in the affirmative), with *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 258 (2d Cir. 1994) (answering in the negative).

court,<sup>48</sup> parties rarely litigate disputes over excludability.<sup>49</sup> In the 2015 proxy season, for example, there were over 200 staff excludability determinations,<sup>50</sup> yet there appears to have been only one action litigated in a federal district court.<sup>51</sup> The staff response thus becomes a “de facto adjudication.”<sup>52</sup>

NALs also exert enormous influence on third parties’ interpretations of the ordinary business operations exclusion.<sup>53</sup> Many practitioners rely on NALs as a source of “de facto law” when advising their clients,<sup>54</sup> and courts have often utilized NALs to discern the exclusion’s scope.<sup>55</sup> Indeed, both the Commission and staff explicitly encourage third-party reliance on NALs.<sup>56</sup> Accordingly, scholars have remarked that NALs have

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48. See Jeffrey L. Kochian et al., *How to Handle Shareholder Proposals*, Practical Law, 2013 WL 4864187 (on file with the *Columbia Law Review*) (last visited Sept. 5, 2016) (noting that companies rarely initiate litigation due to the “potential expense,” “[t]iming concerns,” and “potential for negative precedent”).

49. A search of Westlaw covering the past ten years (2005 to 2014) revealed only ten reported district court decisions citing Rule 14a-8 out of hundreds of NALs issued every year. Westlaw, <http://1.next.westlaw.com> (search “17 C.F.R. 240.14a-8”; then follow “citing references” hyperlink; then filter by “cases”; then filter by all dates ranging from January 1, 2005 to December 31, 2014; then filter by jurisdiction “district court”) (last visited July 31, 2016).

50. *Infra* Appendix at Figure A.1.

51. A Westlaw search of decisions citing Rule 14a-8 returned only one judicial opinion originating out of the 2015 proxy season. Westlaw, *supra* note 49 (search “17 C.F.R. 240.14a-8”; then follow “citing references” hyperlink; then filter by “cases”; then filter by all dates after “August 1, 2014”; then filter by jurisdiction “district court”); see also *Ashford Inc. v. Unite Here*, No. 3:15-cv-0262-M, 2015 WL 11121019 (N.D. Tex. May 12, 2015).

52. Harold S. Bloomenthal & Samuel Wolff, *The Exclusion Process*, 3E *Sec. & Fed. Corp. L. Rep.* (West) § 24:70.50 (last updated 2016); see also Keith F. Higgins, Dir., Div. of Corp. Fin., U.S. Sec. & Exch. Comm’n, *Rule 14a-8: Conflicting Proposals, Conflicting Views* (Feb. 10, 2015), <http://www.sec.gov/news/speech/rule-14a-8-conflicting-proposals-conflicting-views.html> [<http://perma.cc/36MF-MY8U>] (acknowledging the Division’s role as an “informal arbitrator”). But see SEC Staff Legal Bulletin No. 14 (July 13, 2001), <http://www.sec.gov/interps/legal/cfslb14.htm> [<http://perma.cc/LK4Q>] (claiming that the staff is not an “arbiter”).

53. See Nagy, NALs, *supra* note 38, at 953–54 (claiming that practitioners “treat the regulatory interpretations in no-action letters on par with SEC rules, orders, and releases”).

54. *Id.* at 924–25.

55. See, e.g., *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 342–43 (3d Cir. 2015); *Austin v. Consol. Edison Co. of N.Y.*, 788 F. Supp. 192, 195 (S.D.N.Y. 1992).

56. See 17 C.F.R. § 240.14a-8(j)(2)(ii) (2016) (requesting that companies’ no-action requests refer to prior NALs as “authority”); Monthly Publication of List of Significant Letters Issued by the Division of Corporation Finance, Securities Act Release No. 33–5691, Exchange Act Release No. 34–12222, Trust Indenture Act Release No. 39–430, 41 Fed. Reg. 13,682, 13,682 (1976) (announcing the monthly publication of a list of “significant” NALs).

created a “common law” governing the meaning of the various Rule 14a-8 exclusions.<sup>57</sup>

B. *Judicial Deference to Administrative Interpretations of Rule 14a-8*

Official Commission-approved interpretive releases, staff-issued NALs, and staff legal bulletins play an important role in both judicial and third-party interpretations of the shareholder proposal rule.<sup>58</sup> In order to properly situate the various views of the ordinary business operations exclusion, this section discusses the weight that courts have accorded these administrative interpretations.

1. *Official Commission Interpretations.* — Among the various administrative interpretations of Rule 14a-8(i)(7), official Commission interpretations have carried the greatest weight with courts.<sup>59</sup> Of these Commission interpretations, the “adopting releases” accompanying the amendments to Rule 14a-8 in 1976, 1983, and 1998, which the Commission adopted by majority vote pursuant to the APA’s notice-and-comment procedures,<sup>60</sup> have been the most influential.<sup>61</sup> These adopting releases, first published in the Federal Register, contain detailed explanations of the Commission’s interpretation of the exclusion and have effected fairly significant changes to the exclusion’s scope.<sup>62</sup> Courts have been inconsistent about whether these adopting releases are “legislative rules,” which are reviewable under an “arbitrary and capricious” standard,<sup>63</sup> or “interpretive rules,”<sup>64</sup> which are “controlling

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57. See, e.g., Fisch, *supra* note 30, at 1151.

58. See Nagy, NALs, *supra* note 38, at 929–33, 946–66 (discussing the role of official Commission interpretations and NALs); David M. Lynn et al., Morrison & Foerster LLP, New Staff Legal Bulletin and Proxy Voting Guidelines Released Ahead of the 2016 Proxy Season, Client Alert (Dec. 4, 2015), <http://www.mofo.com/~media/Files/ClientAlert/2015/12/151204ProxySeason.pdf> [<http://perma.cc/BHH6-GMWA>] (advising clients on the impact of a staff legal bulletin); *supra* notes 53–57 and accompanying text (noting NALs’ influence).

59. See *infra* notes 63–77 and accompanying text (discussing the differing weights accorded to official Commission interpretations and informal staff opinions); cf. Nagy, NALs, *supra* note 38, at 929–33 (discussing the statutory authority underscoring official Commission interpretations).

60. 5 U.S.C. § 553 (2012). The APA requires administrative agencies, before promulgating a rule or amending an existing rule, to provide notice of the proposal and solicit public comment. *Id.*

61. See *infra* section I.C (discussing the history of the ordinary business operations exclusion).

62. See *infra* section I.C.

63. *AFL-CIO v. Donovan*, 757 F.2d 330, 340–42 (D.C. Cir. 1985) (discussing the standard of review for legislative rules).

64. Compare *N.Y.C. Emps.’ Ret. Sys. v. SEC (NYCERS)*, 45 F.3d 7, 13 (2d Cir. 1995) (reasoning that the “significant policy” exception in an interpretive release was a “legislative rule”), with *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 337 n.9 (3d Cir. 2015) (accord[ing] the various releases deference under *Auer v. Robbins*), and *Am. Fed’n of State, City, & Mun. Emps. v. AIG (AFSCME)*, 462 F.3d 121, 126 (2d Cir. 2005) (same).

unless plainly erroneous or inconsistent with the regulation” under *Auer v. Robbins*.<sup>65</sup> Regardless, both of these standards of review are highly deferential.<sup>66</sup>

2. *Informal Staff Opinions.* — In the Rule 14a-8 context, informal SEC staff opinions come in two varieties: NALs and staff legal bulletins (SLBs). Both have been influential on third-party interpretations of the ordinary business operations exclusion.<sup>67</sup>

Courts have sometimes struggled to determine the proper weight to accord NALs,<sup>68</sup> but the emerging consensus indicates that the “persuasive authority” approach of *Skidmore v. Swift & Co.*<sup>69</sup> is appropriate.<sup>70</sup> Under *Skidmore*, certain regulatory interpretations by agencies are “entitled to respect” . . . but only to the extent that those interpretations have the ‘power to persuade.’”<sup>71</sup> As Professor Donna Nagy has argued, this means that a body of NALs could be persuasive according to (1) whether the SEC rule is ambiguous, (2) the quality of the NALs’ reasoning, (3) whether the full Commission has reviewed and approved the NALs, (4) whether there is consistent application of the interpretation in the NALs, (5) whether there is staff expertise, and (6) whether there are reliance

65. 519 U.S. 452, 461–62 (1997) (internal quotation marks omitted) (quoting *Robertson v. Methow Valley Citizens Council*, 490 U.S. 332, 359 (1989)).

66. See *Auer*, 519 U.S. at 461–62; *Trinity*, 792 F.3d at 337 n.9; *AFSCME*, 462 F.3d at 126. But cf. *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (holding that the SEC acted arbitrarily and capriciously by promulgating its “proxy access” rule without adequately considering the economic consequences).

67. See supra note 58 and accompanying text.

68. See, e.g., *Austin v. Consol. Edison Co. of N.Y.*, 788 F. Supp. 192, 195 (S.D.N.Y. 1992) (conflating NALs with official Commission interpretations).

69. 323 U.S. 134 (1944); see also infra note 71 and accompanying text.

70. See, e.g., *Trinity*, 792 F.3d at 342 n.11 (granting a body of NALs “careful consideration”); *S&D Trading Acad., LLC v. AAFIS Inc.*, 336 F. App’x 443, 448 (5th Cir. 2009) (according NALs “persuasive authority”); *Gryl ex rel. Shire Pharm. Grp. PLC v. Shire Pharm. Grp. PLC*, 298 F.3d 136, 145 (2d Cir. 2002) (entitling NALs “no deference beyond whatever persuasive value they might have”); *Apache Corp. v. Chevedden*, 696 F. Supp. 2d 723, 735 (S.D. Tex. 2010) (holding NALs are nonbinding but constitute persuasive authority); *Peck v. Pac. CMA, Inc.*, No. 05-cv-00569-WYD-PAC, 2007 WL 1630703, at \*8 (D. Colo. June 1, 2007) (holding that NALs “do not change substantive law and are not binding on courts” but “may be treated as persuasive”); *Hall v. Tyco Int’l Ltd.*, 223 F.R.D. 219, 248 (M.D.N.C. 2004) (giving weight to a consistent line of NALs); cf. *United States v. Mead Corp.*, 533 U.S. 218, 224 (2001) (according *Skidmore* weight to short tariff letters that, although sometimes “set[ting] out a rationale in some detail,” usually “contain[ed] little or no reasoning”); *Christensen v. Harris County*, 529 U.S. 576, 587 (2000) (holding that *Skidmore* provides the appropriate framework for agency interpretations in formats such as opinion letters, policy statements, agency manuals, and enforcement guidelines); *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 427 n.19 (D.C. Cir. 1992) (holding that NALs do not receive *Chevron* deference); *Atl. Tele-Network v. Prosser*, 151 F. Supp. 2d 633, 640 (D.V.I. 2000) (noting that NALs “generally are entitled to less deference than other agency pronouncements”). But cf. *Lapidus v. Hecht*, No. C 98-3130 MMC, 2002 WL 1034042, at \*5 (N.D. Cal. May 17, 2002) (citing an NAL as authority for substantive law).

71. *Christensen*, 529 U.S. at 587 (quoting *Skidmore*, 323 U.S. at 140).

interests.<sup>72</sup> However, the staff-expertise factor is unlikely to contribute significantly to the persuasiveness of NALs that interpret the ordinary business operations exclusion.<sup>73</sup> SEC staff attorneys are experts in securities law, not business operations or social policy.<sup>74</sup> Moreover, the reliance factor is only relevant when the Commission initiates an enforcement action—as opposed to a private action between a company and a shareholder—because it is the SEC, not the company or shareholder, that has instilled reliance through its NALs.<sup>75</sup> Thus, given that Rule 14a-8 NALs generally contain little explanation of their reasoning and that the Commission rarely reviews and approves them,<sup>76</sup> the only factors likely to contribute to the persuasiveness of Rule 14a-8(i)(7) NALs are the exclusion’s ambiguity and, for certain interpretations of the exclusion of which a consistent application appears in the NALs, the consistency of that interpretation. Even then, however, the majority of the *Skidmore* factors militate against giving the NALs much weight.

The emerging judicial consensus for SLBs, like NALs, suggests that *Skidmore*’s “persuasive authority” approach is appropriate.<sup>77</sup> SLBs, like NALs, are informal SEC staff opinions—not official Commission pronouncements—and lack binding legal effect.<sup>78</sup> Indeed, each SLB contains a disclaimer to this effect.<sup>79</sup> Regarding the precise weight to accord SLBs under *Skidmore*, many of the considerations relevant to NALs should

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72. Nagy, NALs, *supra* note 38, at 1003–13.

73. *Id.* at 1010–11.

74. *See id.*

75. *See id.* at 1012–13.

76. *See supra* section I.A.

77. *See, e.g., Allen v. Admin. Review Bd.*, 514 F.3d 468, 478 (5th Cir. 2008) (noting that SEC staff accounting bulletins do not carry force of law); *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 163–64 (2d Cir. 2000) (holding that SEC staff accounting bulletins do not carry “force of law” but may serve as “persuasive guidance”); *In re Trade Partners, Inc. Inv’r Litig.*, No. 1:07-md-1846, 2009 WL 440904, at \*3 (W.D. Mich. Feb. 23, 2009) (holding that an SLB “is not binding on the court” but may be “helpful and persuasive”); *see also Oceana Capitol Grp. Ltd. v. Red Giant Entm’t, Inc.*, 150 F. Supp. 3d 1219, 1224 (D. Nev. 2015) (adopting the *Trade Partners* approach). Although some courts have cited SLBs for legal propositions without referencing their nonbinding nature, these oversights do not appear to reflect conscious decisions about the weight of SLBs. *See, e.g., Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 346–47 (3d Cir. 2015) (quoting an SLB for substantive law without noting that the SLB was not a Commission interpretation); *Express Scripts Holding Co. v. Chevedden*, No. 4:13-CV-2520-JAR, 2014 WL 631538, at \*3 n.2, \*5 n.5 (E.D. Mo. Feb. 18, 2014) (citing SLBs as SEC guidance without noting that they are staff opinions).

78. *See* SEC Staff Legal Bulletin No. 14H (CF) (Oct. 22, 2015), <http://www.sec.gov/interps/legal/cfslb14h.htm> [<http://perma.cc/N3GK-YXQM>] [hereinafter SLB 14H] (noting that the bulletin is “not a rule, regulation or statement of the [SEC]” and that “the Commission has neither approved nor disapproved its content”); Staff Legal Bulletins, U.S. Sec. & Exch. Comm’n, <http://www.sec.gov/interps/legal.shtml> [<http://perma.cc/85EW-NET2>] (last visited July 27, 2016) (noting that “[SLBs] are not legally binding”).

79. *See, e.g.,* SLB 14H, *supra* note 78.

apply to SLBs as well.<sup>80</sup> Perhaps the biggest difference is that SLBs tend to exhibit much greater depth of reasoning than NALs, suggesting that the former may generally carry greater weight according to the quality-of-reasoning factor.<sup>81</sup>

C. *The History and Scope of the Ordinary Business Operations Exclusion*

Rule 14a-8(i)(7) allows a corporation to exclude any proposal that “deals with a matter relating to the company’s ordinary business operations.”<sup>82</sup> This section examines the exclusion’s scope according to the SEC’s adopting releases, which courts grant considerable deference.<sup>83</sup>

1. *The Genesis of the Ordinary Business Operations Exclusion.* — In the shareholder proposal rule’s first iteration in 1942, the only substantive limitation on proposals’ content was that a proposal must be “a proper subject for action by the security holders.”<sup>84</sup> Over time, the substantive bases for exclusion grew to thirteen, with the SEC introducing the ordinary business operations exclusion in 1954.<sup>85</sup>

The original impetus behind the ordinary business operations exclusion is somewhat mysterious,<sup>86</sup> although there are clues in congressional records. In a congressional hearing held shortly after the exclusion’s introduction, the presiding SEC Chairman testified, in reference to the new exclusion, that “[d]ay-to-day operation of a business is generally a function of management under State law, and in this area shareholder participation even by way of advisory resolutions does not seem necessary under section 14 [of the ’34 Act] for the protection of investors generally.”<sup>87</sup> It thus appears that the SEC originally promulgated the exclusion

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80. See *supra* notes 71–75 and accompanying text (discussing the application of *Skidmore* to NALs).

81. Compare SLB 14H, *supra* note 78 (explaining the staff’s interpretation of Rule 14a-8(i)(7)), with Wal-Mart Stores, Inc., *supra* note 40, at \*1 (concluding that a proposal was excludable under Rule 14a-8(i)(7) with little explanation).

82. 17 C.F.R. § 240.14a-8(i)(7) (2016).

83. See *supra* section I.B.1 (discussing the weight given by courts to SEC adopting releases).

84. Solicitation of Proxies Under the Act, Exchange Act Release No. 34–3347, 7 Fed. Reg. 10,655, 10,656 (Dec. 22, 1942) (codified at 17 C.F.R. pt. 240).

85. See 17 C.F.R. § 240.14a-8(i)(7); Solicitation of Proxies, Exchange Act Release No. 34–4979, 19 Fed. Reg. 246, 246 (Jan. 14, 1954) (codified at 17 C.F.R. pt. 240).

86. See Solicitation of Proxies, 19 Fed. Reg. at 246 (briefly mentioning the exclusion); cf. Solicitation of Proxies: Notice of Proposed Rule Making, Exchange Act Release No. 34–4950, 18 Fed. Reg. 6646, 6647 (proposed Oct. 20, 1953) (codified at 17 C.F.R. pt. 240) (characterizing the exclusion’s purpose as “reliev[ing] 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”).

87. Securities Exchange Act Amendments: Hearing on S. 2846 Before the Subcomm. on Sec., Ins. & Banking of the S. Comm. on Banking & Currency, 83d Cong. 118 (1954) (statement of Ralph H. Demmler, Chairman, Securities and Exchange Commission). Chairman J. Sinclair Armstrong echoed a similar sentiment three years later, characterizing the exclusion’s policy as “confin[ing] the solution of ordinary business problems to the

to preserve state law's distinction between management and shareholder functions but went beyond state law by permitting companies to omit proposals even when framed in precatory terms.<sup>88</sup> This understanding comports with the text of the 1954 version of the exclusion, which provided that a company may omit any proposal that "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."<sup>89</sup>

2. *The 1976 Amendments: Origin of the Significant Social Policy Exception.* — Responding to a growth in proposals focused on corporate social responsibility,<sup>90</sup> the Commission, through amendments to Rule 14a-8 adopted in 1976, created an exception to the exclusion for proposals that focus on "significant policy" issues.<sup>91</sup> Explaining that the term "ordinary business operations" should be interpreted "more flexibly than in the past," the adopting release clarified that the exclusion does not permit omission of proposals with "significant policy, economic or other implications inherent in them."<sup>92</sup> For example, a proposal urging a utility company not to construct a proposed nuclear power plant would no longer be excludable under the SEC's new interpretation.<sup>93</sup> The change did not eviscerate the exclusion entirely, though, as companies could still omit

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board of directors and plac[ing] such problems beyond the competence and direction of the shareholders." Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 34-19135, Public Utility Holding Company Act Release No. 35-2266, 47 Fed. Reg. 47,420, 47,428 n.45 (Oct. 26, 1982) (codified at 17 C.F.R. pt. 240) (internal quotation marks omitted) (quoting Hearing on SEC Enforcement Problems Before the Subcomm. on Sec. of the S. Comm. on Banking & Currency, 85th Cong. 118 (1957) (statement of J. Sinclair Armstrong, Chairman, Securities and Exchange Commission)).

88. Cf. *supra* note 33 (citing a case and articles noting that state law permits precatory resolutions at shareholder meetings).

89. Solicitation of Proxies, 19 Fed. Reg. at 247 (emphasis added). Past scholarly work has sometimes focused on the state-law origin of the exclusion without fully acknowledging the extent to which the SEC intended, from the start, for the exclusion to diverge from state law. See, e.g., Palmiter, *supra* note 12, at 890-92.

90. See Donald E. Schwartz, The Public Interest Proxy Contest: Reflections on Campaign GM, 69 Mich. L. Rev. 419, 421-23, 427 (1971) (describing social activists' use of Rule 14a-8).

91. Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 34-12,999, Public Utility Company Act Release No. 35-19,771, 41 Fed. Reg. 52,994, 52,998 (Dec. 3, 1976) (codified at 17 C.F.R. pt. 240). The "significant policy" exception appears in the amendments' adopting release, not the text of the rule itself. See *id.* For a thorough discussion of the 1976 amendments, see Kevin W. Waite, Note, The Ordinary Business Operations Exception to the Shareholder Proposal Rule: A Return to Predictability, 64 Fordham L. Rev. 1253, 1262-64 (1995).

92. Adoption of Amendments Relating to Proposals by Security Holders, 41 Fed. Reg. at 52, 998.

93. See *id.*

proposals involving “mundane” business matters without “any substantial policy or other considerations.”<sup>94</sup>

3. *The 1983 Amendments: “Substance over Form.”* — The next major modification to the ordinary business operations exclusion came in 1983.<sup>95</sup> Prior to the amendments, the staff had interpreted the exclusion as inapplicable to proposals requesting that the board issue a report or form a special committee, regardless of the subject matter of that report or special committee.<sup>96</sup> The adopting release changed this practice by directing the staff to “consider whether the subject matter of the special report or the committee involves a matter of ordinary business,”<sup>97</sup> and subsequent NALs followed suit.<sup>98</sup>

4. *The Cracker Barrel No-Action Letter.* — In 1992, the staff issued a sweeping NAL, which the Commission later affirmed,<sup>99</sup> that created a bright-line rule providing for exclusion of all proposals relating to employment issues, regardless of whether the proposal focuses on significant social policy issues.<sup>100</sup> Departing from its theoretical “addressee only” position on NALs,<sup>101</sup> the staff made clear its intention for *Cracker Barrel* to apply to third parties by announcing that it would apply the *Cracker Barrel* rule to other no-action requests as well.<sup>102</sup> Although courts subsequently held that *Cracker Barrel* was nonbinding and did not require their deference,<sup>103</sup> the letter nevertheless had far-reaching practical effects.<sup>104</sup>

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94. *Id.*

95. Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 34-20091, 48 Fed. Reg. 38,218, 38,220-21 (Aug. 23, 1983) (codified at 17 C.F.R. pt. 240).

96. *Id.* at 38,221.

97. *Id.*

98. See, e.g., Newport Pharm. Int'l Inc., SEC No-Action Letter, 1984 WL 45581, at \*1, \*5 (Aug. 10, 1984).

99. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998) (codified at 17 C.F.R. pt. 240) (citing Letter from Jonathan G. Katz, Sec'y, U.S. Sec. & Exch. Comm'n, to Sue Ellen Dodell, Deputy Counsel, Office of the Comptroller, City of N.Y. (Jan. 15, 1993)).

100. Cracker Barrel Old Country Store, Inc., *supra* note 4, at \*1. The shareholder proposal requested that the company's board implement nondiscriminatory hiring practices regarding sexual orientation. *Id.*

101. Nagy, NALs, *supra* note 38, at 942.

102. See Cracker Barrel Old Country Store, Inc., *supra* note 4, at \*1 (“[T]he 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.”).

103. See, e.g., Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc., 821 F. Supp. 877, 890 (S.D.N.Y. 1993).

104. See Daniel E. Lazaroff, Promoting Corporate Democracy and Social Responsibility: The Need to Reform the Federal Proxy Rules on Shareholder Proposals, 50 Rutgers L. Rev. 33, 67 n.184, 68-69 (1997) (discussing post-*Cracker Barrel* developments).

5. *The 1998 Amendments: Retreat from Cracker Barrel.* — Just five years after *Cracker Barrel*, the Commission reconsidered its application of the ordinary business operations exclusion to proposals “relating simultaneously to both an ‘ordinary business matter’ and a significant social policy issue.”<sup>105</sup> Following notice and comment, the Commission reversed course on *Cracker Barrel* in an adopting release accompanying 1998 amendments to Rule 14a-8, returning to its earlier “case-by-case” inquiry.<sup>106</sup> Because this release is the latest word from the Commission on the ordinary business operations exclusion, it is the most authoritative statement by the SEC about the exclusion’s scope.<sup>107</sup>

In the release, the Commission announced a two-part test to determine whether a proposal is excludable.<sup>108</sup> First, if the subject matter of the proposal relates to ordinary business matters, then the proposal is excludable, unless the “significant social policy” exception applies.<sup>109</sup> Ordinary business matters are those matters involving tasks “so fundamental to management’s ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight,” such as “management of the workforce, . . . decisions on production quality and quantity, and the retention of suppliers.”<sup>110</sup> The significant social policy exception applies if the proposal nevertheless “focus[es] on sufficiently significant social policy issues (e.g., significant discrimination matters).”<sup>111</sup>

Second, if a proposal “seeks to ‘micro-manage’ the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment,” then the proposal is excludable, irrespective of whether it also raises significant social policy issues.<sup>112</sup> Examples include proposals that “involve[] intricate detail, or seek[] to impose specific time-frames or methods for implementing complex policies.”<sup>113</sup> This step of the inquiry appears to be a codification of one of the holdings of *Roosevelt v. E.I. Du Pont de Nemours & Co.*, a D.C. Circuit opinion permitting exclusion of a proposal that requested an acceleration of the company’s timeline for phase-out of atmosphere-damaging chlorofluorocarbons

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105. Amendments to Rules of Shareholder Proposals, Exchange Act Release No. 34-39093, 62 Fed. Reg. 50,682, 50,688 (proposed Sept. 26, 1997) (codified at 17 C.F.R. pt. 240).

106. Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998) (codified at 17 C.F.R. pt. 240).

107. See *supra* section I.B.1 (discussing the weight of official Commission interpretations).

108. See Amendments to Rules on Shareholder Proposals, 63 Fed. Reg. at 29,108.

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. *Id.*

(CFCs).<sup>114</sup> In *Roosevelt*, management had already planned to phase out its CFC production, and the proponent's timeline differed from management's by only one year.<sup>115</sup> Although a proposal to immediately halt all CFC production may raise "significant policy" issues, the court found that the proposal's focus on such a small difference in timing rendered it excludable under the ordinary business operations exclusion.<sup>116</sup>

## II. THE RULIFICATION OF THE ORDINARY BUSINESS OPERATIONS EXCLUSION

Part I laid out the regulatory framework governing shareholder proposals and the ordinary business operations exclusion. This Part explores the exclusion's "rulification," which has occurred primarily through SEC no-action letters. Section II.A discusses the conflict created by the recent Third Circuit case *Trinity Wall Street v. Wal-Mart Stores, Inc.*<sup>117</sup> and the SEC staff's subsequent response. Section II.B explains the rulification theory and, drawing on evidence from the 2015 proxy season, empirically tests this theory. Section II.C concludes by arguing that this rulification has been problematic.

### A. *Trinity and Its Aftermath*

The saga surrounding the recent Third Circuit case *Trinity Wall Street v. Wal-Mart Stores, Inc.* illustrates some of the problems related to interpretation of the ordinary business operations exclusion. In *Trinity*, shareholder Trinity Wall Street submitted a proposal to Wal-Mart requesting that the board provide for oversight concerning the creation of policies and standards that determine whether the company should sell a product that (1) "especially endangers public safety and well-being," (2) "has the substantial potential to impair the reputation of the Company," or (3) "would reasonably be considered offensive to the family and community values integral to the Company's promotion of its brand."<sup>118</sup> The proposal specified that this oversight was intended to cover policies and standards related to whether "the company should sell guns equipped with magazines holding more than ten rounds of ammunition," referencing concerns about the use of such weapons in mass killings like those in Newtown and Columbine.<sup>119</sup> Essentially, Trinity wanted Wal-Mart to stop

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114. See Amendments to Rules of Shareholder Proposals, Exchange Act Release No. 34-39093, 62 Fed. Reg. 50,682, 50,689 n.79 (proposed Sept. 26, 1997) (codified at 17 C.F.R. pt. 240); see also *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 427 (D.C. Cir. 1992) (R.B. Ginsburg, J.).

115. See *Roosevelt*, 958 F.2d at 427-28.

116. *Id.*

117. 792 F.3d 323 (3d Cir. 2015).

118. *Wal-Mart Stores, Inc.*, supra note 40, at \*7-8.

119. *Id.* at \*8.

selling assault rifles, although it framed the proposal in terms of board oversight.<sup>120</sup>

After the SEC staff issued a no-action letter indicating that Wal-Mart could omit the proposal in reliance on the ordinary business operations exclusion,<sup>121</sup> Trinity brought an action in federal court seeking a declaratory judgment that Wal-Mart must include the proposal.<sup>122</sup> The district court (and amici law professors) agreed with Trinity on two alternative grounds: first, that the proposal, being couched in terms of board oversight, did not relate to Wal-Mart's ordinary business operations; and second, that the proposal raised significant social policy issues.<sup>123</sup> But the Third Circuit reversed, holding that framing the proposal in terms of board oversight did not remove it from the exclusion's reach, and even though the proposal raised significant policy issues, those issues did not "transcend" Wal-Mart's ordinary business operations.<sup>124</sup> In the majority's view, a proposal must both raise significant social policy issues *and* transcend the company's day-to-day business operations in order to qualify for the social policy exception.<sup>125</sup> A proposal that pertains to the "nitty-gritty" of the company's "core business"—in Wal-Mart's case, selling consumer products—would fail the second part of this two-part test.<sup>126</sup> Notably, the majority derived its test from a staff legal bulletin,<sup>127</sup> not a Commission-approved release, and supported its position by reference to a series of NALs that, in the majority's view, suggested a more-or-less bright-line rule rendering all proposals relating to "the sale of particular products or services" excludable.<sup>128</sup>

Judge Patty Shwartz, concurring in the judgment, disagreed with the majority's analytical approach to the social policy exception.<sup>129</sup> By separating the significance and transcendence requirements into a two-part test, the majority was deviating from the SEC's approach as ex-

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120. See *id.* (contending Wal-Mart's sale of "guns equipped with high capacity magazines . . . facilitate[s] mass killings" but insisting that the proposal focuses on "Board-level oversight").

121. *Id.* at \*1. The staff explained its reasoning only by noting that "the proposal relates to the products and services offered for sale by the company," and "[p]roposals concerning the sale of particular products and services are generally excludable under rule 14a-8(i)(7)." *Id.*

122. See *Trinity*, 792 F.3d at 331.

123. See *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 75 F. Supp. 3d 617, 630–31 (D. Del. 2014), *rev'd*, 792 F.3d 323; Brief of Amici Curiae Corporate and Securities Law Professors at 6–16, *Trinity*, 792 F.3d 323 (No. 14-4764), 2015 WL 740873.

124. *Trinity*, 792 F.3d at 351.

125. See *id.* at 346.

126. *Id.* at 347.

127. See *id.* at 346 (quoting SEC Staff Legal Bulletin No. 14E (CF) (Oct. 27, 2009), <http://www.sec.gov/interps/legal/cfslb14e.htm> [<http://perma.cc/MX7P-9ETB>]).

128. *Id.* at 347 (internal quotation marks omitted) (quoting Rite Aid Corp., SEC No-Action Letter, 2015 WL 364996, at \*1 (Mar. 24, 2015)); see also *id.* at 347–51.

129. See *id.* at 352–54 (Shwartz, J., concurring in the judgment).

pressed in its adopting releases and from the purposes underlying section 14 of the '34 Act.<sup>130</sup> Instead, Judge Schwartz found Trinity's proposal excludable because it did not focus on a significant social policy issue.<sup>131</sup> Even if Wal-Mart's sales of guns might qualify as a sufficiently significant issue, the proposal was framed so broadly—covering many different products—that, “as a whole,” it did not “focus” on that issue.<sup>132</sup> The SEC staff, perhaps somewhat strangely in light of its position that only federal courts can adjudicate excludability disputes,<sup>133</sup> announced its preference for Judge Schwartz's approach over the majority's in a subsequent SLB.<sup>134</sup>

*Trinity* thus presents three different views on the ordinary business operations exclusion: first, the district court's opinion;<sup>135</sup> second, the Third Circuit majority's opinion;<sup>136</sup> and third, Judge Schwartz's and the SEC staff's opinion.<sup>137</sup> This means that parties could face different legal standards depending on whether they seek no-action relief from the SEC or a declaratory judgment in the Third Circuit (where Delaware is located<sup>138</sup>)—with uncertainty about which approach other circuits will follow.

#### B. *Informal SEC Staff Opinions as De Facto Rulemaking*

In addition to creating confusion about the scope of the ordinary business operations exclusion, the *Trinity* saga raises troubling issues regarding the SEC staff's role in creating the substantive law that governs the exclusion. First, the Third Circuit majority's reliance on no-action letters and staff legal bulletins<sup>139</sup>—even when those opinions arguably conflict with the Commission's position<sup>140</sup>—suggests that the staff's interpretations impact the law as much as the interpretations that the full Commission, whose members were appointed by the President on advice and consent of the Senate,<sup>141</sup> has adopted after notice and comment. Second, the majority's extraction of a bright-line rule from a series of

130. See *id.*

131. See *id.* at 354.

132. *Id.*

133. See, e.g., Adobe Systems Inc., SEC No-Action Letter, 2015 WL 9002919, at \*1 (Jan. 4, 2016) (“Only a court such as a U.S. District Court can decide whether a company is obligated to include shareholder proposals in its proxy materials.”).

134. See SLB 14H, *supra* note 78.

135. See *supra* note 123 and accompanying text.

136. See *supra* notes 124–128 and accompanying text.

137. See *supra* notes 129–134 and accompanying text.

138. See Third Circuit District Courts, U.S. Court of Appeals for the Third Circuit, <http://www.ca3.uscourts.gov/third-circuit-district-courts> [http://perma.cc/VDE6-VQUE] (last visited July 27, 2016). Delaware is the state of incorporation for the majority of Fortune 500 companies. Lewis S. Black, Jr., *Why Corporations Choose Delaware I* (2007), [http://corp.delaware.gov/pdfs/whycorporations\\_english.pdf](http://corp.delaware.gov/pdfs/whycorporations_english.pdf) [http://perma.cc/9MCT-2RXB].

139. See *supra* notes 127–128 and accompanying text.

140. See *supra* note 130 and accompanying text.

141. See 15 U.S.C. § 78(d)(a) (2012).

NALs suggests that the ordinary business operations exclusion has undergone what some scholars have called “rulification,”<sup>142</sup> with the staff’s subsequent SLB constituting a “rule against rulification” directed at courts.<sup>143</sup> Together, these two insights imply that the SEC staff has substituted itself for the Commission as principal rulemaker for the ordinary business operations exclusion. This section will explain the rulification theory and present empirical evidence through an analysis of SEC no-action letters.

1. *The Rulification Theory.* — Scholars have frequently divided legal directives into two categories: rules and standards.<sup>144</sup> According to one popular account, rules are directives whose legal content is determined ex ante, while standards’ legal content is determined ex post.<sup>145</sup> However, legal directives do not always fit perfectly into the rules–standards dichotomy—rather, they exist as part of a continuum, usually lying somewhere between the “pure” versions at either end.<sup>146</sup> And within this continuum, there is a strong tendency for standards to drift toward rules—a phenomenon some scholars have called “rulification.”<sup>147</sup> Rulification, which can take place at either the higher or lower court level,<sup>148</sup> may occur even without formal acknowledgement of the rules’

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142. See Schauer, Rulification, *supra* note 21, at 805–08; see also Michael Coenen, Rules Against Rulification, 124 *Yale L.J.* 644, 653–58 (2014); Sydney Foster, Should Courts Give Stare Decisis Effect to Statutory Interpretation Methodology?, 96 *Geo. L.J.* 1863, 1904 (2008); Rosen, *supra* note 21, at 491; Mark Tushnet, The First Amendment and Political Risk, 4 *J. Legal Analysis* 103, 106 (2012).

143. See *infra* notes 175–176 and accompanying text.

144. See, e.g., Larry Alexander & Emily Sherwin, The Rule of Rules: Morality, Rules, and the Dilemmas of Law 28–30 (2001); H.L.A. Hart, The Concept of Law 124–41 (3d ed. 2012); Frederick Schauer, Playing by the Rules: A Philosophical Examination of Rule-Based Decision-Making in Law and in Life 17–37 (1991) [hereinafter Schauer, *Playing by the Rules*]; Kaplow, *supra* note 13, at 559–60; Duncan Kennedy, Form and Substance in Private Law Adjudication, 89 *Harv. L. Rev.* 1685, 1777 (1976); Russell B. Korobkin, Behavioral Analysis and Legal Form: Rules vs. Standard Revisited, 79 *Or. L. Rev.* 23, 25–30 (2000); Parchomovsky & Stein, *supra* note 27, at 172–81; Pierre Schlag, Rules and Standards, 33 *UCLA L. Rev.* 379, 400–01 (1985); Kathleen M. Sullivan, Foreword: The Justices of Rules and Standards, 106 *Harv. L. Rev.* 22, 57–62 (1992); Cass R. Sunstein, Problems with Rules, 83 *Calif. L. Rev.* 953, 961–65 (1995); cf. Colin S. Diver, The Optimal Precision of Administrative Rules, 93 *Yale L.J.* 65, 72–74 (1983) (framing the rules–standards binary in terms of precision).

145. See Kaplow, *supra* note 13, at 559–60.

146. See *id.* at 561–62.

147. See *supra* note 142 (citing examples); cf. Kaplow, *supra* note 13, at 577–79, 608–18 (noting that precedent can render standards more like rules). For example, while the Sherman Act suggests a broad standard prohibiting contracts, combinations, and conspiracies “in restraint of trade or commerce,” the Supreme Court has created “per se rules” prohibiting “price fixing, tying arrangements, and resale price maintenance.” Schauer, Rulification, *supra* note 21, at 806–07.

148. See Coenen, *supra* note 142, at 656 n.29.

existence by a decisionmaker—instead, a rule can exist so long as decisionmakers behave as if it exists.<sup>149</sup>

The ordinary business operations exclusion, being an open-ended standard,<sup>150</sup> seems ripe for rulification.<sup>151</sup> As in *Trinity*, decisionmakers could easily infer, based on precedent (and perhaps giving weight to a body of NALs based on the *Skidmore* ambiguity and consistency factors<sup>152</sup>), that certain categories of proposals—such as proposals relating to a retailer’s sale of particular products—are per se excludable (or per se not excludable).<sup>153</sup> One would expect NALs to be the primary source of these rules, given the dearth of judicial opinions as to the exclusion’s scope.<sup>154</sup> The next subsection empirically tests this theory that the exclusion has become “rulified.”

2. *Evidence from the 2015 Proxy Season.* — An examination of no-action letters from the 2015 proxy season supports the rulification hypothesis described above. Although the SEC staff rarely explains its reasoning in detail, the language that does appear shows that the staff places most proposals into specific categories,<sup>155</sup> and the category into which a proposal is placed is predictive of whether the staff will determine that the company may exclude the proposal.<sup>156</sup> These insights constitute strong evidence that the staff has been relying on categorical rules to determine whether proposals are excludable under the ordinary business operations exclusion.

The dataset consists of all shareholder proposals made under Rule 14a-8 to Fortune 500 companies during the 2015 proxy season.<sup>157</sup> Out of

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149. See Schauer, *Playing by the Rules*, supra note 144, at 64, 71.

150. See supra note 13 and accompanying text.

151. Cf. Coenen, supra note 142, at 654 (“[C]ommon law adjudication stands ready to convert an open-ended pronouncement into a far more specific patchwork of rules.”).

152. See supra section I.B.2 (explaining the *Skidmore* factors’ relevance to NALs).

153. See *Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 347 (3d Cir. 2015) (inferring a bright-line rule from a series of NALs); supra note 128 and accompanying text.

154. See supra notes 48–51 and accompanying text.

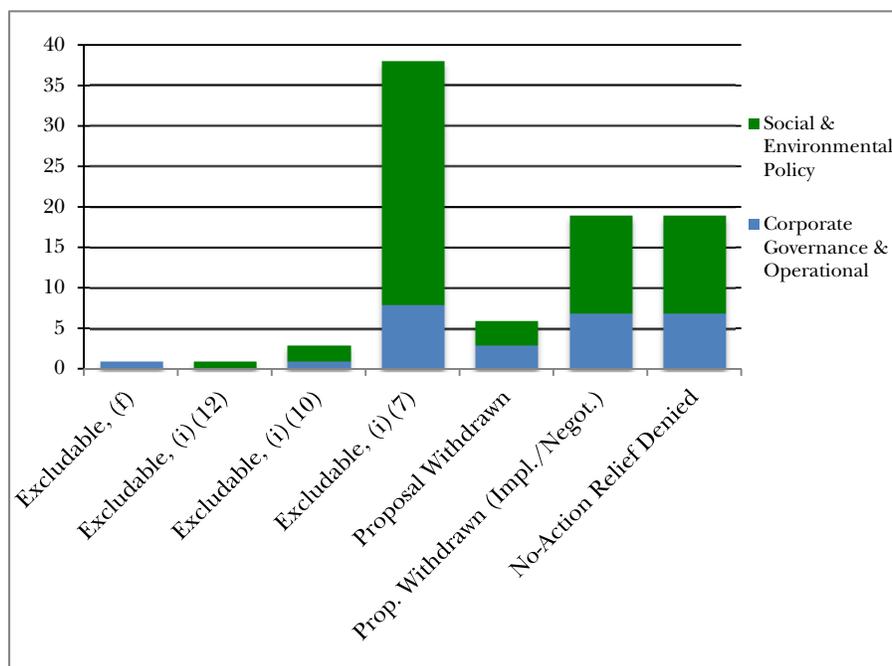
155. See infra notes 162–163 and accompanying text.

156. See infra note 165 and accompanying text.

157. Initial data were obtained from FactSet’s “Shark Repellent” database. Shark Repellent, FactSet, <http://sharkrepellent.net> (select “Proxy”; filter “Meeting Date” by 10/1/14–9/30/15; select “Annual Meeting”; exclude “Non US Companies”; select “Fortune 500” index; select “Shareholder” under “Proxy Proposal Brought By”; select “Yes” under “Rule 14a-8”; select “Include” under “Proposals not in the Proxy”; select appropriate data items in “User Columnar Reports”) (on file with the *Columbia Law Review*) (last visited Oct. 16, 2015) [hereinafter Dataset]. After filtering these data by “no-action letter sought” in Excel and excluding one proposal that did not receive a staff response, see Division of Corporate Finance: 2015 No-Action Letters Issued Under Exchange Act Rule 14a-8, U.S. Sec. & Exch. Comm’n, [http://www.sec.gov/divisions/corpin/cf-noaction/2015\\_14a-8.shtml](http://www.sec.gov/divisions/corpin/cf-noaction/2015_14a-8.shtml) [<http://perma.cc/KZ5K-4U28>] (last modified Jan. 11, 2016) (reporting “no response” for a proposal made to Wal-Mart Stores, Inc.), the author obtained all 250 SEC responses to no-action requests from Westlaw and the SEC

a total of 587 proposals, companies sought NALs for 250 proposals.<sup>158</sup> Of those 250, companies sought exclusion based on (i)(7) for 87 proposals.<sup>159</sup> Of those 87 proposals, proponents withdrew 25 proposals before the SEC staff could issue a response on the merits, with 19 proposals withdrawn because management implemented the proponents' requests or showed willingness to negotiate with the proponents.<sup>160</sup> Out of the remaining 62 proposals, the staff determined that 19 were not excludable (i.e., no-action relief was denied), 38 were excludable under (i)(7), and 5 were excludable on other grounds.<sup>161</sup>

FIGURE 1: RULE 14A-8 NO-ACTION REQUEST RESULTS, EXCLUSION BASED ON (I) (7) SOUGHT, 2015 PROXY SEASON (FORTUNE 500)



website and manually coded them according to proposal type, bases for exclusion sought, the result of the request, and the staff-created category. Coding of staff-created categories directly tracked the staff's language in its NALs. For example, if the staff opined that a proposal was excludable because "the proposal relates to the nature, presentation and content of programming and film production," the proposal was coded as fitting the "news, television, or film programming" category. The author's coding is available at Fortune 500 Shareholder Proposal No-Action Letters (2015 Proxy Season), *Columbia Law Review*, [http://columbialawreview.org/?attachment\\_id=1513](http://columbialawreview.org/?attachment_id=1513) (on file with the *Columbia Law Review*) (last visited Sept. 30, 2016).

158. Dataset, *supra* note 157. This figure excludes one proposal for which the staff recorded no response. See *supra* note 157.

159. *Infra* Figure 1.

160. *Infra* Figure 1.

161. *Infra* Figure 1.

The relevant subset of data that may provide evidence of rulification thus consists of the 57 NALs in which the SEC staff made a determination as to excludability under (i) (7). Of the 38 proposals (67%) that the staff determined were excludable, the staff placed 35 proposals (92% of excludable proposals) into a specific category, such as “employee policy” (12 proposals) or “news, television, or film programming” (3 proposals).<sup>162</sup> Of the 19 proposals (33%) that the staff determined were not excludable, it placed 14 proposals (74% of nonexcludable proposals) into a specific category, such as “climate change” (4 proposals) or “senior executive compensation” (4 proposals).<sup>163</sup> Of all 57 proposals, the staff placed 49 proposals (86%) into a specific category.<sup>164</sup> Intracategory staff determinations as to excludability were uniform—that is, for any given category, the staff made the same determination as to all proposals within that category.<sup>165</sup> The category into which the staff placed a proposal was thus 100% predictive of whether the staff found the proposal excludable.<sup>166</sup>

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162. *Infra* Figure 2; *infra* Table 1.

163. *Infra* Figure 3; *infra* Table 1.

164. *Infra* Table 1.

165. *Infra* Table 1.

166. Granted, for 11 of the 49 categorized proposals, that proposal was the only proposal in its category, and one might question the probative value of these single-proposal categories. However, the single-proposal categories did not appear out of thin air. In previous years, the staff had frequently used similar—and often identical—language to the language that it used in 2015. See *infra* note 169 and accompanying text. For example, the staff has categorized “Advertising of Products and Services” proposals along similar lines for well over a decade. See *infra* notes 215–216 and accompanying text.

FIGURE 2: SEC STAFF CATEGORIZATION IN RULE 14A-8 NO-ACTION LETTERS, EXCLUSION BASED ON (I) (7) PERMITTED, 2015 PROXY SEASON (FORTUNE 500)

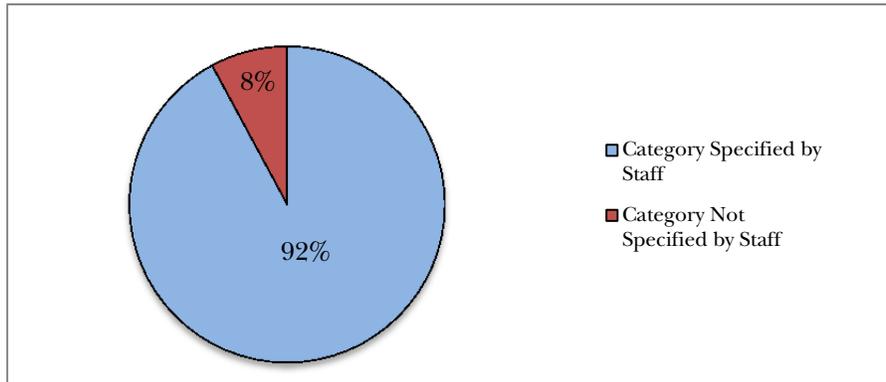


FIGURE 3: SEC STAFF CATEGORIZATION IN RULE 14A-8 NO-ACTION LETTERS, EXCLUSION BASED ON (I) (7) DENIED, 2015 PROXY SEASON (FORTUNE 500)

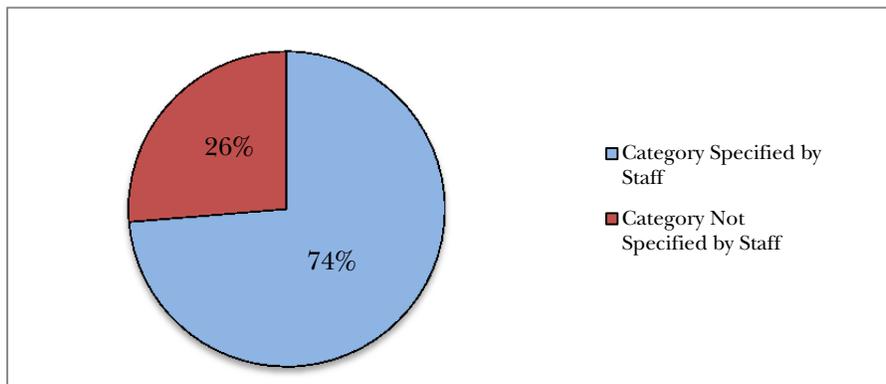


TABLE 1: SEC STAFF DETERMINATIONS AS TO RULE 14A-8(I) (7)  
EXCLUDABILITY BY STAFF-IMPOSED CATEGORY, 2015 PROXY SEASON  
(FORTUNE 500)

<b>Staff-Imposed Category</b>	<b>Count</b>	<b>Proportion Determined Excludable by Staff</b>
N/A—No Category Specified	8	37.5%
Advertising of Products or Services	1	100%
Affect the Conduct of Ongoing Litigation	1	100%
Charitable Contributions to Specific Organization	2	100%
Disclosure of Ordinary Business Matters	1	100%
Employee Policy	12	100%
General Adherence to Ethical Business Practices	2	100%
General Employee Compensation	4	100%
Legal Compliance	1	100%
Management of Expenses	1	100%
Monitoring of Preliminary Voting Results	1	100%
News, Television, or Film Programming	3	100%
Product Development	1	100%
Products and Services	3	100%
Tax Expenses and Sources of Financing	1	100%
Use of Customer Information to Make Pricing Determinations	1	100%
Climate Change	4	0%
Extraordinary Business Transaction	1	0%
Fundamental Business Strategy (Pricing)	2	0%
Human Rights	1	0%
Political Activities	2	0%
Senior Executive Compensation	4	0%
<i>Sum of Categorized Determinations</i>	<i>49</i>	<i>71.4%</i>

The high rate at which the SEC staff places proposals into specific categories,<sup>167</sup> combined with the fact that placement into a specific category predicts whether the staff will determine that a proposal is excludable,<sup>168</sup> constitutes strong evidence that the staff frequently relies on rules to determine whether to exclude a proposal under Rule 14a-8(i)(7). Indeed, the staff uses nearly identical language, year after year, to identify many of the categories into which it places proposals.<sup>169</sup>

It might be tempting to downplay the significance of these results because of the possibility that the staff may only be relying on “rules of thumb”—soft rules that provide helpful guidance but may be overridden by external exceptions or the inapplicability of the rules’ background justifications.<sup>170</sup> After all, the staff often states only that proposals in a specified category are “generally” excludable.<sup>171</sup> The reference to “general” excludability implies that exceptions exist. But even if the evidence establishes only rules of thumb, the existence of rules of thumb would still significantly impact the exclusion’s operation. First, rules of thumb still carry normative force for decisionmakers because they raise the confidence level required to make a decision inconsistent with the rule and thereby deviate from presently practiced norms.<sup>172</sup> Confronted with a rule of thumb, a decisionmaker may find it easier to simply follow the rule—even when there is a plausible exception. Accordingly, one would expect presumptive excludability to effectively shift the burden of persuasion onto the proponent, with presumptive nonexcludability effectively increasing the company’s burden of persuasion. Second, as exemplified by *Trinity*, these rules may guide courts and market participants regardless of their effect on the staff’s judgment.<sup>173</sup> The possibility of judicial and market-participant reliance on such “apparent” rules would be equally troublesome if the staff were not itself following the rules—for

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167. See *supra* Figures 2, 3.

168. See *supra* note 165 and accompanying text.

169. See, e.g., Comcast Corp., SEC No-Action Letter, 2015 WL 274205, at \*1 (Mar. 24, 2015) (permitting exclusion of a proposal as relating to “the nature, presentation and content of programming and film production”); CBS Corp., SEC No-Action Letter, 2013 WL 287990, at \*1 (Mar. 22, 2013) (permitting exclusion of a proposal as relating to “the nature, presentation, and content of television programming”); General Electric Co., SEC No-Action Letter, 2009 WL 4024868, at \*1 (Dec. 10, 2009) (permitting exclusion of a proposal as relating to “the nature, presentation and content of television programming”); The Walt Disney Co., SEC No-Action Letter, 2006 WL 3436486, at \*1 (Nov. 22, 2006) (permitting exclusion of a proposal as relating to “the nature, presentation and content of programming and film production”).

170. Cf. Schauer, *Playing by the Rules*, *supra* note 144, at 104–11 (defining rules of thumb).

171. E.g., The Walt Disney Co., SEC No-Action Letter, 2015 WL 7179994, at \*1 (Nov. 23, 2015) [hereinafter 2015 Walt Disney Co. NAL] (“Proposals concerning the sale of particular products and services are generally excludable under Rule 14a-8(i)(7).”).

172. See Schauer, *Playing by the Rules*, *supra* note 144, at 108–11.

173. See *supra* note 128 and accompanying text (noting the majority’s reliance on NALs).

then the staff and other parties would be operating according to different principles, creating confusion as to which law governs.<sup>174</sup>

One might also object that the most recent SLB, which emphasizes the importance of a case-by-case inquiry (a “rule against rulification”),<sup>175</sup> discounts the continued relevance of any prior rulification. But this objection would be misguided, given that the bulletin does not purport to signal any sort of paradigm shift for staff interpretation of (i) (7).<sup>176</sup> Moreover, staff interpretations in NALs issued after the bulletin’s release suggest that the staff will continue to utilize rules in their application of the exclusion.<sup>177</sup>

### C. *A Suboptimal Rulification?*

Rulification is not necessarily undesirable.<sup>178</sup> In some cases, rulification may lower enforcement costs, provide certainty and consistency, and promote more accurate results.<sup>179</sup> Moreover, when lower and intermediate courts rulify standards, there may be additional benefits resulting from experimentation and transparency.<sup>180</sup> But the rulification of the ordinary business operations exclusion has been problematic. It lacks democratic legitimacy and transparency, and the resulting rules have often been overinclusive when measured against their background justifications. These problems can be divided into three types: rulemaking procedure, rule format, and rule overinclusivity.

1. *Rulemaking-Procedure Defects.* — The first major class of defects in the exclusion’s rulification relates to the procedures through which the

174. Cf. Bert I. Huang, *Shallow Signals*, 126 Harv. L. Rev. 2227, 2244–47, 2249–50 (2013) (describing the effect of “quiet exceptions” that are difficult to observe).

175. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998) (codified at 17 C.F.R. pt. 240) (announcing that the staff will use a “case-by-case analytical approach” to the exclusion); SLB 14H, *supra* note 78 (noting that the staff will “continue to apply Rule 14a-8(i) (7) as articulated by the Commission” and citing the 1998 release adopting return to case-by-case analysis of social policy proposals); cf. Coenen, *supra* note 142, at 658–60 (describing “rules against rulification”).

176. See SLB 14H, *supra* note 78 (indicating that the staff “intends to apply Rule 14a-8(i) (7) as articulated by the Commission and consistent with the [staff’s] prior application of the exclusion”). If anything, the SLB appears to be a rule against rulification directed at courts—the SLB’s section on the exclusion was a direct response to *Trinity* and explicitly condoned current and past staff practice. See *id.*

177. See, e.g., *Viacom, Inc.*, SEC No-Action Letter, 2015 WL 6774394, at \*1 (Dec. 18, 2015) (permitting the exclusion of a proposal as relating to “the nature, presentation and content of advertising”); 2015 Walt Disney Co. NAL, *supra* note 171, at \*1 (permitting the exclusion of a proposal as relating to “the sale of particular products and services”).

178. See Schauer, *Rulification*, *supra* note 21, at 809–13 (discussing the benefits of rulification).

179. See, e.g., Kaplow, *supra* note 13, at 562–63 (discussing the efficiency benefits of rules); Schauer, *Rulification*, *supra* note 21, at 809–10 (explaining why a decisionmaker might voluntarily constrain her choices to promote more accurate results).

180. See Coenen, *supra* note 142, at 680–93.

SEC staff “promulgates” these rules. These defects are apparent if we view (i)(7) rulemaking through either of two models: administrative rule-making or common law rulemaking.

Under the administrative model, the democratic legitimacy of rules depends in part on public participation in rulemaking,<sup>181</sup> as reflected in the APA’s notice-and-comment requirements.<sup>182</sup> In the (i)(7) context, however, the staff issues NALs and SLBs without significant public participation,<sup>183</sup> undermining the rules’ legitimacy. Even if the staff-created rules governing (i)(7) are legally exempt from notice-and-comment requirements,<sup>184</sup> the rules’ practical ability to fix the rights and obligations of companies and shareholders<sup>185</sup> is nevertheless troubling as a matter of policy<sup>186</sup>—a problem exacerbated by the staff’s insulation from electoral accountability.<sup>187</sup> Moreover, this lack of accountability increases the risk of regulatory capture,<sup>188</sup> the phenomenon whereby an agency promotes

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181. See, e.g., Gillian E. Metzger, *Administrative Constitutionalism*, 91 *Tex. L. Rev.* 1897, 1901 (2013); Mark Seidenfeld, *A Civic Republican Justification for the Bureaucratic State*, 105 *Harv. L. Rev.* 1511, 1559–62, 1576 (1992).

182. See 5 U.S.C. § 553 (2012).

183. See *supra* section I.A (describing the staff’s procedures in connection with issuing NALs); cf. Staff Legal Bulletins, U.S. Sec. & Exch. Comm’n, <http://www.sec.gov/interp/legalshtml> [<http://perma.cc/85EW-NET2>] (last visited July 27, 2016) (describing the function of SLBs as “summariz[ing] the Commission staff’s views regarding various aspects of the federal securities laws and SEC regulations”).

184. *NYCERS*, 45 F.3d 7, 12 (2d Cir. 1995) (ruling that an NAL, being an “interpretive rule,” was exempt from notice-and-comment requirements).

185. See *supra* section II.B (discussing the exclusion’s rulification).

186. See Note, *The SEC and “No-Action” Decisions Under Proxy Rule 14a-8: The Case for Direct Judicial Review*, 84 *Harv. L. Rev.* 835, 845–48 (1971) [hereinafter *Case for Review*] (criticizing the SEC’s use of NALs as a lawmaking tool); cf. Anthony, *supra* note 24, at 1359–63 (criticizing the use of guidance documents by agencies to effectively bind the public); Lisa Schultz Bressman, *Beyond Accountability: Arbitrariness and Legitimacy in the Administrative State*, 78 *N.Y.U. L. Rev.* 461, 541–44 (2003) (announcing a general preference for notice-and-comment rulemaking).

Granted, given the “ossification” of rulemaking procedures, it may sometimes be desirable to circumvent notice-and-comment procedures. See Raso, *supra* note 24, at 107–11 (evaluating the costs and benefits of avoiding rulemaking procedures). Indeed, in light of the costs imposed by judicial oversight of SEC rulemaking, see *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) (striking down an SEC rule on the basis of inadequate cost–benefit analysis); Donna M. Nagy, *The Costs of Mandatory Cost–Benefit Analysis in SEC Rulemaking*, 57 *Ariz. L. Rev.* 129, 149–51 (2015) [hereinafter *Nagy, CBA*] (describing the “SEC paralysis” resulting from onerous cost–benefit oversight), perhaps some use of informal staff opinions in place of notice-and-comment rulemaking may be desirable. But in the Rule 14a-8 context, in which loss of public input into agency decisionmaking could lead to loss of public input into another type of decisionmaking (corporate decisionmaking), circumvention of notice and comment could create a pernicious negative feedback loop.

187. Cf. Seidenfeld, *supra* note 181, at 1559–60 (arguing that accountability concerns call for public participation in administrative rulemaking).

188. Cf. Nagy, *CBA*, *supra* note 186, at 156–57 (discussing the risk of agency capture in the SEC).

the interests of the industry it is designed to regulate rather than the interests of the public.<sup>189</sup> Indeed, given the association between staff use of rules and staff determination that a proposal is excludable, it appears that the staff has utilized the rules to companies' benefit more frequently than to proponents' benefit.<sup>190</sup>

Under the common law model, one expects the judicial system that develops the law to have multiple layers of review: lower courts and appellate courts. Appellate courts benefit the development of the common law by both providing for review of individual decisions and allowing for more thoughtful and centralized development of the law.<sup>191</sup> But in the Rule 14a-8 context, there is little meaningful review of NALs. First, intra-SEC review is limited. Although SEC regulations allow for Commission review of NALs, that review is wholly discretionary,<sup>192</sup> and the Commission rarely grants requests for review.<sup>193</sup> Moreover, even when the Commission does grant review, it characterizes its opinions as "informal,"<sup>194</sup> and the opinions do not thoroughly explain the Commission's reasoning.<sup>195</sup> Second, the impact of judicial intervention is nominal. Even when courts are occasionally willing to depart from the staff's interpretation, such judicial departures have limited effect on the (i) (7) "common law" because of the staff's apparent view that it is not bound by courts' interpretations of the exclusion.<sup>196</sup> Furthermore, although companies might have enough resources to bring direct actions, many shareholders lack the finances and motivation to take their disputes to court,<sup>197</sup> particularly in light of collective-action and free-rider problems.<sup>198</sup> This undermines Rule 14a-8 as a medium for shareholder communication without regard to shareholders' financial standing.<sup>199</sup> Of course, if staff interpretations were consistently correct, one might find

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189. See George J. Stigler, *The Theory of Economic Regulation*, 2 *Bell J. Econ. & Mgmt. Sci.* 3, 3–4 (1971) (outlining the regulatory-capture theory).

190. Of the 49 proposals to which the staff assigned a category, the staff determined that 35 proposals (71%) were excludable. *Supra* Table 1. By contrast, out of the 8 proposals to which the staff did not assign a category, the staff determined that only 3 proposals (38%) were excludable. *Supra* Table 1. Granted, the significance of the latter result is limited by a small sample size.

191. See Victor Eugene Flango, *State Supreme Court Opinions as Law Development*, 11 *J. App. Prac. & Process* 105, 105, 108–17 (2010); cf. *Palsgraf v. Long Island R.R.*, 162 N.E. 99, 99–101 (N.Y. 1928) (developing tort law by clarifying the proximate cause requirement).

192. See 17 C.F.R. § 202.1(d) (2016).

193. See Nagy, NALs, *supra* note 38, at 944; Bartkus, *supra* note 46, at 208.

194. 17 C.F.R. § 202.1(d).

195. See Nagy, NALs, *supra* note 38, at 944.

196. See SLB 14H, *supra* note 78 (announcing the staff's intention to not follow a Third Circuit opinion).

197. See *Case for Review*, *supra* note 186, at 855.

198. See *Palmiter*, *supra* note 12, at 895–900.

199. See *Case for Review*, *supra* note 186, at 855.

the lack of review less troubling—but given the staff’s periodic changes in its interpretation of the exclusion,<sup>200</sup> it seems unlikely that the staff has finally settled on “the” correct interpretation.

The SEC’s current approach to social policy proposals is problematic under both of these models. First, as an agency focused on protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation,<sup>201</sup> the SEC is not well situated to determine whether a social policy issue is “sufficiently significant” to merit shareholders’ attention.<sup>202</sup> Second, individual staff members’ personal political beliefs seem bound to subconsciously, if not consciously, color their determinations, notwithstanding the staff’s attempts to look to objective measures of significance.<sup>203</sup> When objective measures do not provide a clear answer, there is little else on which to rely. Third, even if the staff can objectively look to external measures of significance, the measure that the SEC has chosen—congressional interest—is itself difficult to determine and prone to create error.<sup>204</sup> Congressional interest could range anywhere from one representative introducing a bill that never makes it out of committee to unanimous congressional recognition of a social policy issue’s importance, making it difficult for the SEC to draw the line as to what level of congressional interest is sufficient. Finally, the staff’s tendency to create *de facto* rules regarding which social policy issues qualify for the social policy exception makes it difficult to adapt to changing public perception of those issues’ significance.<sup>205</sup> Ultimately, this entrenchment may trigger a “doctrinal feedback” loop in which NAL-created customs become legally binding in spite of changing circumstances.<sup>206</sup>

2. *Rule-Format Defects.* — The second meaningful defect results from the format in which the rules appear. Simply put, NALs contain only

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200. See, e.g., J. Robert Brown, Jr., *The Politicization of Corporate Governance: Bureaucratic Discretion, the SEC, and Shareholder Ratification of Auditors*, 2 *Harv. Bus. L. Rev.* 501, 511 (2012); Schapiro, *supra* note 12, at A19 (criticizing the staff’s decisionmaking for “shift[ing] with the political and corporate governance views of the staff and individual commissioners”).

201. See *What We Do*, U.S. Sec. & Exch. Comm’n, <http://www.sec.gov/about/whatwedo.shtml> [<http://perma.cc/8VZ8-CDPC>] (last modified June 10, 2013).

202. See *supra* notes 73–74 and accompanying text (noting this lack of expertise in social policy).

203. Cf. Schauer, *Playing by the Rules*, *supra* note 144, at 209–10 (noting the potential effect of social, political, and moral beliefs on rule interpretation). Additionally, the Commissioners’ political views may influence staff practice. See Brown, *supra* note 200, at 510–11; Schapiro, *supra* note 12, at A19.

204. See Palmiter, *supra* note 12, at 882 n.13.

205. See *supra* section II.B.2 (presenting evidence of the exclusion’s rulification).

206. Cf. James Gibson, *Doctrinal Feedback and (Un)Reasonable Care*, 94 *Va. L. Rev.* 1641, 1644–45, 1653–61 (2008) (examining the cyclical transformation of excessive-medical-treatment practices into legally binding customs as a result of doctors’ aversion to medical malpractice liability).

nominal explanation of the staff's reasoning,<sup>207</sup> which makes it difficult to discern the rules' content and imposes information externalities.<sup>208</sup> The confusion surrounding *Trinity* aptly illustrates the problem: The district court, Third Circuit majority, and SEC staff all pointed to prior staff practice as support for their interpretations of Rule 14a-8(i)(7), yet three different interpretations of the exclusion emerged.<sup>209</sup> To the extent that transparency is an important attribute of administrative rules,<sup>210</sup> the Rule 14a-8 rulemaking system falls flat.

3. *Rule-Overinclusivity Defects.* — The third noteworthy defect relates to the rules' overinclusivity as measured against their justifications.<sup>211</sup> Specifically, the rules have resulted in the unfounded exclusion of proposals that focus on significant social policy issues, in direct conflict with the SEC's position in the 1998 adopting release.<sup>212</sup> For example, the staff recently permitted (i)(7) exclusion of a proposal by FedEx shareholders that requested a report on steps the company was taking to distance itself from the Washington Redskins football team, whose stadium is called "FedExField."<sup>213</sup> Notwithstanding substantial outcry (including from the White House) about the racist undertones of the Redskins' name,<sup>214</sup> the staff determined that the proposal was excludable as "relat[ing] to the manner in which FedEx advertises its products and services"<sup>215</sup>—falling squarely into a category on which the staff has previously relied to exclude proposals.<sup>216</sup> The staff's resort to a bright-line rule in *FedEx* paral-

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207. See, e.g., *supra* note 177 (citing NALs making conclusory determinations as to excludability).

208. Cf. Huang, *supra* note 174, at 2239–40 (explaining how individualized regulatory rulings may create "shallow signals" and noting that "[p]artial revelation might worsen the risk of misunderstanding").

209. See *supra* section II.A.

210. See generally Diver, *supra* note 144, at 67 (discussing the role of transparency in effective rulemaking).

211. See generally Sunstein, *supra* note 144, at 992–93 (discussing the recurring "overinclusivity" problem that attends highly generalized rules).

212. See *supra* section I.C.5.

213. See FedEx Corp., SEC No-Action Letter, 2015 WL 3453723, at \*1 (July 21, 2015).

214. See, e.g., Jonathan O'Connell, *Obama Administration Rebuffs D.C.'s Efforts to Bring Back the Redskins*, Wash. Post: Digger (July 1, 2015), <http://www.washingtonpost.com/news/digger/wp/2015/07/01/obama-administration-rebuffs-d-c-s-efforts-to-bring-back-the-redskins/> (on file with the *Columbia Law Review*); Theresa Vargas, *U.S. Patent Office Cancels Redskins Trademark Registration, Says Name Is Disparaging*, Wash. Post (June 18, 2014), [http://www.washingtonpost.com/local/us-patent-office-cancels-redskins-trademark-registration-says-name-is-disparaging/2014/06/18/e7737bb8-f6ee-11e3-8aa9-dad2ec039789\\_story.html](http://www.washingtonpost.com/local/us-patent-office-cancels-redskins-trademark-registration-says-name-is-disparaging/2014/06/18/e7737bb8-f6ee-11e3-8aa9-dad2ec039789_story.html) (on file with the *Columbia Law Review*).

215. FedEx Corp., *supra* note 213, at \*1.

216. See, e.g., The Quaker Oats Co., SEC No-Action Letter, 1999 WL 152450, at \*1 (Mar. 16, 1999) (permitting the exclusion of a proposal relating to the company's review of its advertising contracts for content that demeans based on race, ethnicity, or religion because it relates to "the manner in which a company advertises its products"); PepsiCo Inc., SEC No-Action Letter, 1998 WL 92657, at \*1 (Feb. 23, 1998) (permitting the exclusion of a proposal requesting a "report regarding the use of non-racist portrayals and

lets the staff's position in *Cracker Barrel*, in which the staff announced that it would grant no-action relief for all employment-related proposals regardless of their social policy focus.<sup>217</sup> But today, there is a greater lack of transparency.

### III. PROPOSALS FOR REFORM

Part II identified problems with the “rulification” of the ordinary business operations exclusion through informal SEC staff opinions. This Part explores ways to reform the exclusion. Section III.A recommends recasting the exclusion as a “catalog” and creating procedures that channel changes to the catalog through notice and comment. Section III.B suggests modifying the “significance” requirement for the social policy exception to provide for private ordering through corporate-charter purpose clauses.

#### A. *Recasting the Ordinary Business Operations Exclusion as a “Catalog”*

Some commentators have proposed drastic reforms, such as eliminating the ordinary business operations exclusion,<sup>218</sup> eliminating Rule 14a-8 altogether (leaving shareholder proposals to state law),<sup>219</sup> and raising share-ownership requirements.<sup>220</sup> But these suggestions, respectively, undervalue the ordinary business operations exclusion as a bulwark against proposals that waste corporate resources,<sup>221</sup> undervalue the shareholder proposal rule as a channel for dialogue between shareholders and management,<sup>222</sup> and undervalue the contributions of small-stake

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designations” in the company’s advertising because it relates to “the manner in which a company advertises its products”).

217. See *supra* section I.C.4.

218. See, e.g., Palmiter, *supra* note 12, at 918–19.

219. See, e.g., Susan W. Liebler, A Proposal to Rescind the Shareholder Proposal Rule, 18 Ga. L. Rev. 425, 454–59 (1984).

220. Cf. John C. Coffee Jr., Editorial, Blocking Bias via Proxy, *Wall St. J.*, Feb. 2, 1993, at A14 (on file with the *Columbia Law Review*) [hereinafter Coffee, Blocking Bias] (mentioning, without necessarily advocating for, higher share-ownership requirements as a potential response to concerns about misuse of Rule 14a-8).

221. Notwithstanding its flaws, the exclusion still serves an important function: ensuring that Rule 14a-8 does not force companies to wastefully subsidize profit-focused proposals that are immaterial to their shareholders’ investments. Shareholders still occasionally make such proposals. See, e.g., Ford Motor Co., SEC No-Action Letter, 2014 WL 7388137, at \*1, \*3 (Jan. 30, 2015) (finding a proposal requesting a report on the impact of oil cartels on gasoline prices excludable under (i)(7)).

222. See *infra* note 223 (addressing objections to shareholder proposals generally); see also section III.B.4 (highlighting the impact of social policy proposals). Tellingly, neither shareholders nor companies have been receptive to leaving regulation of shareholder proposals to states. See Amendments to Rules of Shareholder Proposals, Exchange Act Release No. 34–39093, 62 Fed. Reg. 50,682, 50,684 n.28 (proposed Sept. 26, 1997) (codified at 17 C.F.R. pt. 240) (reporting the results of a survey by the SEC).

shareholders.<sup>223</sup> This section proposes a more modest approach to reform: recasting the ordinary business operations exclusion as a “catalog.”

1. *Constructing the Catalog.* — Neither rules nor standards seem entirely appropriate for the ordinary business operations exclusion. Rules tend to be a poor fit for conduct that frequently varies in relevant ways from case to case, which calls for particularistic decisionmaking.<sup>224</sup> Given the infinite variety of proposals that shareholders could devise, rules therefore seem ill suited to the ordinary business operations exclusion—they would inevitably be either vastly underinclusive or vastly overinclusive (or both).<sup>225</sup> But a standard would present complications as well. First, the current, standard-like formulation of the exclusion is difficult to construe in light of the inherent ambiguity of the term “ordinary business operations.”<sup>226</sup> Unlike with more familiar standards like “reasonableness,” the line between ordinary and nonordinary business operations, much less between sufficiently and insufficiently significant social policy issues, is not intuitive.<sup>227</sup> Second, as Part II of this Note suggests, the

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223. First, small-stake shareholders have meaningfully contributed to U.S. corporate governance. Early in the rule’s history, Lewis Gilbert used shareholder proposals to urge practices like consistent financial accounting that modern financial economists now support. Palmiter, *supra* note 12, at 897. More recently, small-stake shareholders have brought proxy-access proposals, see, e.g., Whole Foods Market, Inc., SEC No-Action Letter (Jan. 16, 2015), <http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2015/jamesmcritchieveddenrecon011615-14a8.pdf> [<http://perma.cc/4D9T-NHDT>], most of which gained majority support in the 2015 proxy season, see Sullivan & Cromwell LLP, 2015 Proxy Season Review 4 (2015) [hereinafter 2015 Review], [http://www.sullcrom.com/siteFiles/Publications/SC\\_Publication\\_2015\\_Proxy\\_Season\\_Review.pdf](http://www.sullcrom.com/siteFiles/Publications/SC_Publication_2015_Proxy_Season_Review.pdf) [<http://perma.cc/DC63-WYBX>]. Second, small-stake shareholders have contributed to important social policy causes, such as divestment from apartheid South Africa. See Donald E. Schwartz & Elliot J. Weiss, An Assessment of the SEC Shareholder Proposal Rule, 65 *Geo. L.J.* 635, 642–48 (1977); see also *infra* note 313 and accompanying text. Although there has been abuse in the past, see Steven Davidoff Solomon, *Grappling with the Cost of Corporate Gadflies*, *N.Y. Times: Dealbook* (Aug. 19, 2014, 8:02 PM), <http://dealbook.nytimes.com/2014/08/19/grappling-with-the-cost-of-corporate-gadflies> (on file with the *Columbia Law Review*) (discussing one shareholder’s practice of encouraging companies to buy copies of her annual newsletter for \$600), companies could respond to such abuse in other ways, cf. Del. Code Ann. tit. 11, § 846(8) (2016) (codifying the elements of extortion).

224. See Schauer, *Playing by the Rules*, *supra* note 144, at 152; Kaplow, *supra* note 13, at 599–601.

225. Cf. Schauer, *Playing by the Rules*, *supra* note 144, at 31–34 (discussing the inclusivity problems associated with rules); Sunstein, *supra* note 144, at 992–93 (same). As the business operations, corporate governance, and social policy landscapes evolve, shareholders will inevitably devise new types of proposals, for which it would be incredibly difficult, if not impossible, to account *ex ante*. Thus, crafting a comprehensive set of bright-line rules would be very costly, leading to severe inclusivity problems for virtually any set of rules that the SEC could plausibly design.

226. See *supra* section II.A (discussing the exclusion’s ambiguity).

227. See *supra* section II.A (describing different views on these terms’ meanings).

exclusion may inevitably become more rule-like even when the SEC attempts to set “rules against rulification.”<sup>228</sup>

There is a third type of legal directive that may fare better: the “catalog.” A catalog, as Professors Gideon Parchomovsky and Alex Stein define it, contains a list of two or more enumerated items with a “general provision” empowering the decisionmaker to proscribe (or permit) other similar items.<sup>229</sup> For example, a statute might prohibit leaving a dog, cat, or other pet unattended in a parked vehicle.<sup>230</sup> To determine the meaning of the general term (“pet”), the decisionmaker searches for the common characteristics shared by the enumerated terms (“dog” and “cat”).<sup>231</sup> If there is more than one characteristic in common, the decisionmaker may refer to the catalog’s context and underlying legislative purpose to find the relevant characteristic.<sup>232</sup>

To create a catalog, the SEC might amend the exclusion’s text to provide for exclusion of any proposal that “focuses on management of the workforce, decisions on production quality and quantity, the retention of suppliers, or other ordinary business operations of the company,”<sup>233</sup> perhaps in table format.<sup>234</sup> In conjunction with this change, the SEC should emphasize that the *focus* of the proposal determines whether it falls within the exclusion’s scope. This would clarify that, consistent with current staff practice, a proposal would not be excludable merely because it “implicates” the company’s ordinary business operations.<sup>235</sup> The SEC should also clarify the meaning of the term “focus,” which has been a recurring source of confusion relating to the exclusion’s scope.<sup>236</sup>

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228. See *supra* Part II (presenting evidence of the exclusion’s rulification).

229. Parchomovsky & Stein, *supra* note 27, at 168. Thus, a typical catalog “consists of an outright ban on a detailed, but incomplete, list of specific activities and a general prohibition of all activities falling into the same category.” *Id.*

230. *Id.* at 170.

231. *Id.* at 182.

232. *Id.* at 183.

233. These examples come from the adopting release accompanying the 1998 amendments. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29,106, 29,108 (May 28, 1998) (codified at 17 C.F.R. pt. 240). In a sense, then, the exclusion is already a catalog. But this Note proposes that the SEC incorporate these and other illustrative examples into the text of Rule 14a-8 itself, which would provide superior guidance, see *infra* notes 238–243 and accompanying text.

234. See *infra* Appendix at Table A.1.

235. Cf. Bank of America Corp., *supra* note 41, at \*1 (concluding that a proposal urging divestment of “all non-core banking business segments” was not excludable under (i)(7)). A proposal urging divestment of certain business segments clearly “relates” to the company’s ordinary business operations in the usual sense of the word. But the proposal was not excludable because, as the staff correctly concluded, the proposal “*focus[ed]* on an extraordinary business transaction.” *Id.* (emphasis added).

236. See *supra* section II.A.

The correct interpretation would, consistent with the 1983 release, track substance over form.<sup>237</sup>

Recasting the ordinary business operations exclusion as a catalog would address many of the concerns previously discussed. First, by constraining the staff's discretion as to excludability, a catalog would reduce the potential for abuse and align staff decisions with Commission policy.<sup>238</sup> Relatedly, these constraints would improve decisional accuracy by mitigating both inclusivity problems and the so-called "tyranny-of-choice" problem.<sup>239</sup> Second, a catalog would provide greater transparency and predictability.<sup>240</sup> Able to rely on the catalog's list of illustrative proposals, shareholders and companies would have less need to divine answers from the nebulous common law of prior NALs, whose weight is unclear to begin with.<sup>241</sup> This is particularly important for Rule 14a-8, since shareholders may submit proposals without consulting counsel or prior NALs at all,<sup>242</sup> wasting corporate resources if the shareholder is mistaken as to excludability.<sup>243</sup> Third, a catalog would still allow the staff enough flexibility to adapt to changing circumstances as shareholders devise new

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237. See *supra* section I.C.3 (discussing the "substance-over-form" principle from the 1983 amendments).

238. Cf. Brown, *supra* note 200, at 532–33 (noting the costs of staff discretion); Parchomovsky & Stein, *supra* note 27, at 184 (arguing that catalogs give decisionmakers "weak (or limited) discretion").

239. The tyranny-of-choice problem, which may partially drive the rulification of standards, arises when decisionmakers, faced with too many different options, are unable to take into account all the considerations necessary to come to an optimal decision. See Schauer, Rulification, *supra* note 21, at 811–13. Because catalogs restrict decisionmakers' analyses to searching for "family resemblance," Parchomovsky & Stein, *supra* note 27, at 185, a catalog would mitigate this problem.

240. Cf. Parchomovsky & Stein, *supra* note 27, at 190 (contending that catalogs generally create certainty and predictability). Along similar lines, one might view a catalog as creating what Professor Bert Huang has called "exceptional spaces." See Huang, *supra* note 174, at 2262–67. Although Professor Huang identifies NALs as a possible model for exceptional spaces, see *id.* at 2263 n.102, 2264, a catalog could more effectively delineate these spaces. Moreover, compared to some of the NALs related to other SEC regulations, Rule 14a-8 NALs do not "identify criteria that are readily observable" to market participants. *Id.* at 2263. Compare Credit Suisse First Boston Corp., SEC No-Action Letter, 1998 WL 799305, at \*1–5 (Sept. 9, 1998) (detailing the basis for a staff determination under non-Rule 14a-8 regulations), with Wal-Mart Stores, Inc., *supra* note 40, at \*1 (making a conclusory determination as to excludability under Rule 14a-8).

241. See *supra* section I.B.2 (discussing the weight given to NALs). Even if there is general agreement that *Skidmore* provides the appropriate framework for analyzing NALs' weight, *Skidmore* provides little certainty as to how much weight courts will accord NALs in any particular instance. Cf. *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) (announcing a multifactor test).

242. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29,106, 29,106–07 (May 28, 1998) (codified at 17 C.F.R. pt. 240) (explaining the reasons for adoption of a plain-language Q & A format for Rule 14a-8).

243. See *infra* note 292 and accompanying text (noting that the cost associated with determining whether to include a proposal is \$54,000).

types of proposals.<sup>244</sup> Indeed, this is one of catalogs' principal advantages: They allow decisionmakers enough flexibility to add items for which it would be too costly—in terms of either informational or political costs—for the rulemaker to craft a rule in the first instance.

2. *Maintaining the Catalog.* — To address concerns about underground staff rulemaking and increase public participation in the rulemaking process,<sup>245</sup> the SEC should, in addition to ensuring that the initial adoption of the catalog adheres to notice-and-comment procedures, create procedures to ensure that future revisions to the catalog are also channeled through notice and comment.<sup>246</sup> The SEC might, for example, require the staff to release an annual report to the public following each proxy season, noting trends in staff interpretation. The SEC could then periodically—perhaps once every five years—funnel any nascent de facto rules through notice-and-comment rulemaking. This would enhance the rules' democratic legitimacy, increase transparency, and decrease the risk of regulatory capture.<sup>247</sup>

Granted, conditioning every small change to Rule 14a-8 on satisfaction of onerous procedural requirements could contribute to the SEC's ossification, making rulemaking more costly and difficult.<sup>248</sup> For example, requiring the SEC to route uncontroversial procedural changes—like announcing a new email address to which companies must send no-action requests—through notice and comment may impose significant costs without commensurate benefits. Such changes are properly announced in SLBs. But for those changes that would substantively affect shareholders' and companies' rights and obligations under Rule 14a-8, as staff-created rules regarding the ordinary business operations exclusion have done,<sup>249</sup> utilizing notice and comment is worth the bother.<sup>250</sup>

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244. See Parchomovsky & Stein, *supra* note 27, at 184 (claiming catalogs “grow and develop through a process of accretion”).

245. See *supra* section I.C (discussing these concerns).

246. Notice-and-comment procedures give notice to the public of a proposed rule change and afford an opportunity to comment on the proposed change before the agency promulgates the final rule. See 5 U.S.C. § 553 (2012).

247. See *supra* notes 181–190 and accompanying text (discussing the benefits of notice-and-comment rulemaking vis-à-vis the undemocratic characteristics of the exclusion's underground rulification).

248. See Thomas O. McGarity, Some Thoughts on “Deossifying” the Rulemaking Process, 41 *Duke L.J.* 1385, 1387 (1992) (discussing the burdensomeness of administrative rulemaking).

249. See *supra* section II.B (documenting the exclusion's rulification).

250. See *supra* note 187 and accompanying text (discussing the benefits of public participation in administrative rulemaking).

B. *Replacing the “Significance” Requirement—A Private Ordering-Based Solution?*

As previously discussed, the requirement that a social policy issue must be “sufficiently significant” in order to qualify a proposal for the social policy exception is problematic.<sup>251</sup> But if the SEC abandons the significance requirement, what should take its place?

1. *Two Extreme Solutions Rejected.* — One option, advanced by Professor Stephen Bainbridge, would be to abandon the social policy exception altogether by requiring materiality as to a reasonable shareholder’s economic interest in the corporation.<sup>252</sup> But there are several issues with this approach. To begin, there is a practical legal obstacle: Elimination of the social policy exception would be inconsistent with the official Commission-approved interpretations of the ordinary business operations exclusion set forth in the adopting releases to the 1976 and 1998 amendments to Rule 14a-8, which the SEC adopted after notice and comment.<sup>253</sup> As previously explained, courts grant these regulatory interpretations considerable deference.<sup>254</sup> Thus, to eliminate the social policy exception, action by either the full Commission or Congress would likely be necessary.

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251. See *supra* section I.C. (discussing several issues with the significance requirement).

252. See Stephen M. Bainbridge, *Revitalizing SEC Rule 14a-8’s Ordinary Business Exemption: Preventing Shareholder Micromanagement by Proposal 31* (UCLA Sch. of Law, Law & Econ. Research Paper No. 16-06, 2016) [hereinafter Bainbridge, *Ordinary Business Exemption*], <http://ssrn.com/abstract=2750153> (on file with the *Columbia Law Review*) (proposing a “material economic importance” standard). In the context of disclosure under Rule 14a-9, the Supreme Court has held that “[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

253. See *supra* sections I.C.2, I.C.5 (describing the 1976 and 1998 adopting releases, respectively).

254. See *supra* section I.B.1. Although Professor Bainbridge correctly recognizes that courts do not owe *Chevron* deference to SEC interpretations of Rule 14a-8, see Bainbridge, *Ordinary Business Exemption*, *supra* note 252, at 28–29, that is because Rule 14a-8 is a regulation, not a statute. *Chevron* governs only judicial review of administrative interpretations of *statutes*, while a different case, *Auer v. Robbins*, governs judicial review of administrative interpretations of *regulations*. Compare *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842–43 (1984) (announcing the standard of review “[w]hen a court reviews an agency’s construction of the *statute* which it administers” (emphasis added)), with *Auer v. Robbins*, 519 U.S. 452, 461–62 (1997) (announcing a different standard of review when a court reviews agency interpretations of the agency’s “own *regulations*” (emphasis added)). See generally Charles H. Koch, Jr. & Richard Murphy, *Review of Interpretations*, 3 *Admin. L. & Prac.* (West) § 10:26 (last updated Feb. 2016) (“One of the most venerable doctrines in administrative law is that a court will give great deference to an agency’s interpretation of its own rules.”). True, the shifting positions expressed in the staff’s NALs may permit courts to accord those NALs less weight under *Mead* and *Skidmore*—but the social policy exception derives from the 1976 and 1998 adopting releases, not from the staff’s NALs. See *supra* sections I.C.2, I.C.5 (describing, respectively, the 1976 and 1998 adopting releases).

But even if this practical obstacle did not exist, there are other problems with Professor Bainbridge's proposal. First, a materiality standard would impose costs of its own. Given that courts have struggled to apply the materiality standard in other contexts,<sup>255</sup> it may also be difficult to determine whether a proposal presents "material" issues. Second, this would imply a uniform federal standard as to corporate purpose, focused solely on profit, which would arguably be inconsistent with state law that allows corporations to pursue "any lawful purpose."<sup>256</sup> Third, it would run contrary to the rationale underlying the Supreme Court's opinions in *Citizens United* and *Hobby Lobby*, which, respectively, assumed shareholder participation in corporate decisions over political spending<sup>257</sup> and

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255. See Dan A. Oesterle, The Overused and Under-Defined Notion of "Material" in Securities Law, 14 U. Pa. J. Bus. L. 167, 184–92 (2011).

256. See, e.g., Del. Code Ann. tit. 8, § 102(a)(3) (2016) (allowing corporations to be organized for any lawful purpose); *A.P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581, 583–86 (N.J. 1953) (recognizing a broad view of corporate purpose); Principles of Corp. Governance: Analysis and Recommendations § 2.01(b)(2)–(3) (Am. Law Inst. 1994) (allowing corporations to "take into account ethical considerations" and "devote a reasonable amount of resources" to the public good); Lynn A. Stout, Why We Should Stop Teaching *Dodge v. Ford*, 3 Va. L. & Bus. Rev. 163, 168–72 (2008) (discussing the states' broad treatment of corporate purpose); cf. *Food & Allied Serv. Trades Dep't v. Wal-Mart Stores, Inc.*, CIV. A. No. 12551, 1992 WL 111285, at \*1, \*4 (Del. Ch. May 20, 1992) (Allen, C.) (holding that moral and political purposes may constitute a "proper purpose" for the exercise of shareholder inspection rights). But cf. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (holding that the inevitable break-up of a company changes directors' duties to maximize shareholder wealth); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 35 (Del. Ch. 2010) (finding that the board's adoption of a defensive measure "that openly eschews stockholder wealth maximization" violated the directors' fiduciary duties); *State ex rel. Pillsbury v. Honeywell, Inc.*, 191 N.W.2d 406, 411–12 (Minn. 1971) (finding political purposes improper for the exercise of inspection rights).

Although courts have sometimes emphasized shareholder-wealth maximization, this has usually been in the context of directors' fiduciary duties, not shareholders' abilities to express normative preferences for certain corporate activity. See Leo E. Strine, Jr., Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit, 47 Wake Forest L. Rev. 135, 145–55 (2012) (highlighting the focus on directors' fiduciary duties in several landmark cases). Perhaps, then, courts have been suspicious of granting management discretion to seek nonpecuniary goals because management could abuse that discretion, whereas this is less of a risk with shareholders. See Mark J. Roe, The Shareholder Wealth Maximization Norm and Industrial Organization, 149 U. Pa. L. Rev. 2063, 2065 (2001) (noting the potential for management abuse of discretion as a reason to expect directors to pursue shareholder-wealth maximization).

257. See *Citizens United v. FEC*, 558 U.S. 310, 361–62, 370 (2010) (tacitly assuming shareholder power over political speech); Lucian A. Bebchuk & Robert J. Jackson, Jr., Shining Light on Corporate Political Spending, 101 Geo. L.J. 923, 944–45 (2013) (arguing that *Citizens United* supports the case for disclosure of corporate political spending to shareholders). Political-spending proposals would probably be excludable under this standard to the extent that this spending is only a small fraction of total revenue or profit. Compare Microsoft Transparency Hub: Political Engagement, Microsoft, <http://www.microsoft.com/about/corporatecitizenship/en-us/transparencynhub/political-engagement/> [http://perma.cc/SJW3-DA6V] (last visited July 27, 2016) (reporting combined 2014 spending in public-policy advocacy, political-action-committee contributions, and direct corporate political contributions of less than \$19 million), with

shareholder ability to impose normative constraints on companies in which they own shares.<sup>258</sup> Finally, denying shareholders a voice in whether their investments are managed in what they believe to be a socially responsible manner, even if that manner is not the most profitable, would lie in considerable tension with nearly fifty years of jurisprudence and SEC practice, as well as the congressional purpose underlying section 14(a) of the '34 Act.<sup>259</sup>

Another route would be to simply eliminate the significance requirement and not replace it at all, opening Rule 14a-8 to social policy proposals of all variety. The obvious downside to this change would be the potential flooding of corporations' proxy statements with social policy proposals about which most shareholders do not care,<sup>260</sup> at the corporation's expense.

2. *A Better Solution: Private Ordering via Corporate Purpose.* — The better solution, lying between these two extremes, would be for the SEC to replace the significance test with a new exclusion that allows for private ordering<sup>261</sup> via corporate purpose.<sup>262</sup> This new exclusion would ask

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Microsoft Corp., Annual Report (Form 10-K), at 28 (July 31, 2015) (reporting 2014 revenue of \$86.8 billion and net income of \$22.1 billion).

258. See *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2770–71 (2014) (contending that “modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else” and corporations may pursue nonprofit objectives “with ownership approval”); Michele Benedetto Neitz, *Hobby Lobby and Social Justice: How the Supreme Court Opened the Door for Socially Conscious Investors*, 68 SMU L. Rev. 243, 260–68 (2015) (discussing *Hobby Lobby's* relevance for social-responsibility investors). For a *Cracker Barrel*-era argument that shareholders should be able to impose “normative constraints” on the companies in which they hold shares, see Coffee, *Blocking Bias*, *supra* note 220, at A14.

259. See *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 427–28 (D.C. Cir. 1992) (R.B. Ginsburg, J.) (recognizing the significant policy exception); *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 680 (D.C. Cir. 1970) (suggesting that exclusion of a proposal because of the proponent's political or social motivations may “conflict with the congressional intent underlying section 14(a) of the [’34] Act”); *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc.* 821 F. Supp. 877, 890 (S.D.N.Y. 1993) (denying exclusion of a proposal requesting a report on the company's equal-employment-opportunity practices); *supra* note 30 (discussing the purpose underlying section 14(a)); *supra* section I.C (discussing SEC practice regarding social policy proposals).

260. See *infra* Appendix at Table A.2 (showing an average of 21.2% support for social policy proposals appearing on Fortune 500 proxy statements in the 2015 season, with no proposal gaining majority support).

261. Private ordering refers to the ability of private actors—here, shareholders and companies—to set the rules that govern their conduct. See James D. Cox & Thomas Lee Hazen, *Private Ordering and Shareholder Suits*, 3 *Treatise on the Law of Corporations* (West) § 15:23 (last updated Dec. 2015) (discussing private ordering in corporate law).

262. State law generally requires a corporation to state the purpose for which it exists in its certificate of incorporation. See, e.g., Del. Code Ann. tit. 8, § 102(a)(3) (2016). Most states permit corporations significant freedom in defining that purpose. See Michael A. Schaeftler, *The Purpose Clause in the Certificate of Incorporation: A Clause in Search of a Purpose*, 58 St. John's L. Rev. 476, 476 n.1 (1984) [hereinafter Schaeftler, *Purpose Clause*]. California is unusual in requiring that most ordinary corporations adopt a standardized

whether the shareholder proposal, if implemented, would be consistent with the corporation's purpose as stated in its certificate of incorporation. If inconsistent, the proposal would be excludable. This test would resemble the classical ultra vires doctrine, which acts as a state law limit on corporate activity that is beyond the corporation's purposes.<sup>263</sup> Corporations with broad purpose clauses in their certificates<sup>264</sup> would thus be unable to challenge social policy-focused proposals under the new exclusion, while corporations with more narrow purpose clauses may be able to successfully challenge such proposals. For example, if a corporation's charter stated that its sole purpose is maximization of shareholder wealth, most social policy proposals would be off the table. Meanwhile, proposals that raise social policy issues but seek to "micro-manage" the details of those policies' implementation would still be excludable under (i) (7) even when the corporation has framed its purpose broadly because such exclusion does not hinge on the "significance" of any social policy issue.<sup>265</sup> Additionally, proposals that are not "significantly related" to the corporation's business would still be excludable under Rule 14a-8(i)(5),<sup>266</sup> meaning there would still need to be some economic nexus between the social policy issues raised and the corporation's business.<sup>267</sup> Given the relative ease with which a corporation may amend its certificate,<sup>268</sup> this change would likely impose fairly low administrative costs on corporations that wish to amend their certificates to provide for a different purpose.

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purpose clause providing that "[t]he purpose of the corporation is to engage in any lawful act or activity" with limited exceptions. Cal. Corp. Code § 202(b) (West 2016). But the California statute also implies that additional statements "by way of limitation" are permissible, *id.*, so it appears that there is flexibility as to corporate purpose even in California.

263. See tit. 8, § 124 (codifying the ultra vires doctrine).

264. See, e.g., Apple Inc., Restated Articles of Incorporation of Apple Inc. (Form 10-Q, exh. 3.1) (July 22, 2009).

265. See *supra* section I.C.5 (describing the micromanagement test). The micromanagement test, which lacks the inherently subjective inquiry into whether a social policy issue is "sufficiently significant," still serves an important function by ensuring that companies are not required to subsidize proposals that seek excessive specificity. Keeping this test intact would strike the proper balance between allowing shareholders to express their normative views on the ethical implications of corporate policies and ensuring that proposals do not delve too deeply into implementation of those policies, about which shareholders are unlikely to be informed. See *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 427 (D.C. Cir. 1992) (R.B. Ginsburg, J.) (holding that small timing differences failed to raise significant policy issues). Instead of abandoning the micromanagement exception, the SEC should clarify its scope by listing examples in a catalog. See *supra* section III.A (recommending a catalog-based approach).

266. See 17 C.F.R. § 240.14a-8(i)(5) (2016).

267. See *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554, 561 n.16 (D.D.C. 1985) (opining that a proposal would be excludable under Rule 14a-8(i)(5) if it lacked a "meaningful relationship" to the company's business).

268. See, e.g., tit. 8, § 242(b)(1) (requiring a board resolution followed by shareholder approval at a meeting).

In order to avoid uncertainty and respect the congressional purpose underlying section 14(a),<sup>269</sup> the SEC could require corporations to demonstrate any inconsistency by clear and convincing evidence.<sup>270</sup> Under this standard, unless the charter manifested clear intent to exclude a certain type of proposal—for example, by declaring that shareholder-wealth maximization is the corporation’s sole purpose—then a proposal would not be excludable under the inconsistent-purpose standard. In a sense, this burden would be analogous to the canon of interpreting ambiguity against the drafter in contract law,<sup>271</sup> which is fitting because many states require boards to initiate the charter-amendment process.<sup>272</sup>

Although purpose clauses now occupy a much less prominent role in corporate law than they once did,<sup>273</sup> a corporate-purpose approach to social policy proposals would have several advantages over the current framework. First, it would strike the right balance between private ordering, a principle that underlies much of corporate law<sup>274</sup> and may improve firm performance,<sup>275</sup> and some degree of mandatory standardization.<sup>276</sup> Second, by recognizing that corporations are not necessarily bound to a single purpose, it would be appropriately deferential to fundamental state law principles,<sup>277</sup> which the SEC has recognized drive the policy be-

269. See sources cited *supra* note 30 and accompanying text (noting the congressional purposes of promoting “fair corporate suffrage” and preventing management abuse of proxy machinery).

270. Cf. Palmiter, *supra* note 12, at 918 (proposing a similar “clear and convincing” burden of proof for several Rule 14a-8 exclusions).

271. See, e.g., Restatement (Second) of Contracts § 206 (Am. Law Inst. 1981) (recommending interpretation against the drafter as a general rule in choosing among reasonable meanings).

272. See, e.g., tit. 8, § 242(b)(1).

273. See, e.g., Schaeftler, Purpose Clause, *supra* note 262, at 477.

274. See Lucian A. Bebchuk, Letting Shareholders Set the Rules, 119 *Harv. L. Rev.* 1784, 1787 (2006).

275. See Gillian K. Hadfield & Eric L. Talley, On Public Versus Private Provision of Corporate Law, 22 *J.L. Econ. & Org.* 414, 415–17 (2006) (modeling the relative efficiency of “public versus private provision of corporate law”).

276. Others have suggested eliminating the ordinary business operations exclusion entirely and instead letting firms’ bylaws govern which types of proposals are excludable. See D. Gordon Smith et al., Private Ordering with Shareholder Bylaws, 80 *Fordham L. Rev.* 125, 185–87 (2011). But too much private ordering could be counterproductive. The presence of company-specific systems would require a specialized, company-specific inquiry for each excludability determination, which would impose additional informational and administrative costs on the SEC, companies, and shareholders. Cf. Thomas W. Merrill & Henry E. Smith, Optimal Standardization in the Law of Property: The Numerus Clausus Principle, 110 *Yale L.J.* 1, 38–41 (2000) (contending that third-party information costs demand a degree of mandatory standardization in property rights). Notably, there has been general opposition to company-specific shareholder proposal systems. See Amendments to Rules of Shareholder Proposals, Exchange Act Release No. 34–39093, 62 *Fed. Reg.* 50,682, 50,684 n.28 (proposed Sept. 26, 1997) (codified at 17 C.F.R. pt. 240).

277. See *supra* note 256 and accompanying text (noting the generally flexible treatment of corporate purpose under state law).

hind the ordinary business operations exclusion.<sup>278</sup> Finally, it would remove the SEC staff from its awkward role as social policy censor, through which bias and shifting views may cause inconsistency and inaccuracy.<sup>279</sup>

3. *A Numerical Cap Reconsidered.* — In the past, others have proposed capping the number of Rule 14a-8 proposals that a company must include for any annual meeting.<sup>280</sup> Under Professor Alan Palmiter's proposal, for example, a company must include only seven proposals, with priority given to the shareholders (or groups of shareholders) with the largest shareholdings should the company receive more than seven proposals.<sup>281</sup> The SEC should, in order to reduce the costs associated with an increased number of social policy proposals, consider such a numerical cap if it eliminates or revises the significance requirement.<sup>282</sup> Even if the overall cost of social policy proposals does not substantially increase,<sup>283</sup> a cap would act as insurance for companies against an unusually high number of proposals in any given year. The SEC might also consider allowing proposals beyond the cap for proponents who are willing to post a bond covering the cost of including the proposal, to be returned only if the proposal gains some threshold level of support from shareholders at the meeting—say, 10 or 15%.<sup>284</sup>

4. *Objections to the Corporate-Purpose Model.* — There are two obvious objections to the corporate-purpose model. First, managers of corporations that adopt narrower purpose clauses may find their freedom to pursue attractive projects constrained by the threat of ultra vires actions.<sup>285</sup> Such suits could impose significant costs without commensurate benefits,<sup>286</sup> and managers may have incentives to favor narrow purpose clauses

278. See *supra* section I.C (discussing the exclusion's history).

279. See *supra* notes 203–204 and accompanying text (discussing the potential for bias).

280. See Palmiter, *supra* note 12, at 918–19 (proposing a numerical cap in conjunction with the elimination of certain exclusions); Longstreth, *supra* note 12, at 11–12 (same).

281. See Palmiter, *supra* note 12, at 918–19. Giving priority to large-stake shareholders has precedent in corporate law. See, e.g., 2015 Review, *supra* note 223, at 4–7 (discussing the minimum-ownership requirements in successful proxy-access proposals during the 2015 proxy season).

282. See *infra* notes 291–295 and accompanying text (noting the possibility of increased costs).

283. See *infra* notes 291–295 and accompanying text (finding a substantial increase in costs unlikely).

284. Professor George Dent proposed requiring that *all* would-be shareholder proponents post a bond that the corporation would refund only if the proposal obtained at least 20% support. See George W. Dent, Jr., Response, Proxy Regulation in Search of a Purpose: A Reply to Professor Ryan, 23 Ga. L. Rev. 815, 823–24 (1989). But Professor Dent's bond requirement, applied to all proposals, would unduly discriminate against small-stake shareholders, who have made valuable contributions through Rule 14a-8. See *supra* note 223 and accompanying text (noting these contributions).

285. Cf. Del. Code Ann. tit. 8, § 124 (2016) (codifying Delaware's ultra vires doctrine).

286. Cf. Michael A. Schaeftler, Clearing Away the Debris of the Ultra Vires Doctrine—A Comparative Examination of U.S., European, and Israeli Law, 16 Law & Pol'y Int'l Bus.

even when they would not be in shareholders' interest. For example, managers may wish to avoid the reputational harm associated with being subjected to social policy proposals notwithstanding any constraints on their abilities to pursue attractive projects. But if narrow purpose clauses would indeed impose more costs than benefits, it seems unlikely that many corporations would adopt them. Ultimately, amending the corporate charter requires approval by both the board and shareholders,<sup>287</sup> and one would not expect shareholders to vote for an amendment that they believe will harm their interests. Moreover, if exposure to ultra vires suits does become a concern, states could respond by further limiting the ultra vires doctrine's reach, as some scholars have already proposed.<sup>288</sup>

More realistically, the corporate-purpose model may result in a substantial uptick in social responsibility proposals for corporations that do *not* adopt narrower purpose clauses, which would be costly. Indeed, most public corporations probably would choose to continue to maintain broad purpose clauses. Not only would shareholders likely find corporate exposure to ultra vires suits undesirable, but profit-only clauses could present public relations difficulties in light of the reputational pressures on corporations to be perceived as committed to corporate social responsibility.<sup>289</sup> Additionally, management may value the latitude that broad purpose clauses allow them to pursue nonpecuniary goals.<sup>290</sup> Thus, one might worry that the change to a corporate-purpose model would result in shareholders bearing the cost of a great many more proposals that they are unlikely to support, with nothing to show for it.

Although an uptick in social responsibility proposals could indeed impose increased costs, these concerns are ultimately misplaced. First,

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71, 79–113 (1984) [hereinafter Schaeftler, *Ultra Vires*] (discussing the costs of the ultra vires doctrine).

287. See, e.g., tit. 8, § 242 (codifying Delaware's charter-amendment procedures).

288. See, e.g., Schaeftler, *Ultra Vires*, supra note 286, at 79–113 (proposing revisions to the ultra vires doctrine).

289. Cf. Paul Polizzotto, *Millenials Are Embracing Corporate Social Responsibility Campaigns*, AdvertisingAge (Dec. 18, 2015), <http://adage.com/article/digitalnext/ways-marketers-create-smarter-csr-campaigns/301796/> [<http://perma.cc/JN6W-NN65>] (recommending that marketers “build a reputation for supporting social causes and initiatives” to create brand loyalty).

290. See supra notes 285–286 and accompanying text (noting the potential constraints on managerial discretion); cf. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (allowing a corporation to consider various constituencies when determining whether to enact takeover defenses). It is unclear how exactly the first prong of *Unocal* would apply to a corporation with a narrow purpose clause, but such a clause may limit the board's ability to consider constituencies other than shareholders. Granted, it is doubtful whether directors could even do this under current law. See *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 35 (Del. Ch. 2010) (striking down a defensive measure “that openly eschew[ed] stockholder-wealth maximization”); David A. Wishnick, Comment, *Corporate Purposes in a Free Enterprise System: A Comment on eBay v. Newmark*, 121 Yale L.J. 2405, 2410–12 (2012) (characterizing *Newmark* as requiring shareholder wealth maximization).

the cost of additional proposals would not be as high as one might initially assume. Although additional proposals would impose printing, mailing, and administrative costs,<sup>291</sup> the certainty afforded by doing away with the “significance” standard would likely result in fewer companies seeking no-action relief, thereby reducing legal costs. And these legal costs are significant: According to one estimate, determining whether to include a proposal costs a company approximately \$54,000 in 2015 dollars.<sup>292</sup> Given that the cost of simply including a proposal is not much higher—around \$73,000 in 2015 dollars by one estimate<sup>293</sup>—fears of enormous costs seem unwarranted. A numerical cap, which this Note recommends,<sup>294</sup> would further reduce the risk of additional costs creating an undue burden.<sup>295</sup>

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291. See Palmiter, *supra* note 12, at 883 n.15.

292. See Stephen M. Bainbridge, A Comment on the SEC Shareholder Access Proposal 7 (UCLA Sch. of Law, Law & Econ. Research Paper No. 03-22, 2003) [hereinafter Bainbridge, Comment], <http://ssrn.com/abstract=470121> (on file with the *Columbia Law Review*) (reporting a \$37,000 cost in 1998); CPI Inflation Calculator, Bureau of Labor Statistics, <http://data.bls.gov/cgi-bin/cpicalc.pl> (type “37000” into “\$” field; select “1998” into first “in” field; select “2015” into second “in” field; follow “Calculate” hyperlink) (on file with the *Columbia Law Review*) (last visited Sept. 6, 2016). Professor Bainbridge’s figures come from the adopting release accompanying the SEC’s 1998 amendments to Rule 14a-8. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 29,106, 29,116 (May 28, 1998) (codified at 17 C.F.R. pt. 240); see also Brown, *supra* note 200, at 532 n.185 (noting a 2010 estimate of \$47,784).

293. See Bainbridge, Comment, *supra* note 292, at 7 (reporting a \$50,000 cost in 1998); CPI Inflation Calculator, *supra* note 292 (type “50000” into “\$” field; select “1998” into first “in” field; select “2015” into second “in” field; follow “Calculate” hyperlink).

294. See *supra* section III.B.3.

295. This is not to say that there would be no other costs associated with narrowing the ordinary business operations exclusion. For example, union pension funds may abuse shareholder proposals as “bargaining chips during wage negotiations,” see John G. Matsusaka et al., *Opportunistic Proposals by Union Shareholders* 26 (Univ. of S. Cal. CLASS, Research Paper No. CLASS15-25, 2016), <http://ssrn.com/abstract=2666064> (on file with the *Columbia Law Review*), thereby imposing what Professors Zohar Goshen and Richard Squire call “principal costs,” see Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 *Colum. L. Rev.* (forthcoming 2017) (manuscript at 25–29) (on file with the *Columbia Law Review*) (explaining how exercise of control by self-serving investors can lead to “principal conflict costs”). However, opportunistic shareholders tend to leverage executive compensation and corporate governance proposals rather than social policy proposals, which serve as weaker bargaining chips. See Matsusaka et al., *supra*, at 18. The changes proposed by this Note would therefore not encourage such opportunism.

One other objection concerns the influence of proxy-advisory firms like Institutional Shareholder Services (ISS). ISS recommends “against” or “withhold” votes for directors who have failed to implement a precatory proposal that gained majority shareholder support, which may coerce directors into implementing successful shareholder proposals that they do not believe are in the company’s best interest in order to retain their positions. See Cohen & Schleyer, *supra* note 12, at 126–28. However, this is a weak argument for elimination of social policy proposals, considering the rarity with which these proposals gain majority support. See *infra* Appendix at Table A.2 (noting that zero social policy proposals at Fortune 500 companies passed in the 2015 proxy season). Moreover, to the ex-

Second, an objection based on the rarity of majority support for social policy proposals in shareholder votes understates shareholder interest. Although they rarely “win” at the polls, these proposals still obtain significant support—just not enough to pass.<sup>296</sup> In the 2015 proxy season, for example, social policy proposals averaged 21.2% support among shareholders at Fortune 500 companies.<sup>297</sup> And even these figures likely understate true support.<sup>298</sup> Given institutional investors’ dominance in proxy voting and these institutions’ strong tendencies not to support social policy proposals,<sup>299</sup> annual-meeting voting results likely do not reflect the views of individual investors—including the holders of beneficial interests in mutual funds.<sup>300</sup> Moreover, voting results do not account for withdrawn proposals, which are likely to have garnered, on average, more support than those proposals that do appear on companies’ proxy statements.<sup>301</sup> Typically, a shareholder withdraws her proposal because management has agreed to some or all of her requests.<sup>302</sup> But management may agree to a proponent’s requests because it believes that shareholder support for the proposal would be high if it were to appear on the company’s proxy statement, whereas management may ignore proponents’ requests because it believes that shareholder support would be low.<sup>303</sup>

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tent that this objection is premised on economic arguments for allocating control to the board, such arguments miss the point when the question is whether shareholders ought to be able to impose normative constraints on corporate behavior.

296. See Cohen & Schleyer, *supra* note 12, at 124–25.

297. *Infra* Appendix at Table A.2.

298. See *infra* notes 299–305 and accompanying text.

299. See, e.g., Rasha Ashraf & Narayanan Jayaraman, *Determinants and Consequences of Proxy Voting by Mutual Funds on Shareholder Proposals* 37, 51 (Feb. 2007) (unpublished manuscript), <http://ssrn.com/abstract=962126> (on file with the *Columbia Law Review*) (recording low levels of mutual-fund support for social policy proposals); Vanguard’s Proxy Voting Guidelines, Vanguard, <http://about.vanguard.com/vanguard-proxy-voting/voting-guidelines/> [<http://perma.cc/NM4J-NFZF>] (last visited July 27, 2016) (noting that Vanguard funds “typically abstain from voting” on social policy proposals).

300. See Scott Hirst, *Social Responsibility Resolutions 16–18* (Harvard Law Sch. Program on Corp. Governance, Discussion Paper No. 2016-06, 2016), <http://ssrn.com/abstract=2773367> (on file with the *Columbia Law Review*) (presenting evidence indicating that mutual funds frequently vote against their investors’ preferences on social policy proposals).

301. See *infra* notes 302–304 and accompanying text.

302. See *supra* Figure 1 (showing that proponents withdrew nineteen out of twenty-five proposals because management implemented the proponents’ requests or showed willingness to negotiate).

303. See John G. Matsusaka & Oguzhan Ozbas, *A Theory of Shareholder Approval and Proposal Rights* 12–26 (Univ. of S. Cal. CLEO, Research Paper Series No. C12-1, 2016), <http://ssrn.com/abstract=1984606> (on file with the *Columbia Law Review*) (introducing an applied theoretical model).

Given social policy proposals' significant withdrawal rate,<sup>304</sup> this effect is likely significant. Finally, shareholders' inability to submit a reply to management's response to the proposal—giving management the last word in the proxy statement—puts proponents at a disadvantage when attempting to persuade fellow shareholders of their position, which may bias outcomes in management's favor.<sup>305</sup>

Third, if the concern is that additional proposals would have no *impact* because they would not win majority support, history does not support this prediction. Although social policy proposals rarely pass, they nevertheless frequently win enough support to put management on notice that a significant number of shareholders care about the policy issues implicated.<sup>306</sup> This often causes management to implement proponents' suggestions even after a proposal fails to gain majority support.<sup>307</sup> Moreover, as previously discussed, proponents frequently induce management to agree to implement their suggestions and withdraw their proposals before management sends out its proxy materials.<sup>308</sup> Indeed, many social policy proponents happily negotiate an agreement with management and subsequently withdraw their proposals,<sup>309</sup> and many withdrawals lead to concrete change.<sup>310</sup> Such successes show that majority support in an actual vote is not necessary for a proposal to have its desired impact.

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304. See *supra* Figure 1 (showing that proponents withdrew fifteen out of sixty social policy proposals for which the company had requested an NAL in reliance on Rule 14a-8(i)(7)).

305. See John C. Coffee, Jr., *The SEC and the Institutional Investor: A Half-Time Report*, 15 *Cardozo L. Rev.* 837, 901 (1994) (noting that shareholders' inability to make "counter-proposals" creates an "unlevel" playing field favoring management); Lee Harris, *The Politics of Shareholder Voting*, 86 *N.Y.U. L. Rev.* 1761, 1776–80, 1785–86 (2011) (arguing that vote outcomes depend in part on persuasion).

306. See *supra* notes 296–300 and accompanying text.

307. See, e.g., Neel Rane, Comment, *Twenty Years of Shareholder Proposals After Cracker Barrel: An Effective Tool for Implementing LGBT Employment Protections*, 162 *U. Pa. L. Rev.* 929, 953–54 (2014) (finding that 64% of the proposals from 2005 to 2012 relating to LGBT nondiscrimination that did not obtain majority support nevertheless resulted in company implementation); Carol Marquardt & Christine Wiedman, *Can Shareholder Activism Improve Gender Diversity on Corporate Boards?* 17–23 (Nov. 2014) (unpublished manuscript), <http://ssrn.com/abstract=2538909> (on file with the *Columbia Law Review*) (finding that companies frequently increased board gender diversity following gender-diversity-focused proposals even when the proposals did not receive majority approval).

308. See *supra* notes 302–304 and accompanying text.

309. See, e.g., Press Release, Trillium Asset Mgmt., *Trillium Successfully Withdraws Board Diversity Proposal at PANW* (Oct. 8, 2015), <http://www.trilliuminvest.com/trillium-successfully-withdraws-board-diversity-proposal-at-panw/> [<http://perma.cc/WZ8V-YLST>] (announcing the withdrawal of a proposal following the company's agreement to implement the proponent's suggestions regarding board diversity).

310. See, e.g., Rane, *supra* note 307, at 954 (finding that most withdrawn proposals relating to LGBT nondiscrimination from 2005 to 2012 led to "concrete corporate change"); cf. Karen Fisher-Vanden & Karin S. Thorburn, *Voluntary Corporate Environmental Initiatives and Shareholder Wealth*, 62 *J. Envtl. Econ. & Mgmt.* 430, 443

Finally, to the extent that shareholder proposals increase the general public welfare, social policy proposals are valuable for reasons other than their worth to corporations and their shareholders. Historically, shareholder proposals have played a small, albeit significant, role in effecting valuable social change.<sup>311</sup> For example, shareholder proposals have been directly responsible for many companies' adoptions of LGBT nondiscrimination policies.<sup>312</sup> Additionally, shareholder proposals played an important role in the 1980s campaign for divestment from apartheid South Africa.<sup>313</sup> Unless we are willing to declare that shareholder proposals' ability to effect such change should have no bearing on Rule 14a-8's design, then any costs that corporations might incur by including more social policy proposals in their proxy statements must be balanced against these benefits. The law, after all, need not confine itself to shareholder-wealth maximization, a truth that Congress recognized when it allowed the SEC to promulgate the proxy rules not only "for the protection of investors," but also as "appropriate in the public interest."<sup>314</sup>

#### CONCLUSION

The underground rulification of the ordinary business operations exclusion underscores the need for reform. The SEC staff may be capable at administering other aspects of the securities laws, but here, there is inadequate public participation and transparency around the staff's de facto rulemaking procedures. In a sense, the problem relates to institutional roles—the staff, which is fairly insulated from electoral accountability, should not be charged with resolving complex policy issues that substantively affect private parties' rights. Recasting the exclusion as a catalog, channeling future changes to the catalog through notice and comment, and replacing the social policy exception's "significance" requirement with a standard tied to corporations' purpose clauses would help to address these issues. By placing some constraints on the staff's discretion, the SEC would also better align the staff's decisions with Commission policy and provide much-needed certainty and predictability for management and shareholders alike.

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(2011) (finding that companies that receive higher numbers of climate-change-related proposals are more likely to adopt environmental programs).

311. See Schwartz & Weiss, *supra* note 223, at 642–48; see also *infra* notes 312–313 and accompanying text.

312. See Rane, *supra* note 307, at 953–54.

313. See, e.g., Aaron A. Dhir, *Realigning the Corporate Building Blocks: Shareholder Proposals as a Vehicle for Achieving Corporate Social and Human Rights Accountability*, 43 *Am. Bus. L.J.* 365, 383 (2006); Shireen B. Rahnema, *The SEC's Reversal of Cracker Barrel: A Return to Uncertainty*, 7 *U. Miami Bus. L. Rev.* 273, 282 (1999).

314. 15 U.S.C. § 78n(a)(1) (2012).

APPENDIX

FIGURE A.1: RULE 14A-8 NO-ACTION REQUEST RESULTS, 2015 PROXY SEASON (FORTUNE 500)

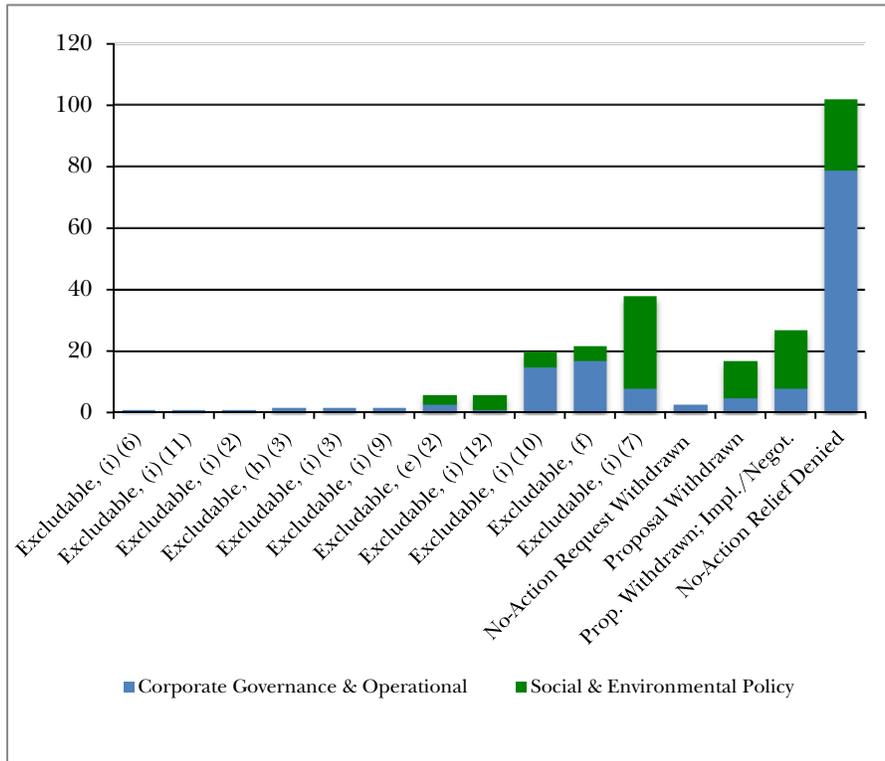


TABLE A.1: SAMPLE CATALOG OF RECURRING PROPOSAL TYPES TO PLACE IN RULE 14A-8(I) (7) TEXT

Focus of Proposal	Excludable?
Nonexecutive Employee Compensation and Benefits	✓
Management of Nonexecutive Employees	✓
Management of Expenses; Expenses < [x]% of Company's Revenue	✓
Product Development; Product < [x]% of Company's Revenue	✓
Marketing of Product; Product < [x]% of Company's Revenue	✓
Management of Ongoing Litigation	✓
Senior Executive Compensation	✗
Corporate Governance	✗
Material Risks to Company Reputation	✗
Proposals Focusing on Social Policy Issues (Even If Otherwise Excludable)	✗

TABLE A.2: RULE 14A-8 PROPOSAL VOTING RESULTS, 2015 PROXY SEASON (FORTUNE 500)

Proposal Type	Fail	Pass	Not Voted On	Total	Average Support
Corporate Governance & Operational	205	45	77	327	34.7%
Social & Environmental Policy	170	0	90	260	21.2%