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## The Public-Interest Proxy Contest: Reflections on Campaign GM

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# THE PUBLIC-INTEREST PROXY CONTEST: REFLECTIONS ON CAMPAIGN GM

*Donald E. Schwartz*

## TABLE OF CONTENTS

I.	INTRODUCTION .....	421
	A. <i>The Year of the Guerrilla Fighter</i> .....	421
	B. <i>What Was Campaign GM?</i> .....	423
II.	ISSUES RAISED BY CAMPAIGN GM .....	430
	A. <i>The Issue of Includibility</i> .....	431
	1. <i>Provisions of Rule 14a-8</i> .....	431
	2. <i>The Function of the SEC</i> .....	433
	3. <i>The Development of Rule 14a-8</i> .....	436
	4. <i>The General Motors Decision</i> .....	451
	5. <i>Rule 14a-8 Revisited: The Meaning of the Gen-         eral Motors Decision</i> .....	454
	B. <i>Corporate Social Responsibility</i> .....	462
	C. <i>The Solicitation of Support</i> .....	483
	1. <i>The Strategy of a Public-Interest Proxy Con-         test</i> .....	483
	2. <i>What Is a Solicitation?</i> .....	486
	3. <i>Shareholder List</i> .....	491
	D. <i>The Institutional Response</i> .....	494
	1. <i>The Legal Position of the Institutions</i> .....	496
	2. <i>The Financial Institutions</i> .....	497
	3. <i>Voting Powers and Duties of Trustees</i> .....	500
	4. <i>The Universities</i> .....	502
	5. <i>Foundations</i> .....	505
	6. <i>Pension Funds</i> .....	506
	7. <i>Mutual Funds</i> .....	508
	8. <i>Contrasts Among Institutions</i> .....	509
	9. <i>Institutional Responsibility in Voting Shares</i> ..	511
	E. <i>The Annual Meeting</i> .....	515

III. LOOKING AHEAD .....	517
A. Possible Public-Interest Questions .....	517
1. Questions Dealing with the Indochina Wars and Particular Weapons .....	518
2. Questions Dealing with Foreign Policy .....	518
3. Questions Dealing with Race Relations .....	518
4. Questions Dealing with the Environment .....	519
B. Suggested Changes in the Proxy Rules .....	520
1. Repeal Subparagraph (c)(2) of Rule 14a-8 .....	522
2. Allow a More Substantial Supporting State- ment To Accompany Management's Proxy ....	523
3. Ease the Existing Requirement That a Proxy Statement Precede or Accompany All Solicita- tions .....	524
4. Expend the Use of Proxy Statements as Infor- mation-Disseminating Devices .....	526
5. Amend Procedures for Review of Questions Arising Under Rule 14a-8 .....	528
6. Appoint a Group To Study Remedial Changes in the Proxy Rules .....	528
IV. REFLECTIONS .....	529
APPENDIX A	
APPENDIX B	
APPENDIX C	

# THE PUBLIC-INTEREST PROXY CONTEST: REFLECTIONS ON CAMPAIGN GM

Donald E. Schwartz\*

## I. INTRODUCTION

### A. *The Year of the Guerrilla Fighter*

PROXY contests are generally fought for control of a corporation. The rules<sup>1</sup> governing this form of corporate combat seek to provide shareholders with adequate information about the rival forces for control so that they can intelligently choose between them. The information furnished in proxy materials and discussions at annual meetings have traditionally been devoted almost entirely to subjects such as finance, production, acquisitions, and the like.

The past year saw new uses made of the proxy machinery and the shareholder meeting. Advocates of social reform, who had heretofore made the corporation a major target of their discontent over social conditions, tried instead to use the corporation as a vehicle for reform. What suddenly exploded in the unlikely arena of the annual meeting was the kind of debate over social issues that is usually reserved for political campaigns. The debate was often forcefully and dramatically asserted before unwilling audiences. It was the year of the "corporate guerrilla fighter."<sup>2</sup>

The problems of the 1960's produced bitter dissent; while the problems grew more serious, our national temper grew hotter. Anger and frustration over the prolonged war in Indochina and a gnawing malaise over our inability to solve increasingly complex problems at home characterized the national mood. Presidential commissions gave discouraging reports on racism and domestic violence.<sup>3</sup> There

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The author was counsel to Campaign GM during the campaign described, and while he has attempted to write this account of the campaign and the legal issues objectively, he cannot be sure that it is free from bias. All he can do is warn the reader. The author is grateful for the assistance of Mr. Peter O Safir, A.B. 1967, Princeton University, a special student at Georgetown Law Center, on military leave from Yale Law School.

1. SEC Reg. 14A, 17 C.F.R. § 240.14a (1969), promulgated pursuant to Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78n(a) (1964) [hereinafter 1934 Act].

2. The phrase was first used by Saul Friedman in the *Detroit Free Press* to describe the General Motors proxy contest. Friedman, *Campaign GM: The Leaders and Their Battle Plan*, *Detroit Free Press*, May 17, 1970, § B, at 43, col. 1. See Flint, *G.M. Will Win Proxy Battle with Nader, But the War May Just Be Starting*, *N.Y. Times*, May 22, 1970, at 18, col. 3.

3. See NATL. ADVISORY COMM. ON CIVIL DISORDERS, REPORT (1968); NATL. COMM. ON THE CAUSES & PREVENTION OF VIOLENCE, PROGRESS REPORT (1969).

were confrontations at the Pentagon, seizures and shutdowns of universities, and riots in the streets of Chicago as the backdrop for a national political convention. Corporations, along with our other institutions, were targets of dissenters.

But in the spring of 1970 a new tactic was adopted by some dissenters who saw corporations to be the core of the problem. They analogized corporations to the state, and saw them as the maker of economic policy.<sup>4</sup> To affect national policy, the dissenters concluded, required them to influence economic policy, and this in turn meant that they had to work *within* the organizations that make such policies. Therefore, the plan evolved to oppose corporate policies not as outsiders, but as participants in the process. In the spring of 1970 it was only natural that the main problems on which the dissenters focused were the corporation's relationship to the war in Vietnam and to the environment.<sup>5</sup>

Starting with the annual meeting of the BankAmerica Corporation in March,<sup>6</sup> corporate executives spent much of their time at annual meetings parrying the thrusts of dissident shareholders who questioned not profit performance but the social impact of the company's activities. Protest was subsequently expressed at the annual meetings of United Aircraft Corporation,<sup>7</sup> American Telephone & Telegraph Company,<sup>8</sup> Columbia Broadcasting System, Incorporated,<sup>9</sup> General Electric Company,<sup>10</sup> Union Carbide Corporation,<sup>11</sup> Commonwealth Edison Company,<sup>12</sup> Gulf Oil Corporation,<sup>13</sup> and Honeywell Corporation.<sup>14</sup> Often the protest was so intense that the protesters were thrown out of the meetings. Both sides occasionally lost

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4. There is nothing original in this idea. The position that there exists in the United States a private economic state was expounded as early as 1932 in A. BERLE & G. MEANS, *THE PRIVATE CORPORATION AND PRIVATE PROPERTY* (1932).

5. See Wall St. J., April 7, 1970, at 40, col. 1.

6. See McAllister, *Protesters Disrupt BankAmerica Meeting: Fail in Bid To Get Vote on Vietnam Policy*, Wall St. J., March 18, 1970, at 11 col. 2.

7. N.Y. Times, April 15, 1970, at 63, col. 4.

8. N.Y. Times, April 16, 1970, at 63, col. 1.

9. N.Y. Times, April 16, 1970, at 63, col. 5.

10. N.Y. Times, April 23, 1970, at 55, col. 5.

11. N.Y. Times, April 23, 1970, at 55, col. 6.

12. James, *Pollution Protests Fill the Air as 1,000 Pack Commonwealth Edison's Meeting*, Wall St. J., April 28, 1970, at 16, col. 3; *BUS. WEEK*, May 2, 1970, at 94. This was a more organized group than that of the other protesters since it was supported by Saul Alinsky, who led a group known as FIGHT against Eastman Kodak in 1967. See *id.*; Gottschalk, *Kodak's Ordeal—How a Firm That Meant Well Won a Bad Name for Its Race Relations*, Wall St. J., June 30, 1967, at 1, col. 1.

13. Wall St. J., April 29, 1970, at 4, col. 2.

14. Wall St. J., April 29, 1970, at 8, col. 2; *BUS. WEEK*, May 2, 1970, at 98.

their composure. At the Gulf meeting, management, in its heat, forgot to nominate its slate of candidates to the board of directors, and overlooked the election of independent accountants. At the Honeywell meeting the dissidents clamored for recognition to nominate their candidates for directors as soon as the meeting was called to order, although they had been promised an opportunity to speak at the appropriate time. As a result, the chairman promptly adjourned the meeting.

The reform effort at General Motors Corporation was conducted by a group known as the Campaign To Make General Motors Responsible, more popularly known as Campaign GM.<sup>15</sup> It utilized not only the annual meeting to express its views, but also the proxy machinery. While Campaign GM focused on some of the issues raised at other meetings, it also raised issues pertinent to the structure of the decision-making process of corporations. Campaign GM's methods were probably the "most polished"<sup>16</sup> of any of the dissident groups, and the techniques used and the issues raised are likely to arise in the future. If the corporation is to be a focal point for social action and its decision-making process a forum for social questions, then the efforts of Campaign GM offer an opportunity for critical analysis. A study of public-interest confrontations with corporations, and of the public-interest aspect of corporation law, should include a study of Campaign GM.

#### B. *What Was Campaign GM?*

Campaign GM was an effort to obtain shareholder approval of several resolutions through the solicitation of proxies. These resolutions were formally offered by the Project on Corporate Responsibility (Project), a Washington-based nonprofit corporation that owned twelve shares of General Motors common stock. The Project was formed in late 1969 to promote corporate responsibility and to educate management and the public about the social role of corporations. Project leaders believed that a proxy contest with General Motors would afford them an opportunity to gain attention for their efforts and would provide a test of the ability of the corporate and economic system to reform itself. Campaign GM, directed by four young lawyers known as "coordinators," was a specially formed unit to carry out this program. Although nine resolutions were proposed

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15. In this Article "Campaign GM" will be used both to refer to the group of people involved in the project and to the project itself.

16. *BUS. WEEK*, May 2, 1970, at 94.

to management,<sup>17</sup> the campaign was mainly an effort to obtain support for two of them.

The first was a proposal to amend the bylaws of the company to increase the number of directors by three persons.<sup>18</sup> The proposal did not define the types of persons who would be eligible for those seats. Thus, no effort was made to classify public-interest directors. Campaign GM revealed that, if this proposal passed, it intended to nominate for the three newly created directorships Miss Betty Furness,<sup>19</sup> Dr. René Dubos,<sup>20</sup> and the Reverend Channing Phillips.<sup>21</sup> It also made clear that these persons would not be nominated unless the board was enlarged so that none of management's candidates was challenged.

The second was a proposal to create a Shareholders Committee for Corporate Responsibility (Committee).<sup>22</sup> This Committee was to consist of fifteen to twenty-five representatives of a variety of interest areas, and it was to be selected by a three-member selection committee consisting of a representative of the board of directors of General Motors, a representative of the United Auto Workers, and a representative of Campaign GM.<sup>23</sup> It was to act in the nature of a commission, serving for a period of one year and submitting a report directly to the shareholders—rather than to the board of directors—in time for the 1971 annual meeting. The Committee was supposed to gather facts and make recommendations on some basic questions concerning the corporation, such as its role in modern society and its prospects for and possible means of achieving a proper balance between the interests of shareholders, employees, consumers, and the general public. The Committee was also supposed to make recommendations on how the decision-making base of the company could be broadened, and specifically on how directors would be nominated and elected and board committee members selected.

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17. The resolutions are reproduced in Appendix B to this Article.

18. See Appendix B *infra*, proposal 2.

19. Former advisor to President Johnson on consumer affairs.

20. Professor of Environmental Biomedicine, Rockefeller University.

21. Community leader in Washington, D.C. Reverend Phillips was the first black man to be nominated for President at a major-party convention at the Democratic Convention in August 1968.

22. See Appendix B *infra*, proposal 3.

23. This process was criticized by various sources during the campaign as being unfair to management. See *Wall St. J.*, April 14, 1970, at 13, col. 2. Campaign GM agreed to relinquish its right to participate in the selection process if a better process was suggested, and said that it would designate a public-spirited citizen to act as its representative in the committee selection process. Eventually it designated John D. Rockefeller, IV, as its representative. See *Washington Star*, May 13, 1970, at 1, col. 1.

Finally, the Committee would evaluate the company's past and present efforts regarding air pollution, safety, mass transportation, and the manner in which General Motors had used its economic power to contribute to the social welfare of the Nation. In effect, the Committee was designed to conduct a social audit of the company's performance and make recommendations for the future.

The campaign was announced on February 7, 1970, by Ralph Nader at a press conference in Washington, D.C.<sup>24</sup> Nader had no affiliation with Campaign GM or the Project, but he supported their goals. He disclosed that three shareholder resolutions (including the two described above)<sup>25</sup> were being submitted to management for inclusion in the proxy statement to be sent to the shareholders of General Motors. After commenting that the legal structure of the corporation contributed to the growing gap between corporate performance and corporate responsibility, he called for "a new definition of the corporation's constituency."<sup>26</sup> Commenting then upon the position of the shareholders, he stated that in theory they owned the corporation; in fact, they were treated as creditors. The result was that "[t]he procedures, the information, the organization, the manpower and the funds are management's to deploy. But the fiction of shareholder democracy continues to plague the reality. By highlighting the fiction a new reality can be borne that will tame the corporate tiger."<sup>27</sup>

Two weeks later, the Project submitted to General Motors its six other proposals, which it said that it intended to present at the shareholder meeting, and which it requested management to include in its proxy statement. These additional proposals offered specific courses of action dealing with mass transportation, air pollution, auto safety, employee safety, product warranties, and minority opportunity.<sup>28</sup>

The nine resolutions were the distillation of several months' effort, beginning in September 1969, to search for means whereby

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24. The speech was widely reported in the press. *See, e.g.*, N.Y. Times, Feb. 8, 1970, § 1, at 44, col. 1; Wall St. J., Feb. 9, 1970, at 8, col. 2; Washington Post, Feb. 8, 1970, § A, at 2, col. 1. It was also inserted in the *Congressional Record* by Representative Benjamin S. Rosenthal of New York. 116 CONG. REC. E1266 (daily ed. Feb. 24, 1970).

25. The third resolution, for which proxies were solicited, but which was not offered at the meeting, would have amended the certificate of incorporation to prevent General Motors' corporate purposes from being implemented in a manner that violated the law or that was detrimental to the public health, safety, or welfare. *See* Appendix B *infra*, proposal 1.

26. 116 CONG. REC. E1266 (daily ed. Feb. 24, 1970) (statement by Ralph Nader).

27. *Id.*

28. *See* Appendix B *infra*, proposals 4-9.



General Motors could be squarely confronted on the issues of corporate responsibility. General Motors was selected, Nader explained, because of "its massive size and pervasiveness."<sup>29</sup> The initial plan of the coordinators of the campaign had been to nominate Nader for election to the board of directors. A working group to promote Nader's candidacy was formed, consisting of the coordinators, lawyers, researchers, press aides, and the administrative staff of the Project. In mid-January 1970, Nader decided that he would not be a candidate for the board of directors, although he agreed to announce publicly and to support a proxy campaign to raise the issues. Rather than merely seeking another candidate, the coordinators sought other ways to focus on the issues that Nader's candidacy would have represented.

The two resolutions that eventually were presented to the annual meeting were the main vehicles for presenting the issues. The enlargement of the board to include three directors of the type sponsored by Campaign GM dramatized what was claimed to be a too-narrow decision-making base, and the absence from corporate boards of blacks, women, consumer advocates, community activists, and scientists whose interests were largely ecological rather than technological. The proposal to create the Shareholders Committee emphasized the claim that corporate decision-making overemphasized profit concerns and neglected the social impact of corporate activities. Hence, these proposals enabled Campaign GM to bring to public attention all of the areas in which it criticized General Motors and major corporations in general.

Voting at a shareholders meeting is by proxy, of course, but Campaign GM could not solicit proxies from all of the General Motors shareholders. The cost was simply prohibitive; postage costs alone for a single first-class mailing to each shareholder would have been close to 100,000 dollars. The strategy, however, as Nader announced it, was to reach all of the corporation's shareholders. This goal could be accomplished only if the resolutions proposed to be offered at the annual meeting were included in the proxy statement that management mailed to the shareholders. It was thus necessary that the legal machinery for regulating proxy solicitations and conducting shareholder meetings recognize the proposals both as valid subjects for corporate concern and, specifically, as matters of shareholder concern. In this manner, Campaign GM would achieve a legitimacy of presence to force debate and consideration of the issues.

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29. 116 CONG. REC. E1266 (daily ed. Feb. 24, 1970) (statement by Ralph Nader).

Rule 14a-8<sup>30</sup> of the proxy rules of the Securities Exchange Commission (SEC) requires management, subject to certain important exceptions, to include in its proxy statement resolutions proposed to be offered at the annual meeting by shareholders, together with a supporting statement of one hundred words or less. This rule, then, was the instrument Campaign GM chose to present its issues to the shareholders.

General Motors opposed the inclusion in the management proxy statement of any of the resolutions proposed by the Project, claiming that the proxy rules permitted their exclusion.<sup>31</sup> This battle led to wide public interest in the campaign, for when the SEC declared that, in its opinion, the two resolutions dealing with the amendment of the bylaws and the creation of the shareholder committee on corporate responsibility were required to be included in the management proxy statement under rule 14a-8, the news media widely reported the event.<sup>32</sup> Thus, Campaign GM was creating a stir well before the scheduled annual meeting.

Because of the one-hundred-word limitation on the supporting statement, Campaign GM could not rely on management's proxy statement as its sole means of communication to shareholders. The coordinators regarded it as essential that they communicate with the public through the media, and with larger shareholders—particularly

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30. 17 C.F.R. § 240.14a-8 (1969). The rule is reproduced in Appendix A to this Article.

31. Wall St. J., March 6, 1970, at 14, col. 2.

32. See, e.g., N.Y. Times, March 20, 1970, at 1, col. 5; Wall St. J., March 20, 1970, at 5, col. 1; NEWSWEEK, April 27, 1970, at 109; TIME, March 30, 1970, at 88. One reason why this story received more attention than the previous announcements is that the news of the decision of the Securities Exchange Commission (SEC) was revealed at a press conference called by General Motors, rather than at one called by Campaign GM. Editorial comment, which generally was favorable to the decision to require inclusion of the resolutions in the proxy statement, followed the release of the story. See, e.g., Christian Science Monitor, March 21-23, 1970, at 18, col. 1; St. Louis Post Dispatch, March 29, 1970, § C, at 2, col. 1; Washington Post, March 26, 1970, § A, at 16, col. 1.

Subsequent events relating to the campaign were also covered by the national press. A debate at Massachusetts Institute of Technology between Joseph Onek, one of the Campaign GM coordinators, and two representatives of General Motors, emphasized the significant role played by institutional investors. See Mintz, *Colleges' Dilemma, 'Campaign GM' Raises Questions of Stock Investment Policies*, Washington Post, April 13, 1970, § A, at 1, col. 1; N.Y. Times, April 14, 1970, at 23, col. 1; Washington Post, April 14, 1970, § A, at 2, col. 1. At Harvard University, an extensive debate within the university community occurred, as evidenced by the detailed articles in the *Harvard Crimson*. See, e.g., Jacobs, *General Motors Proxy Challenge Catches Harvard in the Middle*, Harvard Crimson, March 3, 1970, at 1, col. 1; Harvard Crimson, April 24, 1970 (entire issue). Congressional support for Campaign GM was reported by the N.Y. Times, May 1, 1970, at 13, col. 1. When the New York City pension funds announced their support for Campaign GM (see text accompanying notes 436-38 *supra*), the story was back on page one of the *New York Times*. N.Y. Times, May 20, 1970, at 1, col. 1.

institutional shareholders, whom they regarded as the focal point in the campaign—through their own proxy statement. Consequently, they prepared a fifteen-page proxy statement, attached a form of proxy, and sent it to approximately 5,000 institutions and brokers. Meanwhile, national attention was much concerned with pollution, one of the major issues raised by Campaign GM. On April 22, 1970, a month before the General Motors annual meeting, there was the nationwide observance of Earth Day.<sup>33</sup> At an early stage in the campaign, President Nixon submitted a legislative proposal dealing with environmental pollution.<sup>34</sup> Scarcely a magazine or a newspaper in the country overlooked the problem of air pollution.<sup>35</sup> Industry, including the automobile industry, announced new plans and programs to deal with air pollution.<sup>36</sup> One result was that Campaign GM became identified in the press as a crusade against automobile air pollution. It was such a crusade, of course, but it was other things as well. The other issues in the campaign tended to become obscured by the attention to the air pollution issue.

Management responded to Campaign GM in a vigorous fashion. Its proxy statement accused the Project of seeking to harass the management and of trying "to promote the particular economic and social views espoused by the proponent of the resolution."<sup>37</sup> Management took the unusual step of enclosing a twenty-one-page booklet entitled *GM's Record of Progress* with its proxy statement. This pamphlet defended management's record in all of the areas of social concern that were part of Campaign GM's program. It also contained an introduction by James Roche, the chairman of General Motors, in which he said, "The Project is using General Motors as a means through which it can challenge the entire system of corporate management in the United States."<sup>38</sup> In addition, on April 10 General Motors published advertisements in about 150 newspapers throughout the country defending its record on air pollution. Man-

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33. BUS. WEEK, April 18, 1970, at 22; N.Y. Times, April 23, 1970, at 1, col. 4.

34. Washington Post, Feb. 11, 1970, § A, at 1, col. 6.

35. E.g., *Fortune's* February 1970 issue was entirely devoted to the environment.

36. See, e.g., Benedict, *Campaign To Clean Up Gasoline May Cause Multibillion-Dollar Headache over a Decade*, Wall St. J., April 8, 1970, at 40, col. 1, describing efforts to reduce exhaust emissions. See also Hill, *Nation Wants To Collect on Detroit's Clean-Air Vows*, N.Y. Times, April 5, 1970, § 11, at 1, col. 2. The degree of the problem is also discussed in N.Y. Times, July 10, 1970, at 1, col. 1.

37. Notice of Annual Meeting and Proxy Statement of General Motors Corp., April 6, 1970, at 19.

38. General Motors Corp., *GM's Record of Progress 1* (1970). This was a theme repeated often by Mr. Roche. He wrote to the regents of the University of California before they voted characterizing Campaign GM as an assault on our system. See Washington Post, April 22, 1970, § A, at 2, col. 7.

agement also telephoned larger shareholders and in other ways made clear that it earnestly desired the support of larger shareholders.<sup>39</sup>

The campaign culminated in Detroit as Campaign GM staged the "First Annual Convention on Corporate Responsibility."<sup>40</sup> On May 21, 1970, the eve of the annual meeting, a rally was held in Cobo Hall at which speakers, including Reverend Phillips, Miss Furness, Dr. George Wald of Harvard, an outspoken critic of the war, and this author, discussed various facets of corporate responsibility and shareholder democracy. The next morning, just prior to the annual meeting, another rally was held in Cobo Hall at which Robert Townsend, former president of Avis and author of *Up the Organization*,<sup>41</sup> spoke on methods of dealing with the major corporations.

The meeting on May 22 lasted a record 6½ hours and was attended by an overflow audience of more than 3,000 shareholders—more than twice the number that had attended the previous meeting.<sup>42</sup> The meeting was largely devoted to Campaign GM's issues, and there were many sharp exchanges between the Campaign's speakers and Mr. Roche, but unlike annual meetings at other companies there was no disruption. General Motors was obviously concerned about the challenge. The customary half-hour film did not discuss new products or profit activities, but rather was almost a point-by-point rebuttal to the charges of irresponsible behavior. The meeting received unusual attention from newspapers, magazines, and tele-

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39. Pearlstine, *Activist Shareholders Provoke GM Offensive for Its Annual Meeting*, Wall St. J., May 21, 1970, at 1, col. 4. Although management never doubted that it would easily defeat the proposals, shareholders were "wooned by management as though a major proxy fight were on. 'We're being treated to a classic example of corporate overkill,' says one bank trust officer who has had intimate exposure to the GM efforts." *Id.*, col. 2. Earlier, the *Wall Street Journal* reported that "GM has been personally contacting many of its larger shareholders urging them to vote in favor of management's recommendations. One Detroit banker, for example, says that GM 'has been putting tremendous pressure on banks' trust departments here to make sure they vote their shares for management.'" *Id.*, April 20, 1970, at 12, col. 1. See also Wargo, *General Motors Defends Policies to Shareholders as Pro-Nader Group and Others Seek Changes*, Christian Science Monitor, April 15, 1970, at 12, col. 3.

40. See Detroit Free Press, May 22, 1970, at 1, cols. 7-8.

41. R. TOWNSEND, *UP THE ORGANIZATION* (1970).

42. The meeting received considerably more press and television coverage than is customary for a shareholders' meeting. More than half of the meeting was spent on Campaign GM's issues. See Detroit Free Press, May 23, 1970, at 1, col. 8; *id.*, at 2, col. 2 ("The shareholders and the management of General Motors Corp., after an unprecedented and broad discussion of its public responsibilities, overwhelmingly defeated Friday attempts which dissidents said would reform the company."); Washington Post, May 23, 1970, § A, at 1, col. 5 ("But few would say that 'Campaign GM' had lost its war to persuade shareholders and the public to start perceiving giant corporations as subgovernments with vast, largely unchecked power over the environment and other great concerns."). See also Carter, *Commotion at GM*, THE NEW REPUBLIC, June 6, 1970, at 8; Kahn, *We Look Forward To Seeing You Next Year*, THE NEW YORKER, June 20, 1970, at 40.

vision.<sup>43</sup> When it was over, each side complimented the other for the manner in which it behaved and this author, speaking on behalf of Campaign GM, informed management that "[w]e look forward to seeing you next year."<sup>44</sup>

The votes on the proposals were announced at the end of the meeting after most of the shareholders had long since departed. Management won overwhelmingly, of course. The proposal for the shareholder committee received 6,361,299 votes, representing 2.73 per cent of the votes cast, from 61,794 shareholders, representing 7.19 per cent of the shareholders voting. The proposal to amend the bylaws was supported by 5,691,130 shares, or 2.44 per cent of the votes cast, and 53,495, or 6.22 per cent of the shareholders voting.<sup>45</sup>

Since the leaders of Campaign GM had, on a number of earlier occasions, announced that they had won the campaign because they had achieved what they wanted—the beginnings of a great national debate on the issues of corporate responsibility<sup>46</sup>—they regarded the meeting almost as an anticlimax. Nonetheless, few in Detroit denied that the meeting had been an important occasion, quite unlike any other shareholder meeting. The feeling prevailed that the campaign had made a significant contribution to corporate life, and that things would not be quite the same as before.

## II. ISSUES RAISED BY CAMPAIGN GM

Campaign GM raised many significant securities law questions at various stages in its development. Paramount among these were the questions concerning the scope of issues that may properly be presented for consideration by the shareholders and the range of methods of solicitation that may be used. Both of these issues are subordinate to the larger legal problem of defining permissible areas of corporate conduct, corporate decision-making, and the conflict between benefits and burdens of corporate ownership. In addition, Campaign GM focused on the role of financial institutions in the public-interest proxy context. The legal issues, of course, are reflec-

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43. See note 42 *supra*.

44. GENERAL MOTORS CORP., SIXTY-SECOND ANNUAL MEETING OF STOCKHOLDERS 220 (1970) [hereinafter Transcript].

45. *Id.* at 218-19. The other shareholder proposals advanced at the meeting, to limit executive compensation and to adopt cumulative voting, each received more votes than Campaign GM's proposals. *Id.* Under rule 14a-8(c)(4) of the SEC proxy rules, 17 C.F.R. § 240.14a-8(c)(4) (1969), Campaign GM's proposals cannot be submitted for three years, if management objects, since they received less than 3% of the total votes cast on the proposal.

46. See, e.g., Washington Post, April 22, 1970, § A, at 2, col. 7: "Campaign GM . . . asserted yesterday that it is winning on all fronts."

tions of larger questions of public policy. Certainly these policy questions are not new, nor have they escaped the concern of contemporary observers of the corporate scene, but it will be useful to examine them in the context of the use of the proxy machinery and of the annual-meeting forum as a means of effecting enlightened social policy.

The primary inquiry must be whether it is viable to deal with questions of social policy through proxy appeals and shareholder meetings. Over the years the machinery of government has been used to deal with public-policy questions. Certainly it appears paradoxical to ask shareholders, who are the beneficiaries of corporate profits, to force the corporation to remedy conditions that result from the quest for profits. The approach seems contrary to human nature. If so, is a public-interest proxy campaign merely a charade to demonstrate a failure in our corporate and economic system rather than an effort to achieve the specific results it ostensibly seeks? Assuredly, some have raised this motive as the underlying issue. On the other hand, it should be observed that there was probably no single dominating motive that brought the various participants of Campaign GM together. The motives may, in truth, be undiscernible. Nonetheless, the campaign may possess an independent validity requiring examination apart from the viewpoints of some or even all of its followers.

#### A. *The Issue of Includibility*

##### 1. *Provisions of Rule 14a-8*

All of Campaign GM's plans turned on being able to include its proposals in management's proxy statement and on the agenda of the annual meeting. The basis for accomplishing these objectives was rule 14a-8 of the SEC's proxy rules,<sup>47</sup> which, as mentioned earlier,<sup>48</sup> requires management to include a shareholder proposal in the management proxy statement<sup>49</sup> with a one-hundred-word sup-

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47. 17 C.F.R. § 240.14a-8 (1969). See Appendix A to this Article for the text of the rule. Paragraphs (a) and (b) give the shareholder his right to include proposals in management's proxy materials. Paragraph (c) qualifies the right, and paragraph (d) describes certain procedures to be followed by the parties.

48. See text accompanying note 30 *supra*.

49. The document distributed to the shareholders is known as management's proxy statement, but this is an unfortunate term. In a contest over control it is perhaps accurate to refer to one document as management's proxy statement and the other as the insurgent's proxy statement, but when control is not at stake, the document is really the "company's" proxy statement, which should not place nonmanagement shareholders in a humble position. It is, of course, paid for by the company, not by management

porting statement. The rule also permits management to exclude shareholder proposals in certain instances.

The rule requires the shareholder to submit his proposal, together with the supporting statement, to management at least sixty days in advance of the day corresponding to the date on which management's proxy material was released in the prior year.<sup>50</sup> If management opposes the inclusion of the resolution in its proxy statement, it must file a statement of its reasons for exclusion with the the SEC at least twenty days before it files its preliminary proxy material and must notify the security holder that it has taken this action. An opinion of counsel is required if management contends that the subject matter is not appropriate for shareholder consideration.<sup>51</sup> The shareholder may respond to management's exclusionary filing with his own written argument.<sup>52</sup>

Although it holds no formal administrative proceedings, the SEC must consider whether the exclusion of the resolution would violate rule 14a-8, and, if so, what the Commission should do about it.<sup>53</sup> The Division of Corporation Finance administers the proxy rules, and it will generally advise both parties by letter that, in its judgment, the rule requires inclusion of the resolution, or that it will recommend that the Commission take no action if management omits the resolution. The letter generally does not set forth any reasons for the conclusions stated therein. In appropriate cases, the Commission reviews its staff's determination, and expresses its view of inclusion or no-action, again without opinion. A view that inclusion is required, however, is not a commitment of agency enforcement.<sup>54</sup>

The argument over includibility concerns the exemptions in paragraph (c) of rule 14a-8. In Campaign GM, attention was focused

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personally. Bayne, Caplin, Emerson & Latcham, *Proxy Regulation and the Rule-Making Process: The 1954 Amendments*, 40 VA. L. REV. 387, 399 (1954) (statement of M. Caplin).

50. Rule 14a-8(a), 17 C.F.R. § 240.14a-8(a) (1969).

51. Rule 14a-8(d), 17 C.F.R. § 240.14a-8(d) (1969).

52. *Id.*

53. The possibilities available to the SEC are (1) commence an administrative proceeding to see if it should issue a declaratory order that exclusion would violate the proxy rules, 5 U.S.C. §§ 554(a), (e) (Supp. V, 1965-1969); (2) determine under 1934 Act § 19(a)(2), 15 U.S.C. § 78s(a)(2) (1964), whether a company's registration under § 12 of the 1934 Act, 15 U.S.C. § 781 (1964), as amended, (Supp. V, 1965-1969), be suspended or withdrawn because of violation of any provision of that statute; or (3) commence an enforcement proceeding in federal district court, probably seeking an injunction to compel inclusion of the resolution in the proxy statement, 1934 Act § 21(e), 15 U.S.C. § 78u(e) (1964). The third alternative is the only practical approach, and it is the only one that the Commission ever employs or seriously considers.

54. See 17 C.F.R. §§ 200.18(b)(3), 200.30-1(e)(4), 202.1-3, 202.5 (1969).

on three subparagraphs of paragraph (c) which provide that inclusion is not required:

(1) If the proposal as submitted is, under the laws of the issuer's domicile, not a proper subject for action by security holders; or

(2) If it clearly appears that the proposal is submitted by the security holder primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the issuer or its management, or primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes; or

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(5) If the proposal consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer.<sup>55</sup>

## 2. *The Function of the SEC*

Under rule 14a-8 the primary issue is whether the shareholder resolution may properly be included in management's proxy materials; the underlying issue is whether management's proxy statement complies with the law and the proxy rules if it fails to include the resolution. Clearly, a shareholder can privately enforce the proxy rules and sue the corporation to compel it to include the disputed resolution.<sup>56</sup> But, if the SEC has taken a no-action position, the shareholder is likely to encounter an attitude in court that defers to the SEC's apparent determination that exclusion is permitted, although technically neither the Commission nor the staff have made any such decision, but have instead made only an enforcement determination that they will not require management to include the resolution.<sup>57</sup> Formerly, the SEC contended that its no-action position was not reviewable agency action under the provisions of the Securities Exchange Act of 1934 (1934 Act).<sup>58</sup> This view was rejected in a decision involving Dow Chemical Company, permitting an appeal

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55. 17 C.F.R. §§ 240.14a-8(c)(1), (2), & (5) (1969). Subparagraphs (3) and (4), 17 C.F.R. §§ 240.14a-8(c)(3), (4) (1969), permit exclusion for reasons not relating to the substance of the resolution.

56. *Mills v. Electric Autolite Co.*, 396 U.S. 375 (1970); *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

57. *See, e.g., Brooks v. Standard Oil Co.*, 308 F. Supp. 810 (S.D.N.Y. 1969); *Curtin v. American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D.N.Y. 1954); *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951).

58. 1934 Act § 25(a), 15 U.S.C. § 78y(a) (1964), provides, in pertinent part:

Any person aggrieved by an order issued by the Commission in a proceeding under this chapter to which such person is a party may obtain a review of such order . . . in the United States Court of Appeals for the District of Columbia [Circuit], by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part.



from a no-action determination.<sup>59</sup> The availability of judicial review was limited in that case, however, since the court's jurisdiction was recognized to be dependent upon the SEC's initial determination to review the staff decision.<sup>60</sup>

The SEC does recognize the necessity, of course, of making internal decisions so that it can fulfill its function in advising the public about the law, and so that it knows whether and when to bring enforcement proceedings. For years this decision-making has been done by means of the no-action letter, which Professor Kenneth Davis considers to be a law-making function.<sup>61</sup> Thus, paragraph (d) of rule 14a-8, requiring that management file with the SEC a statement of its reasons for omitting the resolution,<sup>62</sup> was inserted into the rule to allow the Commission sufficient time to consider the correctness of management's decision to exclude a resolution.<sup>63</sup> The SEC has made it clear that the burden of proof is on management to show why the proposal should be omitted.<sup>64</sup>

The Commission's decisions, in whatever form they appear, are generally obeyed by the parties. The SEC has brought only one enforcement proceeding in the twenty-eight-year history of rule 14a-8.<sup>65</sup> Three cases have been brought against issuers,<sup>66</sup> and two appeals have been taken against the SEC, out of perhaps 1,000 shareholder proposals that have been rejected.<sup>67</sup>

While "the law" of what resolutions must be included in management's proxy statement ultimately is a question of what a court

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59. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970).

60. 432 F.2d at 675.

61. Symposium, *Public Information Act and Interpretative and Advisory Rulings*, 20 ADMIN. L. REV. 1, 29 (1967) (remarks of Professor Kenneth Davis).

62. 17 C.F.R. § 240.14a-8(d) (1969). See text accompanying note 51 *supra*.

63. SEC Securities Exchange Act of 1934 Release No. 4979 (Jan. 6, 1954), 19 Fed. Reg. 246 (1954).

64. *Hearings on a Report from the SEC on Its Problems in Enforcing the Securities Laws Before a Subcomm. of the Senate Comm. on Banking and Currency*, 85th Cong., 1st Sess., pt. 1, at 118 (1957) (statement of Chairman J. Sinclair Armstrong) [hereinafter 1957 *Hearings*].

65. *SEC v. Transamerica Corp.*, 163 F.2d 511 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948).

66. *Brooks v. Standard Oil Co.*, 308 F. Supp. 810 (S.D.N.Y. 1969); *Curtin v. American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D.N.Y. 1954); *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951).

67. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970); *Dyer v. SEC*, 266 F.2d 33 (8th Cir.), *cert. denied*, 361 U.S. 835 (1959). This estimate of the number of rejected proposals may even be conservative. According to the annual reports of the SEC from 1956 to 1969, the total was 826; from 1943 to 1955 the reports contained no statistics concerning rejected proposals.

will enforce,<sup>68</sup> obviously "the law," from a practical standpoint, means something more rudimentary in this context. Counsel must advise their clients, whether they be shareholders or management, what is the likely position of the SEC.<sup>69</sup> What further complicates matters is that the question of includibility is a mixed question of federal and state law. Subparagraph (c)(2) of rule 14a-8 seeks to ascertain the proponent's purpose to see if it is one, as a matter of federal securities law, that precludes his access to management's proxy statement. But the larger questions are whether the resolution relates to a question that is not a proper subject for action by shareholders (subparagraph (c)(1)), or whether it concerns a matter relating to the conduct of ordinary business (subparagraph (c)(5)). A finding that either one of these latter conditions exists would allow management to exclude the resolution. And the question under both of these subparagraphs is one of state law.<sup>70</sup>

The problem with the standards of subparagraphs (c)(1) and (c)(5), as Professor Loss notes, is "that there is simply not very much state law to use as a guide in these matters."<sup>71</sup> Consequently, in the search for state law, the SEC has developed its own common law defining what is a proper subject for action by shareholders or what constitutes the ordinary business operations of the corporation.<sup>72</sup> This law-making procedure again emphasizes the significance of the SEC's findings concerning which resolutions may be excluded. Clearly the SEC's role in proxy contests has greater importance as a result of the Dow Chemical case,<sup>73</sup> and that case may likewise give the federal courts a larger role since some SEC rulings can be appealed.<sup>74</sup> More judicial review should in turn stimulate the articula-

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68. O. HOLMES, JR., *The Path of the Law*, in COLLECTED LEGAL PAPERS 167, 169 (1920). See B. CARDOZO, *THE GROWTH OF THE LAW* 21-55 (1924).

69. Judge Frank noted that "the practice of law has been aptly termed an art of prediction." J. FRANK, *LAW AND THE MODERN MIND* 51 (1963).

70. See *SEC v. Transamerica Corp.*, 163 F.2d 511, 514-15 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948); *1957 Hearings*, *supra* note 64, at 118 (statement of chairman J. Sinclair Armstrong).

71. 2 L. LOSS, *SECURITIES REGULATION* 905 (2d ed. 1961).

72. *Id.* at 906, 909 n.200; *Crown Cork & Seal Co., Inc., A Minute of a Meeting of the SEC*, Feb. 28, 1964, reprinted in W. CARY, *CASES AND MATERIALS ON CORPORATIONS* 327 (4th ed. 1969).

73. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970).

74. The court in the *Medical Committee* case held not only that the petitioner in that case was a party "aggrieved" by an "order" of the SEC for purposes of § 25(a) of the 1934 Act, 15 U.S.C. § 78y(a) (1964) (*see* note 58 *supra*), despite the seeming informality and lack of finality that characterized the SEC's no-action procedure with respect to the proposed resolutions (432 F.2d at 665-72), but also that judicial review was not barred by § 10 of the Administrative Procedure Act, 5 U.S.C. § 1009(2) (1964), *as amended*, 5 U.S.C. § 701(a)(2) (Supp. V, 1965-1969), which prohibits judicial review

tion by the SEC of the reasons for particular decisions.<sup>75</sup>

The determination that a resolution is a proper matter for inclusion in the proxy statement subsumes the question of what matters may properly be brought before the annual shareholder meeting. If the resolution is excluded, management can use its discretionary authority under the proxy rules to vote against the proposal if it is introduced,<sup>76</sup> and it can even keep the matter off the agenda and rule it out of order at the meeting.<sup>77</sup> Therefore, the significant question to consider in a public-interest proxy contest is what questions are proper matters for inclusion in the proxy statement within the meaning of rule 14a-8.

### 3. *The Development of Rule 14a-8*

Resolution of the question whether issues involving the public interest can come before a shareholder meeting requires an assessment of the meaning of rule 14a-8 in light of some recent developments. The exercise is largely an effort to understand what subparagraph (c)(2) of the rule means when it allows management to omit a proposal that "clearly appears" to be submitted "primarily for the purpose of promoting general economic, political, racial, religious, social

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of matters "committed to agency discretion" (432 F.2d at 673-76). The court stated that here, the full Commission has exercised its discretion to review this controversy, and . . . has ostensibly acted in accord with a very dubious legal theory. The Medical Committee asks us merely to examine this allegedly erroneous legal premise and return the controversy to the Commission so that it may properly exercise its further discretion regarding the propriety and desirability of enforcement activity.

Limited and partial review to examine the legal framework within which administrative discretion must be exercised . . . has been repeatedly sustained . . . . 432 F.2d at 674-75.

75. See *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 674 (D.C. Cir. 1970).

76. Rule 14a-4(c)(4), 17 C.F.R. § 240.14a-4(c)(4) (1969), permits shareholders, by proxy, to confer discretionary authority upon management to vote with respect to "[a]ny proposal omitted from the proxy statement and form of proxy pursuant to § 240.14a-8 [rule 14a-8] or § 240.14a-9 [rule 14a-9]." Campaign GM argued to the SEC that a shareholder could consistently vote both management's proxy and its proxy and that in that event the discretionary authority given management should not prevail over a specific vote in favor of a resolution that was ultimately excluded under rule 14a-8. The staff of the Division disagreed with this position and said rule 14a-4 allowed management to vote against the proposal. Communication to the author from Mr. Carl Bodolus, Branch Chief, Div. of Corp. Fin., SEC.

77. Chairman Fred Borch of General Electric Co. ruled out of order at an annual meeting resolutions dealing with the environment, defense business, and alleged strike-breaking, on the advice of counsel that these measures could not be voted on since the majority of shareholders did not have an opportunity to study them. *N.Y. Times*, April 23, 1970, at 63, col. 5. This dubious ruling shows how management can dominate the subject matter of the meeting unless the shareholder can succeed in getting his resolution included under rule 14a-8.

or similar causes." At the same time, it is necessary to determine which public-interest proposals are, "under the laws of the issuer's domicile, not a proper subject for action by security holders" within the meaning of subparagraph (c)(1) of the rule, or are matters relating to the conduct of "ordinary business operations" under subparagraph (c)(5), since public-interest proposals face the possibility of being excluded under those provisions as well as under subparagraph (c)(2).

Thoughts of shareholder proposals surely were distant from Congress' mind when it adopted the 1934 Act.<sup>78</sup> True, the congressional reports spoke of furthering "fair corporate suffrage"<sup>79</sup> and of facilitating the consideration of "major questions of policy,"<sup>80</sup> but nothing in the legislative history suggests that Congress intended to provide a means by which shareholders could use the company proxy statement to present their proposals. Misuse of the proxy machinery by management was the real concern—Congress was well aware of the power wielded by managers and of the separation of ownership from control.<sup>81</sup> But the 1934 Act does charge the SEC with responsibility for promulgating rules necessary or appropriate either "in the public interest"<sup>82</sup> or "for the protection of investors,"<sup>83</sup> thus giving the Act enough breadth to encompass the regulation of shareholder proposals.

The history of shareholder proposals in proxy statements predates the adoption of a formal rule. In 1938 under the antifraud<sup>84</sup> rule, the Commission staff maintained that if management had been notified by a shareholder that he intended to propose a resolution at the annual meeting, management's proxy statement could not omit the proposal and then add the usual recital that management was unaware of any other business to come before the meeting.<sup>85</sup> Similarly, management could not omit the proposal and at the same

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78. Securities Exchange Act of 1934, ch. 404, 48 stat. 881, *as amended*, 15 U.S.C. §§ 78a-hh-1 (1964), *as amended*, (Supp. V, 1965-1969).

79. H.R. REP. No. 1383, 73d Cong., 2d Sess. 13 (1934).

80. S. REP. No. 792, 73d Cong., 2d Sess. 12 (1934).

81. *See* H.R. REP. No. 1383, 73d Cong., 2d Sess. 5, 13-14 (1934); *Hearings on H.R. 8720 and 7852 Before the House Comm. on Interstate and Foreign Commerce*, 73d Cong. 2d Sess. 140 (1934) (testimony of Mr. Thomas Corcoran, one of the draftsmen of the Act).

82. 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1964).

83. 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1964).

84. Rule X-14A-5, SEC Securities Exchange Act of 1934 Release No. 1823 (Aug. 11, 1938).

85. Dean, *Non-Compliance with Proxy Regulations—Effect on Ability of Corporation To Hold Valid Meeting*, 24 CORNELL L.Q. 483, 499 (1939).

time obtain discretionary authority to vote against it, nor could it use its discretionary authority for the more limited purpose of obtaining a quorum and then relying on those present to vote down the proposal.<sup>86</sup>

In late 1942, the SEC adopted rule X-14A-7,<sup>87</sup> the predecessor of rule 14a-8, and the rule instantly encountered such hostility that bills were introduced in Congress to suspend its effectiveness. At the hearings before the House Interstate and Foreign Commerce Committee, Chairman Purcell explained an underlying reality that prompted the adoption of the rule:

Once a shareholder could address the meeting, today he can only address the assembled proxies which are lying at the head of the table. The only opportunity that the stockholder has of expressing his judgment comes at the time when he considers the execution of the proxy form, and we believe, whether we are right or whether we are wrong—and I think we are right—that that is the time he should have the full information before him and the ability to take action as he sees fit.

The proxy solicitation is now in fact the only means by which a stockholder can act and can perform the functions which are his as owner of a corporation. It, therefore, seems clear to us that only by making the proxy a real instrument for the exercise of those functions can we obtain what the Congress and this committee called for in the form of "fair corporate suffrage."<sup>88</sup>

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86. Freeman, *An Estimate of the Practical Consequences of the Stockholder's Proposal Rule*, 34 U. DET. L.J. 549, 550 (1957). The SEC emphasized the need to describe proposals that were to be presented at the meeting if the proxies were to be used in a way that could affect disposition of the proposal in SEC Securities Exchange Act of 1934 Release No. 2376 (Jan. 12, 1940).

87. SEC Securities Exchange Act of 1934 Release No. 3347 (Dec. 18, 1942), 7 Fed. Reg. 10,655-56 (1942).

88. *Hearings on H.R. 1493, H.R. 1821, and H.R. 2019 Before the House Comm. on Interstate and Foreign Commerce, 78th Cong., 1st Sess., pt. 2, at 174-75 (1943) [hereinafter 1943 Hearings]*.

One scholar has recently commented that "the proxy system has developed to the point where it not merely leads up to but supplants the shareholders' meeting for most substantive purposes, and in some respects, for formal purposes as well." Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489, 1494 (1970). See Bernstein & Fisher, *The Regulation of the Solicitation of Proxies: Some Reflections on Corporate Democracy*, 7 U. CHI. L. REV. 226, 227 (1940); Caplin, *Shareholder Nominations of Directors: A Program for Fair Corporate Suffrage*, 39 VA. L. REV. 141, 159 (1953).

Commissioner O'Brien explained to the Conference Board, in a speech in New York, on January 21, 1943, a month after the rule was adopted:

It seems to me that the heart of the problem lies in the failure of corporate practice to reproduce through the proxy medium an annual meeting substantially equivalent to the old meeting in person. I know that the old-fashioned meeting cannot be revived. Admittedly, that is impossible. It is not impossible, however, to utilize the proxy machinery to approximate the conditions of the old-fashioned meeting.

Address of Robert H. O'Brien, Commissioner, SEC, Before The Conference Board, New

The new rule permitted shareholders to propose resolutions only if they were "proper subject[s] for action by the security holders."<sup>89</sup> Some members of Congress were worried about the politicalization of the proxy statement. They expressed fears that radical proposals could be offered under the rule, and that the one-hundred-word statement might be used as a propaganda vehicle.<sup>90</sup> The SEC appeared untroubled by these doubts. Chairman Purcell said that the Commission could not be concerned with the wisdom of the proposal offered.<sup>91</sup> Baldwin Bane, who was the Director of the Division of Corporation Finance, acknowledged that the rule did not necessarily prohibit radical proposals, stating that such proposals could be a proper subject for shareholder action.<sup>92</sup>

Clearly, it was necessary for the Commission to develop an understanding of what was a "proper subject" within the meaning of the rule. Two events were particularly significant in the rule's early development. In 1947 the United States Court of Appeals for the Third Circuit, in the *Transamerica* case,<sup>93</sup> affirmed the view that the determination of a "proper subject" is to be made under state law. In that case, the shareholder had proposed resolutions for independent auditors to be elected by shareholders, for amendment of the bylaws to eliminate a requirement that notice of a proposed amendment of the bylaws be contained in the notice of meeting, and for a requirement that a report of the proceedings of the annual meeting be sent to shareholders. The court found that each of these proposals was a subject "in respect to which stockholders have the right to act under the General Corporation Law of Delaware."<sup>94</sup> Under *Transamerica's* bylaws, the resolutions could not be voted upon because the proponents failed to comply with the provision requiring that notice of the proposals be contained in the notice of meeting, but the court said that this "minor provision" could not be used to frustrate "the intent of Congress to require fair opportunity for the operation of corporate suffrage."<sup>95</sup>

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York City, Jan. 21, 1943, at 3. A former Chairman of the SEC quoted this passage in a recent speech. Remarks of Hamer H. Budge, Chairman, SEC, Before the Am. Soc. of Corporate Secretaries, White Sulphur Springs, W. Va., June 12, 1970, at 11.

89. Rule X-14A-7, 7 Fed. Reg. 10,656 (1942).

90. 1943 Hearings, *supra* note 88, at 161, 225.

91. 1943 Hearings, *supra* note 88, at 180.

92. *Id.* at 225.

93. SEC v. *Transamerica Corp.*, 163 F.2d 511 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948).

94. 163 F.2d at 518.

95. 163 F.2d at 518. See *Analysis: An Examination of the Stockholder Proposal*

Reference to state law, as noted earlier,<sup>96</sup> presents problems because of the paucity both of state statutory provisions and of judicial decisions on point. As a result, federal common law has developed as a substitute. All state statutes are clear, however, that "the business and affairs of a corporation shall be managed by a board of directors."<sup>97</sup> This provision enables management to argue in almost every case that the resolution invades the province of the board. While this argument clearly proves too much, as shown by the *Trans-america* case, the SEC, in the development and administration of rules X-14A-7 and 14a-8, has been mindful of the necessity to avoid stripping the board of its basic governing function.

An event of greater significance to the public-interest proxy contest was Mr. Bane's private interpretation of rule X-14A-7 which the SEC made public on January 3, 1945, in the oft-cited Release Number 3638.<sup>98</sup> Resolutions had been submitted to a company asking first, that dividends paid to shareholders should be free of federal income tax; second, that the antitrust laws and their enforcement be revised; third, that all ensuing federal legislation providing for workers and farmers to be represented should be made to apply equally to investors. The SEC staff agreed with the company that all of the proposals could be omitted from the company's proxy statement as not "proper subjects" within the meaning of rule X-14A-7. The purpose of the rule, said Mr. Bane, was to

place stockholders in a position to bring before their fellow shareholders matters of concern to them as stockholders in such corporation; that is, such matters relating to the affairs of the company concerned as are proper subjects for stockholders' action under the laws of the state under which it is organized. It was not the intent of [the rule] to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a *general* political, social or economic nature. Other forums exist for the presentation of such views.<sup>99</sup>

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*Provisions of the Proxy Rules*, BNA SEC. REG. & L. REP. No. 41, at B-1, B-8 (March 11, 1970).

96. See text accompanying note 71 *supra*.

97. ABA-ALI MODEL BUS. CORP. ACT. § 33 (1966). The Delaware statute adds "except as may be otherwise provided in this chapter or in its certificate of incorporation." DEL. CODE ANN. tit. 8, § 141(a) (Supp. 1968). The principal draftsman of that statute, Professor Ernest L. Folk, has observed that in Delaware the corporation "enjoys the broadest grant of power in the English-speaking world to establish the most appropriate internal organization and structure for the enterprise." E. FOLK, AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW 5 (1969).

98. SEC Securities Exchange Act of 1934 Release No. 3638 (Jan. 3, 1945), 11 Fed. Reg. 10,995 (1946).

99. *Id.* (Emphasis added).

The ruling draws a contrast between those questions over which the corporate body has power to act—and hence are of interest to it in its corporate capacity—and those questions over which the corporation has no power to take any action—and hence belong in another forum because they are of *general* interest to citizens. All of the resolutions described in the release fell into this latter category since their adoption by the shareholders could not affect the areas in question.

In 1948, the SEC amended rule X-14A-7 to permit management to exclude a proposal if it was proposed primarily “for the purpose of enforcing a personal claim or of redressing a personal grievance against the issuer or management . . . .”<sup>100</sup> This amendment was the first hint that “purpose” was relevant to the includibility of a resolution, and although it seems clear that the Commission intended to shield management from harassment,<sup>101</sup> it was not explained how this objective related to the “purpose” of a proposal.

Purportedly relying on Mr. Bane’s 1945 interpretation, a federal district court in 1951 sustained a no-action determination by the SEC staff that permitted the Greyhound Corporation to exclude a shareholder proposal that had recommended the abolition of the “segregated seating system in the South.”<sup>102</sup> The shareholder sought to compel the inclusion of the proposal in management’s proxy statement by bringing suit in the federal district court, but the court found that the shareholder had not exhausted his administrative remedies.<sup>103</sup> The court added that, on the proof before it, there was no basis to overrule the agency’s interpretation of the rule. Clearly there was no *de novo* review of the question.

Contemporaneous comment supported the Greyhound decision on fairly narrow grounds. One commentator pointed out that the decision was clearly correct because the proponents had asked the company to take action that was illegal under state law; thus the appropriate forum for such action was the state legislature.<sup>104</sup> An-

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100. SEC Securities Exchange Act of 1934 Release No. 4185 (July 6, 1948), 13 Fed. Reg. 6678-79 (1948).

101. *Id.*; Address of Edward McCormick, Commissioner, SEC, Before the Am. Soc. of Corporate Secretaries, May 13, 1950, cited in Ledes, *A Review of Proper Subject Under the Proxy Rules*, 34 U. DET. L.J. 520, 522 n.11 (1957).

102. *Peck v. Greyhound Corp.*, 97 F. Supp. 679, 680 (S.D.N.Y. 1951).

103. 97 F. Supp. at 680. The Commission’s determination was made by an assistant director of the Division of Corporation Finance. 97 F. Supp. at 680.

104. Note, *Rule X-14A-8 of the SEC: Stockholder Participation in Corporate Affairs*, 47 Nw. U. L. REV. 718, 719-20 (1952). The writer of this Note cautioned against reading the case to bar proposals that relate to company policy but also raise controversial political, social, or economic questions.



other comment noted that the resolution was excessive since it was not limited to the company's activities but sought to end segregation "in the South."<sup>105</sup> Although the SEC gave no indication that it was seeking to enlarge the 1945 Bane interpretation in the Greyhound case, it appears to have done so. The resolutions excluded in 1945 dealt with subjects with which the corporation was powerless to deal; they barely related to the corporation, and certainly did not relate to any practices of the corporation. The Greyhound Corporation shareholders, on the other hand, were asked to condemn a practice actually engaged in by their company, and although it may have been necessary to go to the state legislature or the state courts in order fully to effectuate that expression, nonetheless an act of will by the corporation was also required. In short, the Greyhound case presented a mixed question of corporate policy and social policy, but the SEC saw it only as a question of social policy. Rightly or wrongly, the Commission went beyond the 1945 Bane interpretation.<sup>106</sup>

In 1952, the SEC adopted the present language of subparagraph (c)(2).<sup>107</sup> Mr. Bane, still Director of the Division of Corporation Finance, explained that the purpose of the 1952 amendment was to codify Release Number 3638.<sup>108</sup> However, he offered no explanation for the decision to express that limitation in a provision that made ineligibility turn on the purpose for which a proposal was submitted.

The SEC tightened rule 14a-8 in 1954,<sup>109</sup> so that, according to

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105. Emerson & Latcham, *The SEC Proxy Proposal Rule: The Corporate Gadfly*, 19 U. CHI. L. REV. 807, 833 (1952). This interpretation was noted approvingly in *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 677-78 (D.C. Cir. 1970).

106. A letter to the SEC from the American Jewish Congress, June 11, 1952, in SEC File No. S 7-35-6-1, pointed out this extension by the *Peck* case of Release No. 3638. The letter also asserted that the company would not rely on state law since the law did not require segregated seating on buses in interstate commerce, *Morgan v. Virginia*, 328 U.S. 373 (1946), and that segregated seating had been abolished in some cases at that time. *Chance v. Lambeth*, 186 F.2d 879 (4th Cir.), *cert. denied*, 341 U.S. 941 (1951).

107. SEC Securities Exchange Act of 1934 Release No. 4775 (Dec. 11, 1952), 17 Fed. Reg. 11,431, 11,433 (1952), codified in 17 C.F.R. § 240.14a-8(c)(2) (1969).

108. Letter from Baldwin Bane, Director, Div. of Corp. Fin., SEC, to John Mathis, Vice President, Am. Soc. of Corporate Secretaries, Feb. 4, 1952, in SEC Docket File No. S 7-35-6-2, in which he stated that the rule was designed to write into the exclusion under rule 14a-8 "the substance of Exchange Act Release No. 3638 . . ."

109. SEC Securities Exchange Act of 1934 Release No. 4979 (Jan. 6, 1954), 19 Fed. Reg. 246 (1954). Hearings were held on the amendments and some feared the "death knell" of shareholder proposals. See 2 L. LOSS, *SECURITIES REGULATION* 912 (2d ed. 1961); Bayne, Caplin, Emerson & Latcham, *Proxy Regulation and the Rule Making Process: The 1954 Amendments*, 40 VA. L. REV. 387 (1954). The amendments specifically added the reference in subparagraph (c)(1) (17 C.F.R. § 240.14a-8(c)(1) (1969)) to state law

Chairman Ralph Demmler, it would "use a screen with a somewhat closer mesh."<sup>110</sup> While some proposals had previously been included in managements' proxy statements because they were expressed as recommendations,<sup>111</sup> and hence deferred to the boards' decision-making power, the new amendment added subparagraph (c)(5) to preclude even recommendations or requests when they related to the conduct of ordinary business operations.<sup>112</sup> The determination of what constituted "ordinary business operations" was a subject to be decided under state law just as was the question of what constituted a "proper subject" under subparagraph (c)(1).<sup>113</sup>

Thus, by the 1952 and 1954 amendments the SEC made clear that it meant to deny shareholders access to the company's proxy statement either for a resolution constituting corporate action, when state law reserved the matter to the board, or for a resolution recommending board action on ordinary business matters. On the other hand, shareholder *recommendations* on *policy* questions or action on matters not exclusively reserved for board action would presumably avoid the Scylla of (c)(1) and the Charybdis of (c)(5),<sup>114</sup> although the purpose test of (c)(2) could still prove to exclude the proposal.

The SEC's interpretations are the common law of rule 14a-8, even though no compendium of rulings is published, and, at least in the past, no reasons were stated for the Commission's conclusion in any given case.<sup>115</sup> Few decisions under the rule have specifically

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as the authority for determining "proper subject." The intent was to reinforce the *Transamerica* case. Memorandum from Byron D. Woodside, Dir., Div. of Corp. Fin., SEC, Dec. 8, 1953, in SEC Docket No. S 7-65-6.

110. Demmler, *Current Thinking at the SEC*, 178 COM. & FIN. CHRON. 1227, 1267 (1953).

111. 2 L. Loss, *supra* note 109, at 908.

112. 17 C.F.R. § 240.14a-8(c)(5) (1969).

113. 1957 *Hearings*, *supra* note 64, at 118 (statement of Chairman J. Sinclair Armstrong).

114. This is because state law would permit the shareholder to vote on such matters and to call a special meeting for such purpose. See, e.g., *In re Auer v. Dressel*, 306 N.Y. 427, 432-33, 118 N.E.2d 590, 593 (1954).

115. The Commission's rather informal administration of the rule has been sharply criticized by a former staff lawyer for its inconsistency, its development of weak law, and its failure to inform the public of the standards being applied. Clusserath, *The Amended Stockholder Proposal Rule: A Decade Later*, 40 NOTRE DAME LAW. 13, 40-42 (1964). Others have criticized the SEC for ever having adopted the rule, as seen, for example, by the House hearings that were ignited by its adoption. See notes 87-90 *supra* and accompanying text. When hearings were held before the SEC in 1953, the first witness expressed a preference for repeal. *In re Conference on Proxy Rules*, Dec. 16, 1953, in SEC Docket No. S 7-65-1, at 29 (testimony of Mr. George Brownell, appearing on behalf of American Telephone & Telegraph Co.) This has also been the position of the American Society of Corporate Secretaries. See Emerson, *Some Sociological and Legal*

concerned public-interest questions. Most cases have dealt with such matters as cumulative voting, executive compensation, appointment of auditors, pre-emptive rights, post-meeting reports, and the place of the annual meeting.<sup>116</sup> The most notable exclusions of political or social questions have been the Greyhound case<sup>117</sup> and the Dow Chemical case.<sup>118</sup> However, as the court of appeals observed in the Dow case, it is not clear whether the SEC agreed with Dow management that they could exclude the proposal to amend the certificate of incorporation restricting the sale of napalm because the proposal was "too general" under subparagraph (c)(2) in dealing with a political or social question, or "too specific" under subparagraph (c)(5) in dealing with a matter of ordinary business operations.<sup>119</sup> The court thought that the possibility of omission under (c)(2) "appears somewhat more substantial,"<sup>120</sup> but the case was remanded to the SEC so that the Commission could decide the issue with sufficient reviewable detail.<sup>121</sup>

Under subparagraph (c)(2), the SEC has permitted an investment company to exclude a proposal that it cease its investment in liquor stocks, and has permitted another company to exclude a proposal that women be extended the same pension benefits as men.<sup>122</sup> The Commission has, on the other hand, indicated the nonincludibility of resolutions that would prohibit charitable contributions by companies,<sup>123</sup> even when it was shown that the proposal was motivated by shareholder concern about giving support to the views of economics professors whose universities were benefited by the charity.<sup>124</sup> The Commission has also permitted a resolution to allow shareholder nomination of directors.<sup>125</sup> While this latter proposal may not appear

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*Aspects of Institutional and Individual Participation Under the SEC's Shareholder Proposal Rule*, 34 U. DET. L.J. 528, 530 (1957). See also Chilgren, *A Plea for Relief from Proxy Rule 14a-8*, 19 BUS. LAW. 303 (1963).

116. 2 L. Loss, *supra* note 109, at 906-07; 35 SEC ANN. REP. 47 (1969).

117. *Peck v. Greyhound Corp.*, 97 F. Supp. 679 (S.D.N.Y. 1951).

118. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970).

119. 432 F.2d at 679.

120. 432 F.2d at 680.

121. 432 F.2d at 682.

122. Heller, *Corporate Democracy: Stockholder Proposals*, 4 VA. L. WEEKLY DIGEST COMP. 72, 73-74 (1953).

123. 35 SEC ANN. REP. 47 (1969) describes proposals seeking to limit charitable contributions as among those most commonly advanced.

124. Monaghan, *Annual Stockholders' Meetings: Some Legal and Practical Problems*, 16 BAYLOR L. REV. 129, 135 (1964).

125. This issue related to the Illinois Central Railroad. *Emerson & Litcham*, *supra* note 109, at 818-19.

to be a political or social question, social activity may focus on the corporation's decision-making process and such a resolution may be motivated by social or political concerns.<sup>126</sup>

Subparagraph (c)(2) of the rule speaks of excluding proposals that are advanced "primarily for the purpose of promoting" certain causes. It is far from clear what is meant by "purpose" or "primarily" in this context, or how this fact is to be determined, and the pre-General Motors cases have not proved particularly instructive.

In general, the law seeks to avoid an exploration of mental state. While the law of contracts, for example, seeks to carry out the intent of the parties, "intent" in this sense means manifestation of intent, which can be very different from subjective desire or motive.<sup>127</sup> Similarly, an agent's authority is determined by the "principal's manifestations of consent to him,"<sup>128</sup> not by the principal's motive. Often the meaning of a statute depends on the legislative "intent," but the inquiry does not pursue the reason why the legislature acted, but rather it seeks to plumb what effect the body sought.<sup>129</sup> To be sure, the distinction between "intent," "motive," and "purpose" is subtle and difficult to grasp; unfortunately, the terms are often used interchangeably.

There are times, however, when legal consequences depend on mental state. The criminal law is the best example. In other situations in which we speak of "motive"—which is apparently a measure of mental state—we may not in fact be examining mental state, but rather ascertaining objectively determinable effect, which we will construe to be the equivalent of motive. Thus, in deciding whether a taxpayer has the wrong "purpose" or "principal purpose," as used in various sections of the Internal Revenue Code, courts and commentators speak of "motive" and "purpose" as if they were the same thing, but proof is based upon objective behavioral facts—what was done and what was the tax effect.<sup>130</sup>

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126. Paragraph 3(E) of the proposal to create the General Motors Shareholders Committee for Corporate Responsibility called for a report on increasing the "diverse sectors of society in corporate decision-making," and "including *nomination* and election of directors" (emphasis added). See Appendix B *infra*, proposal 3.

127. See generally O. HOLMES, JR., *THE COMMON LAW* 334-35 (1881).

128. *RESTATEMENT (SECOND) OF AGENCY* § 7 (1958).

129. The classic case is *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 131 (1810), in which the Supreme Court disregarded the fact that the legislature was bribed as the probable motive for its action. The first Justice Harlan, dissenting in *New York v. Roberts*, 171 U.S. 658, 681 (1898), said, "In a legal sense the object or purpose of legislation is to be determined by its natural and reasonable effect, whatever may have been the motives upon which legislators acted."

130. Examples are *INT. REV. CODE* of 1954, §§ 269, 532, & 1551, in which adverse

The syntax of rule 14a-8(c)(2) suggests that includibility of a proposal is supposed to depend on the dominant motive of the proponent. One may be initially inclined to read "purpose" as the "effect" of a resolution, and hence confine his thinking to the language of the proposal. One would then determine whether the effect is to bring before the shareholders a question with which they are empowered to deal. But it is difficult to pursue this line of inquiry in the face of "primarily," which qualifies "purpose." In any given case, the resolution would either deal with a matter of shareholder concern, or it would not. Objectively, if one were measuring only "effect," a proposal could not be "primarily" a question for the shareholders and "secondarily" not, or vice versa. But there can be primary and secondary reasons for action. Thus, by inserting "primarily" in the sentence, it appears that the SEC intended to direct the inquiry into the reasons *why* a resolution was advanced—in other words, the proponent's motive is the test. Then, in order for the proposal to be excluded, it must "clearly" appear that the improper motive is the primary one.

But syntax alone suggests this interpretation. Bane's 1945 ruling never examined or mentioned motive—it was addressed entirely to the effect of the proposal<sup>131</sup>—and he claimed in 1952 to be codifying the earlier release.<sup>132</sup> More significantly, perhaps, there is no mechanism created or existing within the SEC procedures to ascertain motive. When the law does inquire into mental state, available machinery usually exists for it to do so.<sup>133</sup> The Commission is furnished only with documents and an opinion of counsel to make a decision whether the proposal must be included in the proxy statement. The only thing it can rationally decide is whether the language of the proposal is proper for shareholders; motive, on the evidence before the Commission, is entirely speculative.<sup>134</sup> True, this reading

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tax consequences can flow from conduct having been undertaken for the wrong "principal purpose" or "purpose." Motive and purpose seem to be used to mean the same thing. See B. BITTKER & J. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* 212-19, 638-40, 673-79 (2d ed. 1966).

131. See text accompanying notes 98-99 *supra*.

132. See note 108 *supra* and accompanying text.

133. Mental state, of course, is a fact, and it must be determined by a trier of facts. Perhaps the best example is a criminal trial, in which mental state may be a fact which determines guilt, or its degree. The issue is decided at trial when evidence is furnished in accordance with rules, and both direct examination and cross-examination are available to the parties.

134. Not only would "motive" have to be divined without the mechanics of a hearing or evidence, but so would whether such motive was the primary one. Tax cases have long grappled with that question. See, e.g., *United States v. Donruss Co.*,

of subparagraph (c)(2) may render it superfluous since such a reading does not appear to add much, if anything, to subparagraph (c)(1), but Bane's original ruling was made without the benefit of any special provision dealing with political or social questions. It was rather an interpretation of "proper subject." Thus, history and policy suggest the proper reading of "purpose" as the equivalent of "effect," rather than "motive."

Furthermore, in other contexts, the SEC has understood the pains of making securities law consequences depend on motive. Section 2(11) of the Securities Act of 1933 defines "underwriter" to include "any person who has purchased from an issuer with a view to . . . distribution . . . ."<sup>135</sup> Thus, the statute seems to dictate that the status of underwriter depends on a person's state of mind when he purchases securities. And if a person is an underwriter with respect to shares that he holds, sales by him would require the delivery of a prospectus,<sup>136</sup> thereby impairing the free marketability of the stock. The consequences of the status of underwriter are sufficiently troublesome that thousands of persons each year write to the Commission staff asking for a "no-action" position, fearing that if they sell their stock without delivering a prospectus they will be deemed to have been underwriters.<sup>137</sup> These persons try to prove that they are not underwriters by showing objective facts, such as having held the stock for two or three years, or having suffered personal financial reverses, which confirm that they did not have the wrong state of mind when they purchased their stock. In other words, they show that they did not purchase stock "with a view to distribution" because if they had, they would have acted differently.

The Commission has seen this type of person's problem and it hopes to clarify the law for persons affected by it. Although Congress defined "underwriter" to indicate that consideration of motive is relevant, the Commission's Disclosure Policy Study recommended the adoption of an administrative rule to ignore such considerations. The study, best known as the *Wheat Report*, observed that "[i]t is this emphasis on state of mind which is at the heart of the problem.

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393 U.S. 297 (1969). How does one judge the *primary* motive of Campaign GM, when people may be moved for different reasons? Indeed, there may be no such thing as an institutional motive.

135. 15 U.S.C. § 77b(11) (1964).

136. 15 U.S.C. § 77e(b)(2) (1964).

137. The author is advised by members of the SEC staff that this is the number of requests that the Division of Corporation Finance has been receiving for no-action letters over the past several years.

In lieu thereof, the Study recommends a specific set of objective rules—rules which would inform the purchaser how long he must hold and how he may sell, irrespective of his state of mind.”<sup>138</sup> Commenting on the operation of the rule proposed, the report states, “It will not be necessary to prove that a person lacked investment intent in order to find that he is an underwriter of securities if it can be shown that he has disposed of restricted securities in a distribution. Conversely, proof of the purity of one’s intent will no longer be crucial to establishment of a claim for exemption.”<sup>139</sup> The solution proposed is a practical one, proposed because of the existing dilemma. The study questioned, “How can [an investor’s] true ‘intention’ be accurately determined? It is obviously impossible to peer into his mind.”<sup>140</sup>

In spite of strong reasons not to do so—history, policy, and experience in related areas—the SEC has tended to interpret subparagraph (c)(2) to require an examination of the proponent’s motive. This policy has resulted in some public-interest questions being excluded from management’s proxy statement although they dealt with subject matters that another shareholder might have been allowed to raise.<sup>141</sup> Thus, because the proponents bore toward management a personal grievance, Radio Corporation of America was able to exclude a resolution prohibiting the hiring of any Communists, and Standard Oil Company of New Jersey was allowed to exclude a resolution prohibiting discrimination in hiring on the basis of race or religion.<sup>142</sup> Similarly, the SEC permitted Link Belt Company to exclude a resolution that would have required full disclosure and a report to stockholders concerning the company’s investment in and operation of a South African subsidiary.<sup>143</sup> Probably the clearest example of how the improper-motive test has caused the exclusion of

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138. F. WHEAT, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE ‘33 AND ‘34 ACTS—THE WHEAT REPORT 152-54 (CCH. ed. 1969).

139. *Id.* at 204.

140. *Id.* at 163.

141. Thus, the shareholder who wanted his investment company to stop owning liquor stocks (*see* text accompanying note 122 *supra*) might have been motivated by a conviction that the economic bottom was about to fall out of all such companies. Conceding that the proposal was germane to the company, “on the facts the Commission determined that the primary motive of the stockholder was the advancement of a cause with which the stockholder had a close association, rather than the solution of a problem pertinent solely to the corporation itself.” Heller, *supra* note 122, at 74.

142. Bayne, *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575, 602 (1957).

143. DIV. OF CORP. FIN., STUDIES ON PROXY STATEMENTS (1958). At the General Motors meeting, Mr. Roche agreed that General Motors shareholders were entitled to similar information. *See* note 479 *infra* and accompanying text.

a proper proposal was the Commission's upholding of the exclusion of a resolution to provide cumulative voting proposed by Mr. Russell McPhail—who has engaged in a control fight with the management of L.S. Starrett Company<sup>144</sup>—even though a proposal for cumulative voting is the most common resolution offered.<sup>145</sup>

Even if the motive of the proponent is unexceptionable, public-interest proposals may involve allegedly "ordinary business matters," as was contended by management recently in both the Dow and General Motors cases. In 1958, shareholders of Ford Motor Company and General Motors proposed resolutions recommending that specific efforts be made by each company to improve the safety of its automobiles, but both proposals were excluded on grounds of subparagraph (c)(5).<sup>146</sup> A court likewise sustained American Telephone & Telegraph Company's exclusion of a resolution dealing with pensions, which the SEC agreed was an ordinary business matter.<sup>147</sup>

On the other hand, dividends are not "ordinary business matters." But are dividends a "proper subject" under subparagraph (c)(1)? Clearly, the decision to pay a dividend is one for the board of directors, but courts acknowledge that shareholders may properly consider some questions even though they cannot take binding corporate action.<sup>148</sup> The SEC split evenly in 1964 on the question whether a proposal to recommend the payment of a dividend was required to be included on the proxy statement,<sup>149</sup> but a close reading of the minutes describing the action indicates that one of the two Commission members who believed that the proposal could be omitted did so not on the grounds that it was not a "proper subject," but because it was not possible under the circumstances to make adequate disclosure in the one hundred words allowed under the rule.<sup>150</sup> The other Commissioner who favored omission was unconvinced by the fact that the proposal was expressed as a recommendation. He believed that a resolution on a point that was not a "proper subject"

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144. *McPhail v. L.S. Starrett Co.*, 257 F.2d 388 (1st Cir. 1958).

145. 35 SEC ANN. REP. 47 (1969); 2 L. LOSS, *supra* note 109, at 906 n.192.

146. DIV. OF CORP. FIN., STUDIES ON PROXY STATEMENTS (1958).

147. *Curtin v. American Tel. & Tel. Co.*, 124 F. Supp. 197 (S.D.N.Y. 1954). It has been suggested that this decision could give great sweep to the "ordinary business" exclusion. E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 293-94 (2d ed. 1968).

148. *In re Auer v. Dressel*, 306 N.Y. 427, 118 N.E.2d 590 (1954). Cf. *Campbell v. Loews, Inc.*, 36 Del. Ch. 563, 134 A.2d 852 (Ch. 1957).

149. *Crown Cork & Seal Co., Inc.*, A Minute of a Meeting of the SEC, Feb. 28, 1964, reprinted in W. CARY, CASES AND MATERIALS ON CORPORATIONS 327 (4th ed. 1969).

150. *Id.* at 328.



for shareholders could be excluded under subparagraph (c)(1) even if it was expressed as a recommendation.<sup>151</sup>

One of the two Commissioners who favored inclusion sharply disagreed with the view just stated. He felt that a precatory resolution could be excluded only by reason of some specific provision in the rule, mainly subparagraph (c)(5), but presumably subparagraph (c)(2) as well. This view was based on a historical analysis of the rule.<sup>152</sup> The other Commissioner favoring inclusion stated that he would not go quite that far, but believed that shareholders could vote on policy questions. He felt that it was useful to allow open discussion of such questions, noting the healthy effect the rule has had on corporate management.<sup>153</sup>

The issue of the includibility of policy proposals was joined again when the Division of Corporation Finance expressed "no action" on the exclusion by Standard Oil Company of New Jersey of a resolution that the company continue its efforts to explore for oil in international waters. The proposal also directed the company to encourage the creation of a "stable international regime." The court deferred to the SEC judgment that this proposal was not a proper subject for shareholders under subparagraph (c)(1).<sup>154</sup> No opinion accompanied the SEC determination, but the court found that it was a correct interpretation of New Jersey law. The key to the proposal was the second part, dealing with the international regime, and, among other things, management questioned the extent to which a company could pursue such an objective.<sup>155</sup> The shareholder's observation was that his concern was policy, and that the objective could be pursued in a variety of ways, as determined by the board.<sup>156</sup> The real problem with the resolution, however, appeared to be the fact that it was not drawn in precatory language.

Thus, the stage was set for Campaign GM's struggle with management. If Campaign GM could convince the SEC that its resolutions were includible in management's proxy statement, a major battle would be won. But management's arsenal to combat the inclusion of the proposals was by no means insubstantial. If the prior SEC decisions provided any guide, they seemed to indicate that

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151. *Id.* at 330.

152. *Id.* at 328-29.

153. *Id.* at 331.

154. *Brooks v. Standard Oil Co.*, 308 F. Supp. 810 (S.D.N.Y. 1969).

155. The argument was much the same as that made concerning the Greyhound case: that the company would violate local law if it adopted the policy of the resolution. See note 104 *supra* and accompanying text.

156. 308 F. Supp. at 812-13.

management had a good chance of excluding most or all of the proposals under rule 14a-8(c)(1), (c)(2), or (c)(5).

#### 4. *The General Motors Decision*

The General Motors management notified the SEC and the Project that it intended to exclude all of Campaign GM's proposals from its proxy statement under rule 14a-8.<sup>157</sup> It argued that it could exclude all of the proposals under subparagraph (c)(2) since it clearly appeared that they were submitted primarily for the purpose of promoting a general economic, political, racial, religious, social, or similar cause.<sup>158</sup> In this regard, management cited a letter from the Project, describing itself as a "newly formed organization which will explore methods by which corporations can be made more responsive to public and social needs."<sup>159</sup> Management also relied largely on statements by Ralph Nader to show that General Motors was viewed as a target rather than as a subject of shareholder concern, and that the company was a symbol of the Project's activities. Campaign GM, it was charged, was interested in the public, not in the corporation. Its activities were directed mainly to citizens, not shareholders. Management's counsel argued that the purpose of subparagraph (c)(2) "is to limit the use by shareholders of the management's proxy material to purposes which are germane to the corporation itself—that is, to matters which primarily concern the corporation or its shareholders *as such* rather than matters which concern them primarily as citizens or members of other groups."<sup>160</sup>

Management also argued that all of the proposals, except the bylaw amendment, were not proper subjects for action by security holders under subparagraph (c)(1) since they either required action not permitted by state law, required action already required by state law, or involved action by shareholders that state law reserved to the board of directors.<sup>161</sup>

Additionally, management argued that all of the proposals except

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157. Management's response was accompanied by opinions of its general counsel, Letter from Mr. Ross L. Malone to General Motors Corp., Feb. 27, 1970 [hereinafter Malone Letter], and a New York law firm, Letter from Davis, Polk & Wardwell to Mr. Ross L. Malone, General Counsel, General Motors Corp., Feb. 27, 1970 [hereinafter Davis, Polk & Wardwell Letter], in addition to about one hundred pages of exhibits.

158. Management also argued that the proxy rules had been violated by Campaign GM's solicitation activities and that the appropriate sanction was to exclude the proposals. See pt. II. C. *infra*.

159. Letter from Mr. Geoffrey Cowan to Mr. Edward B. Wallace, Secretary, General Motors Corp., Feb. 6, 1970, reprinted in 116 CONG. REC. E1267 (daily ed. Feb. 24, 1970).

160. Davis, Polk & Wardwell Letter, *supra* note 157, at 9.

161. *Id.* at 11.

the proposed amendment to the certificate of incorporation and the bylaws were excludible under subparagraph (c)(5) since they consisted of recommendations or requests that management take action with respect to matters relating to the conduct of ordinary operations of the company.<sup>162</sup> Finally, management argued that the proposal to amend the bylaws related to an election to office and was excludible under paragraph (a) of rule 14a-8.<sup>163</sup>

The Project's reply noted the significance of the includibility issue. It argued that

[i]t must be recognized that Management's proxy statement is the only effective vehicle through which all of the shareholders can have an opportunity to express themselves, and even to hear any arguments on the questions involved. It is too glib to say that the proponents of the resolutions can undertake their own proxy solicitations. As Management well knows, the cost is virtually prohibitive except to extremely well heeled shareholders. . . . This is no ordinary dispute with Management; it is not an effort by insurgent shareholders to seize control of the corporation. If it were so, one could justify large expenditures because the individual rewards are great and because, if successful, the insurgents could obtain reimbursement of their expenses from the company. The issues here lack that personal pecuniary bias. Denial of access to the shareholders through Management's proxy solicitation, practically is total denial.<sup>164</sup>

The Project noted that the proposed resolutions dealt with matters of great importance to General Motors, as was indicated by management's formidable submission to the Commission of documents showing the company's great involvement in safety, pollution, and other public-interest fields. The Project then argued that management could not contend that the resolutions were excludible *both* for the reason that they were concerned with a matter of general social or political questions and at the same time that they were ordinary business matters.<sup>165</sup> In truth, said the Project, the proposals were neither, but were rather matters of company policy. The social orientation of the resolutions was not disputed, but it was argued that modern notions of the corporation rendered social concerns legitimate areas for corporate activity and for shareholder consideration. Moreover, the Project urged that it was good

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162. Malone Letter, *supra* note 157, at 20-27.

163. Davis, Polk & Wardwell Letter, *supra* note 157, at 15-16.

164. Letter from the author to the SEC, March 10, 1970, reprinted in 116 CONG. REC. E2147-51 (daily ed. March 17, 1970).

165. This same inconsistency was noted by the court in *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 679 (D.C. Cir. 1970).

business for the corporation to weigh social factors in business decisions.

Attention at the SEC focused on the proposal to create the shareholder committee. The Commission was advised, both by its General Counsel and by the Division of Corporation Finance, that the proposal to amend the certificate of incorporation and the six proposals to require specific action in various problem areas could be excluded from management's proxy statement. Both also agreed that the proposal to enlarge the board of directors by amendment of the bylaws required inclusion in the proxy statement. However, the General Counsel advised the Commission that the shareholder committee proposal should be included in the proxy statement, while the Division of Corporation Finance agreed with management that the proposal could be excluded, apparently on the basis of subparagraph (c)(2).<sup>166</sup> The Commission resolved, by a two-to-one vote,<sup>167</sup> to advise management that the shareholder committee proposal should be included if the proposal "were revised promptly (1) to restrict the funds to be allocated to the Committee to reasonable amounts as determined by the Board of Directors and (2) to restrict the information to be made available to the Committee to areas which the Board of Directors did not deem privileged for business or competitive reasons."<sup>168</sup>

The Commission's decision posed a dilemma for Campaign GM. Access to corporate information was central to the shareholder committee proposal. The one-hundred-word supporting statement emphasized this point by declaring that "[p]ast efforts by men such as Ralph Nader to raise these issues have been frustrated by the refusal of management to make its files and records available either to the shareholders or to the public. Only a committee representing a broad segment of the public with adequate resources and access to information can prepare a report which will accomplish these objectives."<sup>169</sup> Consequently, the last sentence of the proposal as originally submitted read, "The committee shall have the power to

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166. Minutes of a Meeting of the SEC, March 18, 1970, at 2 (April 14, 1970).

167. Chairman Budge and Commissioner Needham were absent.

168. Minutes of a Meeting of the SEC, March 18, 1970, at 3 (April 14, 1970). Commissioner Richard B. Smith, who proposed the motion, would have gone further. He favored hearing oral argument on the proposals because of "his belief that the proposals presented serious issues raised by the movements in the nation toward increased consumer protection and greater corporate social responsibility. It was [his] feeling that these developing concerns should be given new attention in the Commission's consideration with respect to the proposals . . ." *Id.*

169. Notice of Annual Meeting and Proxy Statement of General Motors Corp., April 6, 1970, at 18.

obtain any information from the corporation and its employees as deemed relevant by the Committee." After the Commission's decision, the Project proposed to meet the Commission's objection by adding to that sentence, "Provided, however, that the committee shall not release to the public any information which the board of directors deems privileged for business or competitive reasons."<sup>170</sup>

The Division of Corporation Finance responded that this proviso did not comply with the Commission's decision of March 18, which, it noted, directed that the change be made "promptly."<sup>171</sup> At this point, Campaign GM seriously contemplated standing its ground and asking a court to compel management to include the proposal as originally written. It finally concluded, however, that the specific language of the proposal was not so important as the general principles embodied in the proposal, and that the principles should be allowed to come to a vote. A lawsuit threatened that possibility. Consequently, Campaign GM decided to accept the Commission's language, modified, however, to limit the board's right to restrict information only if it "reasonably" determined that such restricted information is privileged.<sup>172</sup> The SEC staff accepted this change,<sup>173</sup> and agreed that the proposal be included.

##### 5. *Rule 14a-8 Revisited: The Meaning of the General Motors Decision*

In the early development of rule 14a-8, the only test of includibility of a resolution was whether a proposal was a proper subject for action by shareholders. What was scrutinized was the proposal—not the proponent. Bane's test, which the Commission purported to adopt, was whether the shareholder meeting was a "proper forum"; in other words, could shareholders properly deal with the subject matter.<sup>174</sup> This test was consistent with the Commission's purpose of having the proxy machinery simulate a meeting that all could attend.<sup>175</sup> Certainly at a meeting, the appropriateness of a

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170. Campaign To Make General Motors Responsible, Preliminary Proxy Statement, filed March 23, 1970.

171. Telephone communication to the author from Carl Bodolus, Branch Chief, Div. of Corp. Fin., SEC, March 24, 1970.

172. See Appendix B *infra*, proposal 3.

173. The change was proposed in the belief that a court would liberally allow shareholders access to pertinent corporate information. See *SEC v. Transamerica Corp.*, 163 F.2d 511, 517 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1948).

174. SEC Securities Exchange Act of 1934 Release No. 3638 (Jan. 3, 1945), 11 Fed. Reg. 10,995 (1946). See text accompanying notes 98-99 *supra*.

175. See 1943 *Hearings*, *supra* note 88, at 174-75 (testimony of Chairman Ganson Purcell); Caplin, *Proxies, Annual Meetings and Corporate Democracy: The Lawyer's Role*, 37 VA. L. REV. 653, 686-97 (1951).

resolution would be judged only by its words, and not by the reason for uttering them.

But the Commission lost sight of this objective, for reasons never stated, but perhaps out of an understandable reaction to much of the abuse it received in respectable quarters for ever having adopted the rule. Consequently, it inserted a test of "primary purpose" in a rule supposedly codifying Bane's release,<sup>176</sup> first with respect to a personal grievance, and later with respect to social and political objectives. Bane never spoke of purposes; the rule does. This discrepancy has resulted in some unfortunate policy under the rule. As Professor Loss notes, resolutions barring an investment company from investing in liquor stocks, or requiring a company to treat women employees equally are germane to the company, but the "purpose" test, which was used to mean "motive," excluded the proposals.<sup>177</sup> The proposals could have been offered at the meeting; why not through the proxy machinery? The murkiness created by the inquiry into "motive" was expressed by Father Bayne:

If the Commission meant merely to exclude the airing of political views, or the use of a proxy statement as a forum for the spread of a religion, or the like, it did not say so. If it meant to prohibit shareholders from formulating corporate policies in regard to basic moral issues, important social questions, broad economic programs or similar causes, it was flatly out of order.<sup>178</sup>

SEC policy after the General Motors decision and the Dow case may be different. The Commission necessarily determined in the General Motors decision that the resolutions were not offered "primarily for the purpose" of dealing with social or political questions. The "motives" of the proponents were not concealed; the alleged disability created by those motives was effectively argued by management. Certainly there was a social purpose behind the resolutions.<sup>179</sup> The purpose of the proposed Shareholders Committee on Corporate Responsibility was to "enable shareholders to assess the public im-

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176. See Letter from Baldwin Bane, Director, Div. of Corp. Fin., SEC, to John Mathis, Vice President, Am. Soc. of Corporate Secretaries, Feb. 4, 1952, in SEC Docket File No. S 7-35-6-2. Cf. Remarks of Hamer H. Budge, Chairman, SEC, Before the Am. Soc. of Corporate Secretaries, White Sulphur Springs, W. Va., June 12, 1970, at 13. See text accompanying notes 100-08 *supra*.

177. 2 L. LOSS, SECURITIES REGULATION 902 n.179 (2d ed. 1961). See text accompanying note 122 *supra*.

178. Bayne, *supra* note 142, at 602.

179. This point was not missed at the Commission table. Commissioner Smith asked for oral argument because "the proposals presented serious issues raised by the movements in the action toward increased consumer protection and greater corporate social responsibility. . . . [T]hese developing concerns should be given new attention in the Commission's consideration with respect to the proposals . . . ." Minutes of a Meeting of the SEC, March 18, 1970, at 3 (April 14, 1970).

fact of the Corporation's decisions, and to determine the proper role of the Corporation in society."<sup>180</sup> The bylaw amendment was offered to achieve broader representation on the board in order to assess the social impact of the corporation's decisions. These concerns were not with the profitability of the corporation, but were nonetheless with the activities of the corporation. In finding that the proxy rules required *any* of the proposals to be included, the Commission was finding that a proponent's concern more for the impact of the corporation on society than with the corporation itself does not render his proposal one which is ipso facto "primarily for the purpose of promoting *general* economic, political, racial, religious, social or similar causes . . ."<sup>181</sup> Rather, the proposals are raised in a proper forum when shareholders consider them because they are within the corporation's scope of action.

The crucial word, under this reading of subparagraph (c)(2), is "general." This word focuses on the resolution, rather than on the reasons for proposing it. Thus, Commissioner Smith, explaining why the proposed amendment to the bylaws was clearly proper, said, "That sort of shareholder proposal has always been considered includible . . ."<sup>182</sup>

Commissioner Smith's reasoning and his decision are right; his history is wrong. The Commission has permitted exclusion of proposals that would clearly have been includible except for the impropriety of the proponent's motive. Thus, a proposal for cumulative voting offered by Lewis Gilbert had to be included; one offered by Russell McPhail to L.S. Starrett Company could be excluded.<sup>183</sup> Perhaps Commissioner Smith, in ignoring the motive for the bylaw change, is suggesting that personal motive is not the meaning of "primarily for the purpose," at least when assessing the propriety of a resolution dealing with political or social questions. In the same speech, Commissioner Smith said that "state law does not in any case enable shareholders to use the corporate machinery to advance *solely personal* interests, *solely general* community interests or matters of ordinary business-type corporate interest."<sup>184</sup> Why does Smith refer to state law when subparagraph (c)(2) itself makes no

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180. Notice of Annual Meeting and Proxy Statement of General Motors Corp., April 6, 1970, at 18.

181. SEC proxy rule 14a-8(c)(2), 17 C.F.R. § 240.14a-8(c)(2) (1969) (emphasis added).

182. Remarks of Richard B. Smith, Commissioner, SEC, Before the ALI-ABA Conference on Securities Regulation, Washington, D.C., June 6, 1970, at 1.

183. DIV. OF CORP. FIN., STUDY ON PROXY STATEMENTS (1958).

184. Remarks of Richard B. Smith, Commissioner, SEC, Before the ALI-ABA Conference on Securities Regulation, Washington, D.C., June 6, 1970, at 9 (emphasis added).

reference to state law? Commissioner Smith seems to be judging the question of excludibility as essentially a determination of "proper subject," which the Commission has held is a question of state law.<sup>185</sup> State law, of course, does not afford a guide in determining motive; thus, the reference to state law indicates that the Commissioners may be looking only at the subject matter of a proposal, not at the motive of the proponent. And the Dow case makes the same point. In that case, Judge Tamm said that "it seems fair to infer that Congress desired to make proxy solicitations a vehicle for corporate democracy rather than an all-purpose forum for malcontented shareholders to vent their spleen about irrelevant matters . . ."<sup>186</sup> But what about the malcontented shareholder who wants to vent his spleen about *relevant* matters?

The General Motors decision, then, may have wide implications. There are doubtless many ways that a corporation could approach problems of social responsibility. In his argument against including the proposal for a shareholder committee, General Motors' general counsel, Ross L. Malone, argued that "[t]he proposed Committee, its composition, appointment, purpose and functions, is no more than a concept, without precedent, that I know of, in corporate law."<sup>187</sup> He also argued that the proposal "is replete with vague, indefinite and theoretical phrases and concepts and may be properly excluded from the proxy soliciting material for that reason alone."<sup>188</sup> These so-called infirmities, however, which Mr. Malone thought made the proposal excludible under subparagraphs (c)(1) or (c)(5), were not sufficient to bar the proposal. Thus, in the wake of the General Motors decision, shareholder proposals may seek approval for new forms of corporate action that lack precedent under traditional notions of corporate law.<sup>189</sup>

The General Motors decision, however, recognized certain limits on the scope of public-interest questions that could be included in management's proxy statement. These limits result from the application of state law to the questions what is a "proper subject" or what

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185. See notes 70, 96-99, 113 *supra* and accompanying text.

186. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 678 (D.C. Cir. 1970).

187. Malone Letter, *supra* note 157, at 27.

188. *Id.*

189. Chairman Budge commented before the Corporate Secretaries that "[i]t is probably safe to assume, however, that Rule 14a-8 will be increasingly focused upon as a means of raising questions which companies have assumed to be outside the perimeter of proper shareholder interest." Remarks of Hamer H. Budge, Chairman, SEC, Before the Am. Soc. of Corporate Secretaries, White Sulphur Springs, W. Va., June 12, 1970, at 16.



is "ordinary business." The Commission's decision to restrict the amount of information available to the Shareholders Committee for Corporate Responsibility to that which the board would permit recognized that state law assigns to the board of directors the primary responsibility for protecting the shareholder interest.<sup>190</sup> A proposal that prevents the board from performing its basic function is not, in the Commission's opinion, a proper subject for action by security holders. Shareholders are protected both by access to corporate information and by the denial to others of access to that information. The board cannot be stripped of its protective role in this regard; to do so would flaunt the governing structure of corporations as defined by state law. At the same time, the staff's acceptance of the insertion of a reasonableness standard<sup>191</sup> suggested by Campaign GM indicated that the Commission recognized that the board could encounter questions concerning the extent of corporate privilege of information that requires criteria for resolution, and, further, that the resolution of such questions might require a judicial determination.

No reasons were advanced by the Commission for permitting exclusion of the seven other proposals, but management had argued that they were excludible under either subparagraph (c)(1) or (c)(5).<sup>192</sup> No single rationale will support the exclusion of the proposals, however, since they represent three different types of proposals.

One of the excluded proposals would have amended the certificate of incorporation to prohibit the company from implementing certain of its corporate purposes by unlawful means, or by means that endangered the public health, safety, or welfare.<sup>193</sup> The proposal was undoubtedly defective in form as the Commission noted—Delaware law requires the board of directors to initiate changes in the certificate of incorporation<sup>194</sup>—but this defect could have been overcome by redrafting the resolution in precatory terms.<sup>195</sup>

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190. See notes 166-71 *supra* and accompanying text. The minutes reflect the belief held by all present at the meeting that without modification of the provision allowing for complete access to information the proposal would be barred under subparagraph (c)(1). Minutes of a Meeting of the SEC, March 18, 1970, at 3 (April 14, 1970).

191. See text accompanying notes 172-73 *supra*.

192. See text accompanying notes 161-62 *supra*.

193. See Appendix B *infra*, proposal 1.

194. DEL. CODE ANN. tit. 8, § 242(d)(1) (Supp. 1968).

195. See notes 114 & 148-56 *supra* and accompanying text. In 1967 and 1968, Mrs. Evelyn Y. Davis proposed to amend the General Motors certificate of incorporation to limit charitable contributions, and the proposal was cast in the same mandatory form as the Campaign GM proposal. Notice of Annual Meeting and Proxy Statement of General Motors Corp., April 19, 1968, at 26; *id.*, April 13, 1967, at 25. But, if the form is defective, the Commission may suggest changes. *In re Union Electric Co.*, 38 S.E.C. 921, 927 (1959).

Thus the Commission must have concluded that the proposal was not a "proper subject" because of its substance.

This decision is puzzling. General Motors' argument that the proposal merely stated the law<sup>196</sup> overlooked the restriction against implementing its purposes "in a manner which is detrimental to the public health, safety or welfare . . ." One suspects that the Commission did not fully understand the implications of the proposal and in that respect they can hardly be blamed since the proposal is a broad statement of policy. But much of the language contained in the purpose clause of a certificate of incorporation is similarly broad and vague. A more appropriate disposition by the Commission on this proposal would have been a suggestion for clarification rather than a bare ruling of exclusion.

Another excluded proposal would have required the company to announce and act upon a commitment to a greatly increased role for public mass transportation.<sup>197</sup> Management objected to this proposal under subparagraphs (c)(1) and (c)(5).<sup>198</sup> The opinion of General Motors' outside counsel distinguished this proposal from the remaining five that were excluded, but said that it dealt with "a matter of business policy"<sup>199</sup> and that, on the authority of *Brooks v. Standard Oil Company*,<sup>200</sup> such matters were not a proper subject for action by security holders. In addition, Mr. Malone's opinion contended that questions of business policy are matters for the directors.<sup>201</sup>

It should be noted, however, that this proposal was worded as a recommendation to management rather than as a mandate. This fact distinguishes the proposal from those excluded in the *Standard Oil* case. But even *recommendations* to the board are properly excluded under subparagraph (c)(5) when they deal with "the conduct of ordinary business operations." The resolution was directed at General Motors' pro-highway lobbying activities, which obviously relate to selling more cars.<sup>202</sup> The proponents' view was that a policy favorable to selling more cars is not necessarily good policy, even if it does make more money for the company. When viewed in this context, the proposal clearly goes beyond everyday operations.

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196. Malone Letter, *supra* note 157, at 16-19.

197. See Appendix B *infra*, proposal 4.

198. Malone Letter, *supra* note 157, at 20, 26-28.

199. Davis, Polk & Wardwell Letter, *supra* note 157, at 13.

200. 308 F. Supp. 810 (S.D.N.Y. 1969). See text accompanying notes 154-56 *supra*.

201. Malone Letter, *supra* note 157, at 21-26, 28.

202. See Statement of Project on Corporate Responsibility in Support of Proposal No. 4, reprinted in 116 Cong. Rec. E1974 (daily ed. March 12, 1970).

To say that the board is empowered to deal with this policy matter does not provide an answer, unless the board's interest at the same time preempts shareholder action or interest. Subparagraph (c)(5) specifically bans shareholder proposals on "ordinary business" matters. Policy questions, on the other hand—at least when cast in precatory terms—seem to be "proper subjects."<sup>203</sup> This distinction was noted by Commissioner Smith when he remarked that "pride of ownership may extend to corporate policies as well as profits."<sup>204</sup> He added, "The Commission's proxy rules, while not explicit on the point, appear to recognize this distinction between expressions of basic corporate policy by shareholders—as to which properly framed proposals under 14a-8 may be includible—and attempts by shareholders to diffuse managerial obligations which state law clearly places upon the board of directors."<sup>205</sup>

It seems likely that the Commission did not clearly distinguish this precatory resolution from the five other properly excluded resolutions that proposed specific measures in particular problem areas.<sup>206</sup> These proposals were objected to as improper—even if worded as recommendations—because they dealt with ordinary business matters. In one sense the proposals were far from ordinary since their implementation would have involved substantial expenditures and they were not calculated to improve the company's profitability. But while the general policy of expending large sums on safety and pollution may be proper for shareholders to consider,<sup>207</sup> anything more specific than that would seem to be a question wholly within the province of the board. The proponents may in fact possess as much expertise as the board in such matters, but the body of shareholders who are asked to decide the question do not, nor can they be expected to be interested in dealing with detailed programs.<sup>208</sup> Consequently, the Commission's decision to allow exclusion of the five specific proposals was the correct disposition under either subparagraph (c)(1) or (c)(5).

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203. See the conflicting views expressed by the Commissioners in the Crown Cork & Seal Co. controversy, in text accompanying notes 149-53 *supra*.

204. Remarks of Richard B. Smith, Commissioner, SEC, Before the ALI-ABA Conference on Securities Regulation, Washington, D.C., June 6, 1970, at 10.

205. *Id.* at 11.

206. See Appendix B *infra*, proposals 5-9.

207. *Analysis: An Examination of the Stockholder Proposal Provisions of the Proxy Rules*, BNA SEC. REG. & L. REP. No. 41, at B-1, B-16 (March 11, 1970).

208. According to Commissioner Smith, "The system has started with the factual assumption that shareholders today are neither interested in nor capable of making ordinary managerial decisions." Remarks of Richard B. Smith, Commissioner, SEC, Before the ALI-ABA Conference on Securities Regulation, Washington, D.C., June 6, 1970, at 10.

Even after the General Motors decision the question whether rule 14a-8 permits the raising of a public-interest issue in management's proxy statement remains a confusing one because of the inquiry into purpose. Happily, the recent interpretations seem to revive the early applications of the rule. The issue of purpose, therefore, requires an exploration first, into whether the proposal is concerned with a question that is within the corporation's power to act, and, second, into whether it is a matter on which the body of shareholders can address themselves in their capacity as shareholders. If both of these questions are answered in the affirmative (and assuming the proposal is not motivated by a personal grudge), the purpose of the resolution cannot be construed to be primarily that of promoting a "general" social or political cause. The personal social or political philosophy that may have motivated the resolution is irrelevant under this test. This interpretation of purpose under subparagraph (c)(2) was not followed by the SEC during the period between the Greyhound and Dow decisions,<sup>209</sup> but it was the original meaning of the rule,<sup>210</sup> and was revived in the General Motors decision consistent with the Dow case.

This revived formulation of the purpose test necessitates a determination of what questions are within the corporation's ambit of action and are of common concern to the shareholder body. If corporation law demands that corporation decision makers consider only questions of profitability and that they ignore social and moral implications of corporate conduct, then such questions are not of common interest to shareholders as shareholders. So the ultimate question must be what is the role of the modern corporation in society; that is, do corporations have a social responsibility. If questions of social and political significance are germane to a corporation, the shareholders' role would seem legitimately to embrace questions of policy. As Judge Tamm, speaking in the Dow case, said:

We think that there is a clear and compelling distinction between management's legitimate need for freedom to apply its expertise in matters of day-to-day business judgment, and management's patently illegitimate claim of power to treat modern corporations with their vast resources as personal satrapies implementing personal political or moral predilections. It could scarcely be argued that management is more qualified or more entitled to make these kinds of decisions than the shareholders who are the true beneficial owners of the corporation; and it seems equally implausible that an application of

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209. See notes 102-08, 122-26, 141-45 *supra* and accompanying text.

210. See notes 89-95, 98-99, 131-32 *supra* and accompanying text.

the proxy rules which permitted such a result could be harmonized with the philosophy of corporate democracy which Congress embodied in section 14(a) of the Securities Exchange Act of 1934.<sup>211</sup>

### B. *Corporate Social Responsibility*

If the key to the includibility of a public-interest question in management's proxy statement is whether the corporate forum is the right one in which to raise the issue, obviously it is necessary to determine the jurisdiction of the corporation. What can an appropriate decision maker do with the aggregation of assets and powers combined in corporate form? The question is a legal one—not a political one. It relates only to power—not social imperatives—although the existence of social imperatives may shape the scope of the power.

The traditional theory of the corporation is that the corporate manager pursues maximum profits for the benefit of the shareholders.<sup>212</sup> The common thread that binds investors to the corporation is the expectation that the managers will make every effort to derive the largest possible profit, consistent with the safety of the invested principal. The devotion to profit is explained not only in terms of investor expectation, but also by the need to adopt criteria to limit the power and judge the performance of management. Adolf Berle wrote in 1932 "that you cannot abandon emphasis 'on the view that business corporations exist for the sole purpose of making profits for their stockholders' until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else."<sup>213</sup>

Pursuit of private gain is relied upon to protect the ownership interest in the private corporation; the protection of the community

211. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 681 (D.C. Cir. 1970). Judge Tamm seemed upset by management's inconsistent defense of exclusion. While urging that the shareholder was moved by moral concerns, and not by corporate interests, management did not try to defend its sale of napalm on grounds of profitability, but admitted that it had adverse profit impact. 432 F.2d at 681. So it was a moral fight on both sides, with management insisting that the shareholders had no right to urge action for moral reasons. This argument seemed too one-sided for Judge Tamm.

212. Ruder, *Public Obligations of Private Corporations*, 114 U. PA. L. REV. 209, 213-14 (1965).

213. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932). That expression finds wide support from contemporary scholars. See, e.g., Hetherington, *Fact and Legal Theory: Shareholders, Managers and Corporate Social Responsibility*, 21 STAN. L. REV. 248 (1969); Katz, *Responsibility and the Modern Corporation*, 3 J. LAW & ECON. 75, 77 (1960); Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, in *THE CORPORATION IN MODERN SOCIETY* 46, 61-62 (E. Mason ed. 1959).

interests affected by corporate activity, however, is a function assigned to the free market. The traditional model operates on the assumption that the economic forces of competition and the price mechanism will afford the public a reasonably free choice and will, in turn, provide optimal allocation of resources.<sup>214</sup> Adam Smith envisioned an enlightened self-interest emerging in an economy free from monopolistic domination to serve society's economic needs.<sup>215</sup> Thus, the logic of the traditional theory demands that managers operate a business with a view only to profit-seeking, and that they leave it to the market place to develop moral or social judgments.<sup>216</sup> The strict logic of this view also limits corporate charitable contributions to those situations in which there is clear corporate benefit.<sup>217</sup>

An efficiently operating securities market is supposed to assist in the economic functions. If the securities market operates fairly, displeased investors can sell their stock for the right price. Supposedly, the combined shareholder dissatisfaction with company policies will result in collective sales that will put pressure on the stock of the company, driving it downward and making it possible for outsiders to seize control. To avoid this result, managers will tailor their policies to prevent shareholder dissatisfaction.<sup>218</sup>

American corporation law has been fashioned as the constitutional law of our economic state based upon the traditional economic model.<sup>219</sup> This constitutional law has developed a structure for decision-making<sup>220</sup> and a mode of acceptable behavior for man-

214. The traditional theory is well expressed in P. HEYNE, *PRIVATE KEEPERS OF THE PUBLIC INTEREST* 7-13 (1968). See also A. ALCHIAN & W. ALLEN, *EXCHANGE AND PRODUCTION—THEORY IN USE* chs. 2, 3 (1969).

215. A. SMITH, *WEALTH OF NATIONS* 14 (Modern Library ed. 1937).

216. Professor Milton Friedman asserts:

Few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stockholders as possible . . . [I]f businessmen do have a social responsibility other than making maximum profits for stockholders, how are they to know what it is? Can self-elected private individuals decide what the social interest is?

M. FRIEDMAN, *CAPITALISM AND FREEDOM* 133 (1962).

217. Manne, Book Review, 24 U. CHI. L. REV. 194, 196 (1956).

218. Manne, *Good for General Motors?*, BARRON'S, May 18, 1970, at 1. The free operation of the securities markets causes Dr. Manne to worry less about the separation of ownership from control. See Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399 (1962).

219. See A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 357 (1932); Eisenberg, *The Legal Roles of Shareholders and Management in Modern Corporate Decisionmaking*, 57 CALIF. L. REV. 1, 4 (1969).

220. See *id.*

agers.<sup>221</sup> The decision-making norm places the responsibility for management activities on the board of directors, but recognizes that owners have a voice in some decisions, most notably the choice of managers. Shareholder democracy becomes expressed as an ideal, but the fact is lamented that control of the corporation has become separated from ownership of the stock.<sup>222</sup>

With respect to conduct of managers, the classical corporate norm demands behavior consistent with the objectives of maximizing profits. Managers must manage the corporation with due care and avoid conflicts of interest. The duty of due care requires diligence and at the same time affords managers protection from liability for errors of judgment if they observe it. This is the well known "business judgment" rule that eliminates judicial scrutiny of everyday business decisions.<sup>223</sup>

It is, however, fair to question an economic system—the framework within which corporate norms are formulated—because as Berle notes, "An economic system is not an end in itself. It exists to serve men. When it ceases to do that, it ceases to be acceptable—or, at all events, has demonstrated effects which require curing."<sup>224</sup> The same is true for the free market. While such a system may be abstractly preferable, "we cannot overlook how the market in question actually operates, and we cannot forget that our aim should be not merely the free market as such, but the improved products and services and lower prices which are presumed to flow from free-market competition."<sup>225</sup>

It is increasingly common for corporate leaders to verbalize business goals other than profits. The growing magnitude of society's problems has commanded the attention of business leaders as well as citizens in other callings. Indeed, since business activity has shaped our national landscape and our goals for so long,<sup>226</sup> one cannot think about social problems without thinking about business responsibility for them.

The crises in the environment, in urban affairs, and in race relations seem to have spurred businessmen to express larger roles for

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221. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259 (1967).

222. See A. BERLE & G. MEANS, *supra* note 219.

223. See Manne, *supra* note 221, at 270-72.

224. A. BERLE, *THE AMERICAN ECONOMIC REPUBLIC* 80 (1963).

225. Schotland, *Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market*, 53 VA. L. REV. 1425, 1468 (1967).

226. Chandler, *The Role of Business in the United States: A Historical Survey*, 98 DAEDALUS 23, 39 (1969).

business that depart from the traditional profit maximization goal. And government, too, has emphasized the need for private-sector involvement in the nation's problems. Shortly before he left the SEC, former Chairman Manuel F. Cohen emphasized the need for business to broaden its horizons. After analyzing the increasing power of the larger corporation and its pervasive influence in society, Mr. Cohen asked: "Doesn't such power carry with it the responsibility . . . to act in full recognition of the responsibility of these corporations to all of society—to their suppliers, their employees, to the communities within which they operate, to the taxpayers and to the needs of the nation as a whole?"<sup>227</sup> Mr. Cohen added:

We have ample evidence that such abuses create smoldering resentments which explode into violence, affecting the whole community. If further evidence of the responsibility of the business community is required, the past several years, a period of incomparable prosperity, have nevertheless spawned tragedy and violence on a scale that boggles the minds of those who believe that our civilization is an advanced one and that we share a common ethical and religious heritage. Apart from this, it is a clear acknowledgement of the political nature of the power of the business community.<sup>228</sup>

Similar expressions have come from the business community.<sup>229</sup> On Earth Day, Dan W. Lufkin, a prominent investment banker, told an audience at Harvard Business School that President Coolidge's aphorism, "the business of America is business" was no longer true. Instead, he said "the business of business is America."<sup>230</sup> He called for a "reordering of business priorities" and a "redefinition, not an abolition, of the concept of profit—one that will assess corporate gains and losses not only in terms of dollars but also in terms of social benefits realized or not realized."<sup>231</sup>

None of these expressions of the social role of corporations in the real world—not in an economic model—is completely new, since businessmen have purported to express concerns for the public constituency for a long time.<sup>232</sup> After World War II business leaders

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227. Address of Manuel F. Cohen, Chairman, SEC, Before the Economic Club of Detroit, Jan. 27, 1969, at 10.

228. *Id.* at 10-11.

229. See generally Monson, *The American Business View*, 98 DAEDALUS 159, 163-64 (1969).

230. Remarks of Dan W. Lufkin at Harvard Business School, April 22, 1970. See Cohn, *Wall Street Banker Scolds Firms on "Quality of Life"*, Washington Post, April 23, 1970, § A, at 15, col. 1.

231. Remarks of Dan W. Lufkin at Harvard Business School, April 22, 1970, at 8.

232. See the statement of Owen D. Young, president of General Electric Co., in 1929, in which he said that he owed obligations to employees and the general public as



encouraged support for education as a responsibility of business.<sup>233</sup> What has occurred in recent times, however, is a much deeper involvement in community problems, often when the benefit to the company is remote. Surveys indicate that a large number of companies have acted in response to the plea for business involvement in urban and ghetto problems.<sup>234</sup> Business as well as general-circulation publications write extensively about the need for business involvement, and describe the large number of activities that are being supported by business.<sup>235</sup> These activities include corporate interest in housing, job-training, minority-hiring, environmental problems, and assisting minority enterprises. Some aspects of business involvement extend beyond any apparent relationship to the goal of profit-seeking, let alone profit maximization. For example, Mattel, Incorporated, a Los Angeles toy manufacturer, helped form a company to manufacture toys that was owned and operated by blacks in Watts.<sup>236</sup>

While businessmen have spoken of the great pleasure that their social activity has provided them, they do not justify or explain their acts in altruistic terms. Invariably they find some link to the welfare of the company, if only to say that their company requires a healthy environment in which to exist.<sup>237</sup>

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well as to stockholders, quoted in W. CARY, *CASES AND MATERIALS ON CORPORATIONS* 239-40 (4th ed. 1969).

233. See C. WALTON, *CORPORATE SOCIAL RESPONSIBILITIES* 48-52 (1967).

234. See Cohn, *Is Business Meeting the Challenge of Urban Affairs?*, 48 *HARV. BUS. REV.*, March-April 1970, at 68 (*passim*).

235. A small sampling would include *Special Report: Business and the Urban Crisis*, *BUS. WEEK*, Feb. 3, 1968, at C-1; *Special Report: Dealing the Negro In*, *BUS. WEEK*, May 4, 1968, at 64; *Special Report: The War That Business Must Win*, *BUS. WEEK*, Nov. 1, 1969, at 63; *Perspectives on Business*, 98 *DAEDALUS* 1-207 (1969) (entire issue); *Special Issue on Business and the Urban Crisis*, *FORTUNE*, Jan. 1968 (entire issue); *SATURDAY REVIEW*, Jan. 13, 1968 (entire issue); *Wall St. J.*, June 11, 1968, at 1, col. 8; *id.*, June 14, 1968, at 1, col. 8; Hunt, *Gamblers in the Ghettos, id.*, Oct. 14, 1968, at 36, col. 1. The Chase Manhattan Bank publishes a digest of corporate approaches to public problems called *Action Report*, which it announces with full-page ads in the *Wall Street Journal*. A company known as Urban Directions, Inc., was formed as a management consultant to help corporations deal with racial, urban, and social problems. Sloan, *Business Aided on Social Goals*, *N.Y. Times*, July 6, 1970, at 47, col. 7.

236. Demaree, *Business Picks Up the Urban Challenge*, *FORTUNE*, April 1969, at 103, 180, 184. Significantly, the new company was called Shindana Toys, "shindana" being the Swahili word for "competitor."

237. Moral exhortation and mild social pressures will get a few small contributions and some attendance at meetings from businessmen, particularly if no major capital commitment or significant diversion of executive attention is ultimately expected. Public approval may be gained, relations with federal agencies cemented, and some sense of participation provided—all with no diminution in potential earnings per share. Many firms that have responded to the program of private Job Corps management or "hardcore" unemployment contracts have been moved

Have either the economic standard or the legal rules that govern corporate conduct changed in the light of all these recent developments? Professors Berle and Dodd perhaps started our systematic thinking about the law that limits corporate goals in their debates in the 1930's.<sup>238</sup> Dodd contended that the business corporation as an economic institution had a social-service as well as a profit-making function. He contended that ethical standards appeared to be developing in the direction of increased social responsibilities. Berle; on the other hand, asked what could be the reasonably enforceable standard to replace profit maximization as a means of limiting and judging the actions of corporate managers. After the New Jersey supreme court decided *A.P. Smith Manufacturing Company v. Barlow*,<sup>239</sup> which upheld a 1,500-dollar contribution to Princeton University as being within the scope of legitimate corporate action, Professor Berle wrote that the debate had been settled squarely in favor of Professor Dodd's position.<sup>240</sup> The court could have sustained the contribution on narrow grounds, but chose instead to expound a theory on the social role of corporations: "It seems to us that just as the conditions prevailing when corporations were originally created required that they serve public as well as private interests, modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities in which they operate."<sup>241</sup> The court concluded that shareholders could not "thwart the long-visioned corporate action in recognizing and voluntarily discharging its high obligations as a constituent of our modern social structure."<sup>242</sup>

Recent decisions have followed the *A.P. Smith* decision in upholding various corporate expenditures. In *Theodora Holding Company v. Henderson*,<sup>243</sup> a Delaware chancellor denied a shareholder's

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by such reasons. There is also the incentive of fear—the realistic recognition that our cities, and with them our urbanized society, might simply fall apart. But these reasons do not suffice to attract the commitment of substantial capital or top executive manpower. One must, therefore, turn to the basic profit motivation of business and its increasingly public scoreboard. Not an oral moral whip, but an enticing economic carrot will make the stubborn business animal get started. Goldston, *New Prospects for American Business*, 98 DAEDALUS 78, 89 (1969).

238. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); Dodd, *Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable*, 2 U. CHI. L. REV. 194 (1935); Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

239. 13 N.J. 145, 98 A.2d 581, *appeal dismissed*, 346 U.S. 861 (1953).

240. A. BERLE, *THE TWENTIETH CENTURY CAPITALIST REVOLUTION* 169 (1954).

241. 13 N.J. at 154, 98 A.2d at 586.

242. 13 N.J. at 161, 98 A.2d at 590.

243. 257 A.2d 398 (Del. Ch. 1969).

challenge to a charitable contribution, commenting that "contemporary courts recognized that unless corporations carry an increasing share of the burden of supporting charitable and educational causes that the business advantages now reposed on corporation by law may well prove to be unacceptable to the representatives of an aroused public."<sup>244</sup> The same court also upheld a payment by U.S. Steel Company in lieu of taxes—clearly a business-motivated expenditure—as made "with a recognition of Steel's responsibilities to the communities in which it was established . . ."<sup>245</sup>

Lest these developments persuade us that a new era has dawned in which profit maximization ceases to govern and limit corporate conduct, however, we should reflect on whether profit maximization ever was the applicable legal standard. Professor Hetherington, arguing a Holmesian view that "the law" means what a court would enforce,<sup>246</sup> feels that "there is no legal obligation of management to maximize profits."<sup>247</sup> Both Hetherington and Professor Blumberg observe the virtual impossibility of defining "profit maximization."<sup>248</sup>

The power to use massive corporate assets is so imposing that the law must devise some means to circumscribe its exercise. And one is drawn to the conclusion that confining power within the profit-seeking goal is safe, if not imaginative. Professor Blumberg, in his recent study of corporate responsibility, concluded that "single minded pursuit of shareholder interest remains the legal standard for corporate conduct,"<sup>249</sup> and that "the validity of corporate activity is believed to rest on the business orientation of the program and the existence of a reasonable relation between the program and the long-term objectives of the business, or, simply put, whether the activity is being reasonably undertaken as good business in the climate of the times."<sup>250</sup> He then noted that

the solution of ghetto, minority group and other social problems has been generally accorded such a high priority as a national political

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244. 257 A.2d at 404. The dissenting judge in *Union Pacific R.R. Co. v. Trustees*, 8 Utah 2d 101, 109, 329 P.2d 398, 403 (1958), (Justice Worthen, dissenting), commented that "only among the inhabitants of Sherwood Forest has need been accepted as justifying the end."

245. *Kelly v. Bell*, 254 A.2d 62, 74 (Del. Ch. 1969), *affd.*, 266 A.2d 879 (Del. Sup. Ct. 1970).

246. See note 68 *supra* and accompanying text.

247. Hetherington, *supra* note 213, at 258.

248. See *id.*; Blumberg, *Corporate Responsibility and the Social Crisis*, 50 B.U. L. REV. 157, 163 (1970).

249. *Id.* at 205.

250. *Id.* at 206.

and social objective as to provide the necessary foundation for recognition of the existence of corporate power in the area. The depth of social needs molds both public opinion and the opinion of corporate managers on what constitutes "good business," and thereby in a sense may be said to create the basis for corporate power to deal with these needs.<sup>251</sup>

Therefore, he concluded, "the current ways in which American business is attempting to respond to social problems through greater corporate involvement seem well supported by existing authority as valid corporate measures."<sup>252</sup>

The danger with such a flexible standard is that it may not constitute any standard at all. To speak of the corporate goal as a search for long-term profits is fine, but "long-term profits" is as difficult to define as "profit maximization." Even if long-term gain could be defined, that goal sacrifices the interests of some shareholders for the benefit of others, since at least some investors are interested in short-term profits to be realized in higher stock prices. Deferral of immediate profits for the long-term gain and the eventual reward is not to them a postponement—it is an outright loss.<sup>253</sup> More appropriately, corporate conduct should be judged by whether it confers a benefit on the corporation.

While this flexibly stated standard tolerates a possible abuse of power, it does permit an imaginative exercise of power. In large corporations managers have, in fact, guided themselves by considerations other than profit.<sup>254</sup> But, as Professor Neil Chamberlain has

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251. *Id.* at 207-08.

252. *Id.* at 208.

253. See Shonfield, *Business in the Twenty-First Century*, 98 DAEDALUS 191, 201 (1969).

254. Some commentators contend that the management of the large corporation has not sought to maximize profits, but has pursued other goals. See, e.g., R. GORDON, *Business Leadership in the Large Corporation* 311-16 (1961). Professor John Kenneth Galbraith describes the aim of the technostucture of the large corporation as maximizing growth—which he carefully notes is not the same as profit—in order to stay in power and enable managers to pursue their individual goals, pecuniary and otherwise. J. GALBRAITH, *THE NEW INDUSTRIAL STATE* 168-72, 309 (1967). The creation of corporate policy based on nonprofit motives is shown in the decision of Dow Chemical Co. to produce napalm for the military despite the adverse economic effects on the company. *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 681 (D.C. Cir. 1970).

An interesting exchange occurred at the General Motors meeting when Mr. A. R. Appleby asked Mr. Roche if the directors would recommend donating profits from weapons sales to rehabilitate civilian war victims. Roche said that this could not be done without shareholders' approval, and, when asked if he would be willing to poll the shareholders on the question, he answered: "No, I think what we should do instead—I firmly believe that President Nixon is doing his best to bring the war to an end. He has made commitments. Let's give him a chance and let's not give Hanoi and Peking a massive victory through a lack of unity here at home." Transcript, *supra* note 44, at 210-11.

written, while social activity by corporations would de-emphasize the role of profits, "to de-emphasize . . . is not to abandon. As long as private enterprise prevails, some profit is essential to survival."<sup>255</sup> Chamberlain also believes that such a standard will invigorate corporate management and attract better managers.<sup>256</sup> And a business leader, writing in the same issue of *Daedalus* as Chamberlain, praised an urban-housing program in which his company had been involved. He felt it was

somewhat less profitable, but somewhat more exciting and satisfying than a good many others to which our executives might have directed their attention. The important lesson, however, is that a reasonable enough opportunity for profit was presented. Our firm was able to consider the project as a major task rather than as a secondary civic assignment or a hobby for a couple of executives. There was not enough profit to compensate fully for top executives attention to complex social controversies, but there was at least enough profit to bolster executive concern about the social problem with a sense of business purpose.<sup>257</sup>

However, even this "marginal-profit" explanation might not provide a sufficient rationale for socially desirable activities that curtail short-term profits, or incur expenses, without promising larger profits in the long run. The business benefit from such conduct is found, as Gardner Means noted, in the effort by corporations "toward assuring their own long-run status and survival."<sup>258</sup> Thus, Berle implores corporations to act for the social weal before the government intervenes to make them act.<sup>259</sup> If privately owned corporations fail to take such actions on their own initiative the ultimate threat to them is that the society which sustains them will no longer tolerate them.<sup>260</sup>

With the "benefit to the corporation" test as a beacon, corporate managers can refrain from seeking the highest profit available and

255. Chamberlain, *The Life of the Mind in the Firm*, 98 *DAEDALUS* 134, 144 (1969).

256. *Id.* at 143-44.

257. Goldston, *supra* note 237, at 98.

258. Means, *Collective Capitalism and Economic Theory*, in *THE CORPORATION TAKE-OVER* 67, 83 (A. Hacker ed. 1964).

259. Berle, *Corporate Decision Making and Social Control*, 24 *BUS. LAW.* 149, 157 (1968).

For example, on July 14, 1970, the federal government announced a program that would give the automobile manufacturers until 1975 to develop a pollution-free vehicle, or face possible elimination of the internal-combustion engine. *Wall St. J.*, July 15, 1970, at 2, col. 3. This resulted in the passage of the Clean Air Amendments of 1970, Pub. L. No. 91-604, § 6(a) (Dec. 31, 1970), amending 42 U.S.C. § 1857f-1(b) (Supp. V, 1965-1969), which require that by 1975 the automobile manufacturers reduce by 90% of the presently allowable levels carbon monoxide and hydrocarbon emissions.

260. See *Theodora Holding Co. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969). See also *THE DIRECTOR LOOKS AT HIS JOB* 15 (C. Brown & E. Smith ed. 1957).

still be reasonably within a standard of being faithful to their shareholders. They can ask their shareholders to make a sacrifice, but they cannot sacrifice their shareholders.<sup>261</sup> In fact, corporation law has always recognized this wide and flexible mandate of power to corporate managers. The proposition is simply that the "business judgment" rule, which is the classic way of expressing managerial latitude, would permit the corporation to engage in socially useful work, entailing costs or a sacrifice in profits, if a decision maker in good conscience could claim a business benefit from it.<sup>262</sup>

There are few examples of courts actually curbing the authority of managers who have acted out of regard for the community interest. The most notable case is *Dodge v. Ford Motor Company*,<sup>263</sup> in which management abruptly terminated "special" dividends in favor of using the money normally paid out to the shareholders for other purposes. A ten-per-cent shareholder sought to compel the payment of these dividends and to enjoin certain other conduct by the corporation, which he alleged was motivated by Mr. Ford's personal feelings. The court found that the refusal to pay dividends was arbitrary, and that the board's plans were not intended to produce a more profitable business, but rather a less profitable one. Mr. Ford's actions were aimed at a larger constituency, but the court observed that "a business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."<sup>264</sup> Payment of a dividend was ordered, but the court refused to enjoin any of the other activities under attack. Ford's proffered justification did not relate his activities to shareholder benefit, but it must have been clear to the court that a

261. A particularly thoughtful expression of the dilemma and the standard to guide business activity is in Carr, *Can an Executive Afford a Conscience?*, 48 HARV. BUS. REV., July-Aug. 1970, at 58, 62-64:

Proposals that fail to promise an early payoff for the company and that involve substantial expense are accepted only if they represent a means of escaping drastic penalties, such as might be inflicted by a government suit, a labor strike, or a consumer boycott. To invest heavily in anti-pollution equipment or in programs for hiring and training workers on the fringe of employability, or to accept higher taxation in the interest of better education for the children of a community—for some distant, intangible return in a cloudy future—normally goes against the grain of every profit minded management.

It could hardly be otherwise.

.....  
Before responsibility to the public can properly be brought into the framework of a top-management decision, it must have an economic justification.

.....  
It may be that the future of an enterprise system will depend on the emergence of a sufficient number of men . . . who believe that in order to save itself, business will be impelled to help save society.

262. Cf. Ruder, *Public Obligations of Private Corporations*, 114 U. PA. L. REV. 209, 223 (1965): "The only limitation is that corporate policy must be reasonably related to long-term corporate benefit."

263. 204 Mich. 459, 170 N.W. 668 (1919).

264. 204 Mich. at 507, 170 N.W. at 684.

corporation *could* explain its proposed plans for vertical integration in shareholder-benefit terms. Therefore, the court must have regarded Mr. Ford's altruistic motives as picturesquely irrelevant, and the plans were not enjoined.<sup>265</sup>

The congruence of business-benefit and social reasons for corporate action, and the relative ease with which managers can justify their acts, is illustrated in *Shlensky v. Wrigley*.<sup>266</sup> In that case a minority shareholder of the Chicago Cubs baseball team was denied relief in a derivative suit challenging management's refusal to install lights at Wrigley Field and schedule night games (presumably to draw larger attendance). The shareholder charged that the refusal to install lights was based upon Mr. Wrigley's personal conviction "that baseball is a daytime sport and that the installation of lights and night baseball games will have a deteriorating effect upon the surrounding neighborhood."<sup>267</sup> The plaintiff alleged that the principles of the *Dodge* case controlled. The court, however, sustained a dismissal of plaintiff's complaint for failure to state a cause of action. It found that the directors' decision to install lights could have been based on a concern that deterioration of the neighborhood would reduce patronage and not be in the long-run interest of the corporation.

The effect of the business judgment rule in practice, as one commentator has observed,<sup>268</sup> is that courts will take management's word that it intended to benefit the corporation by its actions, and, more, that management is the best judge of what is good for the corporation. Thus, management is put to the task of devising business-sounding reasons for its conduct but, as is indicated in *Wrigley*, the courts are not particularly interested in deciding the merits of a challenge. Professor Rostow, who finds the implications of corporate social responsibility confusing,<sup>269</sup> asks whether, apart from the areas of self-interest, management is doing anything that it could not justify in classical profit-seeking terms.<sup>270</sup>

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265. Two English cases have imposed liability on conduct that conferred community benefit but did not benefit the corporation or reasonably relate to its activities. The older case, *Hutton v. West Cork Ry. Co.*, 23 Ch. D. 654 (C.A. 1883), was long thought to be a bar against charitable gifts. The later case, *Parke v. Daily News, Ltd.*, [1962] 1 Ch. 927, has been described as "myopic." Pennington, *Terminal Compensation for Employees of Companies in Liquidation*, 25 MODERN L. REV. 715, 719 (1962).

266. 95 Ill. App. 2d 173, 237 N.E.2d 776 (1968).

267. 95 Ill. App. 2d at 176, 237 N.E.2d at 778.

268. Beuthian, *The Range of Company's Interests*, 11 CORP. PRAC. COMMENTATOR 331 (1970), in 86 S. AFR. L.J. 155 (1969).

269. Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, in THE CORPORATION IN MODERN SOCIETY 46, 63 (E. Mason ed. 1959).

270. *Id.* at 70.

What is different from the traditional approach, perhaps, is that managers more openly embrace society's goals as business objectives, all in the name of good business.<sup>271</sup> Today, business has wider horizons, and self-interest is more commonly linked with enlightenment. As always, the power of managers is sufficiently broad to permit them to engage in new activities that can reasonably be defended as beneficial to the business, and such power also permits them to conduct avowedly profit-seeking activities with a view to social impact.

Thus, corporation law reposes great power in management to deal with social problems. But what the General Motors management sought to deny and what is at issue in a public-interest proxy contest is the power of the shareholders to take an active interest in those areas.<sup>272</sup> General Motors argued that the particular shareholders proposing the resolutions—members of Campaign GM—were not interested in the welfare of the corporation, but rather with the impact of the corporation's activities on society.<sup>273</sup> Some commentators have seen significance in this distinction. Professor Hetherington observes that

[t]he principal pressures for reform and change both in the structure of the business community and in its role in society come from outside forces that are primarily concerned, not with business itself, but with social goals and values. Any realistic analysis of the legal duties and responsibilities of corporate management and of the enterprises that comprise the industrial and financial community cannot ignore this important fact.<sup>274</sup>

And Professor Blumberg maintains that the ultimate question of legitimate corporate *conduct* is affected by the motivation of the proponents of that conduct.<sup>275</sup> Similarly, the motive of the share-

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271. Thus at the conclusion of the General Motors meeting, Mr. Roche stated that "we leave this meeting more determined than ever to continue to fulfill our social responsibilities . . ." Transcript, *supra* note 44, at 221.

272. Senator Muskie noted this point, and in his speech to the Advanced Management Institute the day before he introduced the Corporate Participation Bill (S. 4003, 91st Cong., 2d Sess. (1970)) he said that "General Motors admitted a social responsibility, but it felt that social questions were out of place on the stockholders' ballots." Remarks of Sen. Edmund S. Muskie at the Advanced Management Institute, New York City, June 22, 1970, at 14. See notes 488-92 *infra* and accompanying text.

273. See General Motors Corp., GM's Record of Progress 1 (1970), in which Mr. Roche claims that "[t]he Project is using General Motors as a means through which it can challenge the entire system of corporate management in the United States." In Letter from James M. Roche, Chairman, General Motors Corp., to the Chairman of the Board of Regents of the University of California, April 15, 1970, he makes the same point.

274. Hetherington, *supra* note 213, at 292.

275. Blumberg, *supra* note 248, at 202 n.269A.



holder was determinative of the question whether he could obtain a shareholders list in *Pillsbury v. Honeywell, Incorporated*.<sup>276</sup>

It is not clear, however, why the reformers' motives have any legal significance on the questions of the corporation's sphere of action or of the shareholder's role therein. Perhaps the supposed indifference by reformers to the corporation's welfare is thought to create a danger to the market place because such a one-sided concern might cause economic distortions.

A capital market, when properly functioning, is an effective allocator of a scarce resource among those who can best use it.<sup>277</sup> While the capital markets may be less significant now than they once were in furnishing capital to business,<sup>278</sup> they continue to play an important role, particularly in a time of inflation and increased cost of borrowed funds. Moreover, they are significant to the 100 million or more persons who have an interest in the performance of the market, either as direct investors or as beneficiaries in some form of pooled investment, such as a variable annuity or a union pension fund.<sup>279</sup> To tamper with the capital markets might be a reckless disregard of the future of millions of people.

The issue of capital market impairment is indeed complex. In part, it depends on the accounting conventions that determine the amount of earnings reported by a company, which in turn dictates the market price. Existing conventions are biased in favor of social irresponsibility, since external diseconomies, such as river pollution, are not borne by the polluter, but rather by society.<sup>280</sup> Accounting innovations might be devised so that earnings could reflect, up or down, a quantitative evaluation of social conduct.<sup>281</sup>

Then, too, it is not clear that the engagement in social activity by corporations would seriously reduce profits or stock prices. California Assemblyman Willie L. Brown, Jr., speaking to a group of

276. No. 663,410 (Dist. Ct. Hennepin County, Minn. April 8, 1970) *appeal filed*, No. 42,541, Minn. Sup. Ct., May 6, 1970. See text accompanying note 373 *infra*.

277. W. BAUMOL, *THE STOCK MARKET AND ECONOMIC EFFICIENCY* ch. 1 (1965).

278. A. BERLE, *POWER WITHOUT PROPERTY* 38-41 (1959).

279. This was the number used by President Nixon in his famous letter to representatives of the security industry during the 1968 presidential campaign. See *Washington Post*, Oct. 3, 1968, § K, at 9, col. 2.

280. Coase, *The Problem of Social Cost*, 3 *J. LAW & ECON.* 1 (1960); Holton, *Business and Government*, 98 *DAEDALUS* 41, 52-53 (1969); Rose, *The Economics of Environmental Quality*, *FORTUNE*, Feb. 1970, at 120.

281. Lufkin claims that social gains can be quantified. For a discussion of the quantification problem, see Beyer, *The Modern Management Approach to a Program of Social Improvement*, *J. ACCOUNTANCY*, March 1969, at 37, 38-39. See also *SOCIAL INDICATORS* (R. Bauer ed. 1966).

International Telephone & Telegraph Company executives, hypothesized a ten-cent reduction from 1969 earnings per share of \$2.90, which, on the basis of existing price-earning ratios, would have lowered the stock price by no more than \$1.40 from its thirty-to-sixty-dollar price range. He declared this to be an insignificant shareholder sacrifice compared to the social values that could have been purchased for the 12 million dollars of diverted cash flow.<sup>282</sup> The facts hardly suggest impairment or distortion of the market place from corporate engagement in social activity.

It is possible, of course, that social activity might sharply reduce earnings, so that equity capital would be diverted away from some companies. Our capital markets have placed a heavy premium on rapid growth in recent years; to the extent that growth would taper off, capital might seek other outlets. If, on the other hand, this reallocation of capital would enable municipalities and other infrastructure capital users to compete more effectively for capital, can it fairly be said that the market place is distorted? Perhaps there already is a real distortion in the market place that considers the best user of capital to be the one who can produce the fastest growth, regardless of what social result is achieved or what financial trickery is used.<sup>283</sup>

It has also been suggested by some commentators that the proper way for shareholders to register their displeasure with management is to sell their stock, not to try to reform the corporation from within. If enough disgruntled shareholders sell, the market pressure would reduce the price of the stock and make management vulnerable to a take-over. Seeking to avoid this catastrophic result, management will change its policies. This, some maintain, is the classic operation of the free market.<sup>284</sup>

This alternative sounds fairly ludicrous when spoken in the context of General Motors. It bears no relationship to the shareholder of any company whose disagreement with management concerns social responsibility. It is unrealistic to expect a selling wave in a profitable company because of a disagreement over social policy. Management need not adjust its policies to avoid a raid prompted by a desire to convert the company into a socially responsible one—

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282. Address of Willie L. Brown, Member, Calif. Assembly, Before the Intl. Tel. & Tel. Co. Public Affairs Seminar, Washington, D.C., June 18, 1970, at 6.

283. See *Hearings on Investment Policies of Pension Funds Before the Subcomm. on Fiscal Policy of the Joint Economic Comm.*, 91st Cong., 2d Sess. 118 (1970) (testimony of Roy A. Schotland).

284. Manne, *Good for General Motors?*, BARRON'S, May 18, 1970, at 1.

social irresponsibility may well have caused higher profits and stock prices, hardly an atmosphere conducive to a raid. The take-over threat, as a response to social inactivity, is a myth, or worse, a decoy.

Moreover, under this alternative shareholders unhappy with social policies are told to pursue a strategy unrelated to their objective. Their objective is to convince managers and shareholders to adopt certain policies. They are not seeking the personal catharsis that might accompany disassociation from distasteful policies. Thus, selling stock in a company that discriminates against blacks might be good for the spirit, but it does not directly affect the company; rather it would place the stock in the hands of persons who either favor the policy, or at least are indifferent to it. So the objectionable policy would be strengthened by selling.

How different the attack on corporate social policy is from an attack on policies that depress profits or dividends. In the latter case, the shareholder views the stock as a piece of paper representing a dollar value and nothing else. He can accomplish his objectives by selling the stock and acquiring a new symbol of dollar value. But, to the shareholder who is concerned about social questions, his stock ownership is not entirely a dollar symbol. His piece of paper is not freely exchangeable with another piece of paper. The only way he can redress the source of his displeasure is by remaining a shareholder. Indeed, his strategy should call for gaining influence by buying stock, rather than abandoning influence by selling it.

The process of decision-making as it affects corporate social policy remains the fundamental issue in this analysis of corporate power because reformers believe that they can affect policy only by active participation. They are not convinced that, having demonstrated the existence of broad managerial power on social questions, they could really accomplish very much if that power is exclusive and pre-empts all shareholder power on those issues. In earlier times, it might have been thought highly significant to demonstrate that managers could use their discretion for the benefit of society; in fact, that was the topic of the Berle-Dodd debate.<sup>285</sup> The belief was that the shareholder interest would dictate a narrower focus for corporate policy and that a more sophisticated and enlightened management would better serve society.<sup>286</sup> Thus, the managerial school believed

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285. See references cited in note 238 *supra* and accompanying text.

286. See A. BERLE & G. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 356 (1932); Manning, *Corporate Power and Individual Freedom: Some General Analyses and Particular Reservations*, 55 NW. U. L. REV. 38, 41 (1960).

itself more progressive than the school of shareholder democracy, which urged more power to the owners of the corporation.<sup>287</sup>

Today's reformers believe that as the argument was framed between those two schools, it missed the point. Shareholder democracy, if it meant only a concern for pecuniary shareholder interests, was entirely too narrow since the appropriate constituency of the corporation includes all those affected by corporate activity, not just shareholders.<sup>288</sup> Managers, on the other hand, are no more expert than shareholders on questions of social policy,<sup>289</sup> and they may be even less representative of many of the interests affected by corporate action. And representation of as many interests as possible is important. The large corporation has emerged as a demistate.<sup>290</sup> Unbridled power, in fact if not in form, in the hands of managers raises the likelihood that arbitrary policies will emerge.<sup>291</sup> Political experience teaches us that the restraint of power through principles of law and republican government best serves the collective interest.<sup>292</sup>

Campaign GM was deeply concerned with attempting to demonstrate the inadequacy of the existing corporate decision-making structure, which it believed instinctively resists change because of its unrepresentative composition. For example, the board of directors of General Motors included several persons with close ties to the oil industry—a liaison which the Justice Department ordered terminated.<sup>293</sup> General Motors also had close ties with universities<sup>294</sup> and

287. Lewis Gilbert is the best symbol of the shareholder democrat. Cf. F. EMERSON & F. LATCHAM, *SHAREHOLDER DEMOCRACY* 113-14 (1954).

288. See Brewster, *The Corporation and Economic Federalism*, in *THE CORPORATION IN MODERN SOCIETY* 72 (E. Mason ed. 1959).

289. Eisenberg, *Access to the Corporate Proxy Machinery*, 83 *HARV. L. REV.* 1489, 1511 (1970).

290. See A. BERLE, *THE THREE FACES OF POWER* ch. 2 (1967); Address of Manuel F. Cohen, Chairman, SEC, Before the Economic Club of Detroit, Detroit, Mich., Jan. 27, 1969, at 7.

291. Manning, *supra* note 286, at 46.

292. Our democratic ideals require that political power be limited; that countervailing power be maintained; that power be responsive to the community's needs and aspirations; and that legitimate power be non-authoritarian. Adolph Berle concluded that corporate power was legitimate because it was generally accepted in the community. I suggest that the exercise of political power (whether by Government or business) cannot be legitimate unless it is non-authoritarian—that is, unless it is subject to free and systematic analysis and criticism—what I have termed “institutional criticism.”

Address of Manuel F. Cohen, Chairman, SEC, Before the Economic Club of Detroit, Detroit, Mich., Jan. 27, 1969, at 7. Professor Chayes argues that the rule of law must be applied to the corporation so that “significant power will be exercised not arbitrarily, but in a manner that can be rationally related to the legitimate purposes of the society.” Chayes, *The Modern Corporation and the Rule of Law*, in *THE CORPORATION IN MODERN SOCIETY* 25, 31 (E. Mason ed. 1959).

293. See Transcript, *supra* note 44, at 24-27.

294. See *id.* at 33-35, 54, 144-45, 154-55.

banks.<sup>295</sup> And the board selection process of General Motors maintained this exclusivity. To replace Richard Mellon, one of the directors linked to the oil industry, management selected John A. Mayer, chairman of the Mellon National Bank and Trust Company, "to provide a highly qualified Board member from the Pittsburgh area."<sup>296</sup> But why was the Pittsburgh area deserving of special concern?<sup>297</sup> And why not a steelworker rather than a banker? When the two new nominees were chosen by the board, no other persons were considered for the position—the nominees were chosen "by common consent."<sup>298</sup> Nor did the board as constituted consider some of the questions that were of greatest concern to Campaign GM. At the annual meeting, it was revealed that the board did not take up the question of the number of black dealerships, or the alleged inadequacy of consumer warranties; it merely "heard reports" on safety and pollution.<sup>299</sup>

Some board members did not take kindly to the criticism that they were an unrepresentative body.<sup>300</sup> Former chairman Frederick Donner referred to the Campaign GM representatives as "pipsqueaks."<sup>301</sup> More untenable was the reaction of former Secretary of Commerce John T. Conner, who said, "I think it is essential for a board to have free and frank discussions . . . I was quite upset by the nature of the questions and the tone of the questions—as if the board was a public body whose deliberations were a matter of public record."<sup>302</sup>

It is not surprising, therefore, that reformers view corporate decision makers as endemically lacking the ability or the will to make necessary changes. Even management efforts to deal with some problems such as pollution, safety, and minority opportunity will not assuage them because these actions and the accompanying rhetoric

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295. *See id.* at 165.

296. Letter from Mr. Ross L. Malone, General Counsel, General Motors Corp., to Philip W. Moore, Executive Secretary of Campaign GM, April 22, 1970, quoted in Transcript, *supra* note 44, at 175-76.

297. *See id.* at 175-77.

298. *Id.* at 181. Stewart Mott, whose father has been a General Motors director since 1917, said he had been told "on good authority" that there was no occasion in the recent past when there was a split vote on any issue. *Id.* at 190.

299. *See id.* at 184-86.

300. Not so Mr. Roche, however. He commented on the "sincerity and honesty and purpose" of the speakers at the meeting. *Id.* at 220. At his press conference after the meeting, he said, "I think that Campaign GM conducted itself in a very fine fashion today." General Motors Corp. Sixty-Second Annual Meeting of Stockholders, News Conference, Detroit, Michigan, May 22, 1970, at 4.

301. Detroit News, May 23, 1970, § A, at 8, col. 4.

302. Bus. WEEK, May 30, 1970, at 84.

are viewed as minimum steps necessary to still an aroused community.<sup>303</sup>

At the press conference announcing Campaign GM, Ralph Nader spoke of a "new reality . . . that will tame the corporate tiger."<sup>304</sup> As others have seen it, that "new reality" would necessarily refine the decision-making process to take into consideration of all the effects of corporate decisions, including the social implications. For example, Assemblyman Brown told the International Telephone & Telegraph gathering, "[t]hese considerations should become a natural, and integral part of the process. We have had enough of afterthoughts, of public relations gestures, of corporate band aids. A new medicine is what we are after."<sup>305</sup> Under the "new reality" the public would be represented on the board "selected from a broad cross-section of the people who will most directly be affected by the operations of the concern," and finally, "we should require that they be *not* exclusively male, *not* exclusively white and *not* exclusively Protestant."<sup>306</sup> In short, the "new reality" envisions the creation of a countervailing force within the corporation to keep its power in check and constructively channeled, rather than relying solely on outside countervailing forces, such as government, labor unions, and free markets to do so. The new force is especially needed in the 1970's since the effectiveness of those outside forces seems to have been weakened over the years.<sup>307</sup>

But how to achieve the internal countervailing force—how to introduce public considerations as part of the corporate decision-making process—is a large question. Nader's "new reality" did not emerge clearly during Campaign GM. Over the years suggestions have been made for introducing a public voice on the board: Justice

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303. Hetherington, *Fact and Legal Theory: Shareholders, Managers and Corporate Social Responsibility*, 21 STAN. L. REV. 248, 289-91 (1969). Those on the New Left suspiciously eye the social activities of business because they view satisfying social needs and making money as distinct and hostile goals. M. HARRINGTON, TOWARD A DEMOCRATIC LEFT 87 (1968). In this view, they share common ground with their more traditional brethren.

An example of the limitations of social activity undertaken without compulsion of some sort is the recent report of curtailed use of DDT. While voluntary action has cut its use, DDT is still as widely used as ever by cotton growers, who account for two thirds of the national consumption. Indications are that they will continue to use DDT until the Department of Agriculture prevents its further use. N.Y. Times, July 20, 1970, at 1, cols. 7-8.

304. See text accompanying note 27 *supra*.

305. Address of Willie L. Brown, Member, Calif. Assembly, Before the Intl. Tel. & Tel. Co. Public Affairs Seminar, Washington, D.C., June 18, 1970, at 5.

306. *Id.* at 3.

307. Hacker, *Introduction: Corporate America*, in THE CORPORATION TAKE-OVER I, 10 (A. Hacker ed. 1965).

Douglas' proposal for professional directors;<sup>308</sup> Beardsley Ruml's suggestion that the board designate each one of its members as a "trustee" for one other interest group, such as employees or the public;<sup>309</sup> Reverend John Maxwell's proposal for government-designated representatives on the boards of major corporations;<sup>310</sup> and Detlev Vagt's proposed emulation of German corporation law which seeks codetermination for employees and the public interest.<sup>311</sup> Conceivably there is merit in some of these suggestions, but only if they are effectively implemented with regard to the selection of directors and provisions for salary and staff.

Perhaps the "new reality" as demonstrated, if not articulated, by Campaign GM was no new form, but merely new wine in old bottles. What is fictitious about shareholder democracy, of course, is its existence.<sup>312</sup> But in a free-enterprise system, particularly one that has striven so hard to create a broad public capital market, are we not bound by those forms that listen to the voice of the owners of the business? Is the new reality, then, a new role for shareholder democracy? Of course, merely posing the question reveals the paradoxical nature of the public-interest proxy contest. The shareholder did not become a shareholder in order to become a social reformer. The purpose of his investment was to make money. As such, his interest as a shareholder is antithetical to the public interest insofar as activity in the public interest involves any sacrifice on his part. But are those interests really antithetical? The great majority of shareholders are affected by corporate decisions more as citizens than as shareholders. With their mounting numbers, the shareholders increasingly represent a cross-section of our society, and if they view their interest as aligned with the general public, then they might serve as a surrogate for the community as a whole. Some of the financial institutions at least should perceive such an identity.<sup>313</sup>

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308. W. DOUGLAS, *DEMOCRACY AND FINANCE* 52-53 (1940).

309. Ruml, *Corporate Management as a Locus of Power*, in N.Y.U. SCHOOL OF LAW, *SOCIAL MEANING OF LEGAL CONCEPTS*, No. 3: THE POWERS AND DUTIES OF CORPORATE MANAGEMENT 219, 235-37 (E. Cahn ed. 1950). First Pennsylvania Banking & Trust Co. is reportedly considering turning over as many as a third of its board seats to consumer representatives, young people, employees, blacks, poor people, and militant feminists. *Wall St. J.*, Aug. 5, 1970, at 12, cols. 4-6.

310. See Latham, *Equality and Power in the Maxwell Memorandum*, 40 U. DET. L.J. 457, 464 (1963).

311. Vagts, *Reforming the "Modern" Corporation: Perspectives from the German*, 80 HARV. L. REV. 23, 85 (1966).

312. See Manning, *Book Review*, 67 YALE L.J. 1477 (1958).

313. See pt. II. D. *infra*.

Does this "new reality" presage any success in achieving the goal of more socially responsible corporations? It probably does not through the electoral process, since most shareholders are unlikely to vote for any proposal opposed by management. Nevertheless, it does make the electoral process significant. Some shareholders will seek social action from the corporation, and, if they are permitted to do so, will raise policy questions with their fellow shareholders. Management could probably defeat any such proposal for social action merely by arguing that it would be bad for business. But it dare not do so, and that is the rub. While management might argue privately that the proposal would hurt the corporation financially, it will not do so in a public-interest proxy contest since what is said to the shareholders will be overheard by nonshareholders. Therefore, management must justify its opposition to the proposal in public-interest terms lest the nonshareholder public react adversely to the corporation. Management's strongest argument is that it is already dealing with the problem.<sup>314</sup> If the same questions are asked periodically, however, management cannot reply merely with rhetoric, but must show positive results that justify renewed confidence in its stewardship. The repeated process also serves to educate the public about the effects of the corporation's activities, and about the way corporate decisions are made.

Hence, under the "new reality" shareholders and the public are brought within the process of corporate decision-making through the debate of issues in a public forum. Naturally, this process is not so effective as institutionalizing a public role in corporate decisions through board representation or participation on committees. One can expect future efforts to achieve such direct representation for proposals for reforming the director nomination process, for furthering cumulative voting,<sup>315</sup> for permanent committees on corporate responsibility to monitor corporate decisions, and the like.<sup>316</sup> In the

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314. This is the argument that General Motors management made. At the stockholder meeting it ran a lengthy film to show the company's efforts in pollution, safety, and race relations. Mr. Roche said that management intended to get much use from the film. Transcript, *supra* note 44, at 197. It has since been shown on national television. *BUS. WEEK*, July 11, 1970, at 72.

315. There were suggestions at the General Motors meeting that shareholders should be able to nominate candidates (Transcript, *supra* note 44, at 59) or that cumulative voting could achieve a public voice on the board (*id.* at 105-06).

316. See Schwartz, *Corporate Responsibility in the Age of Aquarius*, 26 *BUS. LAW.* 513 (1970) (Address Before the ABA Convention, St. Louis, Mo., Aug. 11, 1970).



meantime, however, the public-interest proxy contest as a vehicle for the public airing of social-responsibility issues may be the only feasible "new reality" within the framework of the free-enterprise system.

This analysis of the social responsibility of corporations allows for three interim conclusions. First, the corporation is not confined to operating within the framework of profit maximization. It can engage in those activities which the appropriate decision maker believes serve to benefit the company. This norm permits the corporation to invest its resources to improve the welfare of the community in which it operates. Thus a corporation can undertake an expense incident to its profit activities, even if that expense is costly or does not increase profits. An example would be an expenditure to improve the safety of a car, or to make it less polluting. And a corporation can undertake activities reasonably related to the welfare of the free-enterprise system in general, such as charitable contributions.

The second conclusion is that the shareholder role in the exercise of corporate social responsibility is important, and may serve to bring a public awareness to the process. At present, the decision makers may not think grandly enough about the implications of their conduct. But policy alone is the concern of the shareholder, not detail.

These first two conclusions are merged in the third in tangible form as we relate corporate social responsibility to the specifics of a proxy contest. The question then is what issues are proper for inclusion in management's proxy statement. Resolutions that deal with some aspect of an activity now carried on by the corporation, or that ask the corporation to undertake some new activity that is within its permissible scope, cannot be dismissed as primarily for the purpose of serving a general social, political, or similar cause and must therefore be included. If the resolution relates to an activity outside the corporation's realm, on the other hand, such as one requesting a government body to take action, or proposes something that the corporation is not empowered to do, such a resolution's purpose relates to a general social, political, or similar cause, and is improper. If the resolution is confined to a proposal of policy, then it is a proper subject for shareholders and must be included in the proxy statement. If, however, it seeks to compel, or even to recommend, the detailed implementation of policy, it may be excluded by management as not a proper subject matter for shareholder interest, or as one that deals with ordinary business.

### C. *The Solicitation of Support*

#### 1. *The Strategy of a Public-Interest Proxy Contest*

Campaign GM was different from the normal proxy contest because it did not actively pursue the votes of most of the voters while it did seek the support of many nonvoters. Understanding why, in a public-interest proxy contest, this may not be so strange, requires a close look at the methods of solicitation and the rules that govern them.

The proxy rules<sup>317</sup> require a proxy to be accompanied or preceded by a proxy statement,<sup>318</sup> which in turn must contain the information detailed in Schedule 14A.<sup>319</sup> The proxy statement must be filed with the SEC at least ten days prior to its use.<sup>320</sup> If a shareholder has been furnished with a proxy statement, supplementary soliciting material may then be distributed to him, but it must also be filed with the Commission.<sup>321</sup> False or misleading solicitations are illegal.<sup>322</sup>

A special rule is applicable to an election contest, which is defined as a solicitation "for the purpose of opposing a solicitation subject to [this regulation] by any other person or group of persons with respect to the election or removal of directors at any annual or special meeting of security holders."<sup>323</sup> Thus, if Campaign GM had opposed the election of any of management's nominees by seeking votes for its nominees without first seeking to enlarge the board of directors, then its solicitation would have been in opposition to management's solicitation. Campaign GM emphasized in the proxy material that Miss Furness, Dr. Dubos, and Reverend Phillips would be nominated only if the bylaws were amended to enlarge the board of directors by three seats. Since a contest over a bylaw to enlarge the board is not an election contest, the special rule did not apply to Campaign GM.<sup>324</sup>

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<sup>317</sup> SEC Reg. 14A, 17 C.F.R. § 240.14a (1969), promulgated pursuant to 1934 Act § 14(a), 15 U.S.C. § 78n(a) (1964).

<sup>318</sup> Rule 14a-3(a), 17 C.F.R. § 240.14a-3(a) (1969).

<sup>319</sup> 17 C.F.R. § 240.14a-101 (1969).

<sup>320</sup> Rule 14a-6(a), 17 C.F.R. § 240.14a-6(a) (1969).

<sup>321</sup> Rule 14a-6(b), 17 C.F.R. § 240.14a-6(b) (1969), requires advance filing by two days, but speeches, press releases, and radio or television scripts may be filed when used or published. Rule 14a-6(g), 17 C.F.R. § 240.14a-6(g) (1969).

<sup>322</sup> Rule 14a-9, 17 C.F.R. § 240.14a-9 (1969).

<sup>323</sup> Rule 14a-11(a), 17 C.F.R. § 240.14a-11(a) (1969).

<sup>324</sup> Rule 14a-11(c), 17 C.F.R. § 240.14a-11(c) (1969), requires all "participants" to file a Form 14B (containing the information specified in Schedule 14B, 17 C.F.R.

In a proxy contest involving control, both sides saturate the shareholders' mailboxes with solicitation material. Proxy statements and supplementary material, each accompanied by proxy cards, are sent to shareholders. Larger shareholders may receive telephone calls from the contestants or from professional proxy solicitors. Personal visits are sometimes made.<sup>325</sup> Occasionally, advertisements supporting one faction or the other appear in the newspapers. Contestants pay particular attention to brokers in soliciting since customers may ask their brokers how to vote. Institutions, of course, often represent the balance of power and they receive the most attention.<sup>326</sup> Proxy contests, consequently, are expensive; in some cases the cost may exceed 1 million dollars.<sup>327</sup> Management ordinarily expects its expenses to be paid out of the company treasury, while only successful insurgents can obtain reimbursement for their expenses.<sup>328</sup>

Campaign GM's strategy differed from that employed by most groups that oppose management because its resources were limited and its objectives were substantially different. The Campaign adopted three basic tactics.

First, Campaign GM would have to get its proposals on management's proxy statement. Its efforts in this regard have been described above.<sup>329</sup> For each proposal that was so included, each shareholder would have an opportunity to vote for Campaign GM on management's proxy.

Second, Campaign GM would file a proxy statement of its own

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§ 240.14a-102 (1969)) before a "solicitation" is made; this requirement can prove cumbersome and cause delays. See Bayne & Emerson, *The Virginia-Carolina Chemical Corporation Proxy Contest: A Case Study of the SEC's New Rule 240, 14a-11 and Schedule B*, 57 COLUM. L. REV. 801 (1957). The SEC staff was uncertain whether to apply the rule to Campaign GM, and finally decided not to do so. A contrary decision could have been troublesome for Campaign GM. Nader insisted that he was not a "participant," but the staff thought that the broad language of the definition in rules 14a-11(b)(3) or (6), 17 C.F.R. §§ 240.14a-11(b)(3), (6) (1969), extended to him. Some persons who contributed money to Campaign GM might not have wanted to do so if they had been required to identify themselves as participants.

325. See Robards, *The Proxy War Is Escalating*, N.Y. Times, Feb. 23, 1969, § 3, at 1, col. 1; Klein, *Proxy War Pros*, Wall St. J., Feb. 23, 1967, at 1, col. 6.

326. See Louis, *The Mutual Funds Have the Votes*, FORTUNE, May 1967, at 150; Maseritz, *The Investment Company: A Study of Influence and Control in the Major Industrial Corporations*, 11 B.C. IND. & COM. L. REV. 1 (1969); *Special Report: Why the Big Traders Worry Industry*, BUS. WEEK, July 25, 1970, at 53.

327. E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL 543 (2d ed. 1968).

328. Steinberg v. Adams, 90 F. Supp. 604 (S.D.N.Y. 1950); Rosenfeld v. Fairchild Engine & Airplane Corp., 309 N.Y. 168, 128 N.E.2d 291 (1955); E. ARANOW & H. EINHORN, *supra* note 327, at 572.

329. See pt. II. A *supra*.

and with it contact directly some of the larger investors, particularly the institutional investors.<sup>330</sup> In this proxy statement, Campaign GM could elaborate on its proposals and advance reasons why it should be supported. Moreover, investors who received the proxy statement would also be sent follow-up soliciting material.

Third, Campaign GM would communicate with the public through Campaign literature oriented toward the public rather than shareholders. It expected to make frequent use of the mass media and to develop newsworthy stories that would create added publicity. This tactic began with Ralph Nader's announcement of the campaign.<sup>331</sup>

Why did the strategy encompass communication with the public? This question has considerable legal significance because in some instances communication with the public might conflict with proxy regulations limiting solicitations. There are basically three reasons why a public-interest proxy campaign, such as Campaign GM, needs to reach the public. First, since the contest involved a program of action that affected the public, it was hoped that the public response to Campaign GM would be heard, and heeded. Thus, Campaign GM believed that favorable newspaper accounts and editorials were important. And, as discussed earlier,<sup>332</sup> it was deemed essential to engage in public debate with management so that the issues would be discussed in broad terms. This was not just a tactic; it was one of the main objects of the campaign. Second, Campaign GM contended that the political structure of the corporation was too narrow, and that the public should be part of the decision-making process. It was thus deemed necessary to try to convince the nonshareholder public of its potential role in the public-interest proxy contest. Finally, Campaign GM felt it necessary to reach the constituencies of financial and other institutions who were shareholders of General Motors to influence their votes. These constituencies included students, alumni and faculty of universities, beneficiaries of pension funds, and policy holders of insurance companies.<sup>333</sup>

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330. The delivery of management's proxy statement, containing the shareholder proposals, did not constitute the furnishing of a proxy statement by Campaign GM to the shareholders within the meaning of rule 14a-3, 17 C.F.R. § 240.14a-3 (1969), since the supporting statement could not disclose the detailed information about Campaign GM required in schedule A. See notes 318-19 *supra* and accompanying text. Thus, to solicit its own proxies, Campaign GM was required by the rules to use its own proxy statement. *SEC v. Dyer*, 180 F. Supp. 903 (E.D. Mo. 1959), *revd. on other grounds*, 291 F.2d 774 (8th Cir. 1961). See 2 L. Loss, *SECURITIES REGULATION* 901 (2d ed. 1961).

331. See text accompanying notes 24-27 *supra*.

332. See text following note 32 *supra*.

333. Campaign GM was not the first proxy contestant to go past the institution to

## 2. What Is a Solicitation?

General Motors argued that Campaign GM violated the proxy rules with Ralph Nader's initial press conference, a second press conference announcing the six additional proposals, and a television interview of Nader on *Face the Nation* since none of these "solicitations" was preceded or accompanied by a proxy statement. It also argued that Campaign GM's contemplated activities foreshadowed future violations of the rules. Management argued that if a shareholder wanted to communicate with shareholders via rule 14a-8 he could not engage in other soliciting activity without furnishing a proxy statement. The appropriate remedy suggested by management for these violations was to bar Campaign GM from including the proposals in management's proxy statement.<sup>334</sup>

Although the SEC did not adopt management's suggestion regarding the proper remedy for improper solicitations, the staff was troubled by the question whether the early public announcements constituted "solicitations" within the meaning of the rule defining that term.<sup>335</sup> In *Studebaker Corporation v. Gittlin*<sup>336</sup> and *Securities*

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those who influence it. In 1966 and 1967, both sides in the Metro-Goldwyn-Mayer proxy contest sought the support of influential members of Congress to try to gain the votes of certain mutual friends. These private conversations, of course, involved no violation of the proxy rules. See Louis, *The Senators, the Funds, and the Law*, *FORTUNE*, May 1967, at 152.

This strategy raises a problem under the proxy rules. The contention of the public-interest proponent is that the beneficiaries of an institution should be encouraged to take part in the decision-making process. Thus, they are addressed not just as interested members of the public, but as persons who can affect the vote. Therefore, it might be argued that it is necessary to send a proxy statement to such beneficiaries before communicating with them. Some SEC staff members were known to be troubled by this problem. But the only practical solution would be to prohibit communication with such constituencies; and this measure would be of highly dubious constitutionality. In effect, the SEC's fears of bias are not well founded since the other side is always free to answer any incorrect or excessive assertions that might be made.

334. Davis, Polk & Wardwell Letter, *supra* note 157, at 2-6; Malone Letter, *supra* note 157, at 11-12. One response by Campaign GM to management's objections was to hold a third press conference revealing its plans. See Wall St. J., March 6, 1970, at 14, col. 2. The SEC then voiced its objection to the press conferences and asked that they be stopped. Campaign GM agreed to do so "until there is available a definitive proxy statement." Letter from the author to Theodore I. Sonde, Special Counsel, Office of General Counsel, SEC, March 9, 1970.

335. Rule 14a-1(f)(1)(iii), 17 C.F.R. § 240.14a-1(f)(1)(iii) (1969), defines "solicitation" to include any "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." At the first meeting with Campaign GM representatives, the Commission staff expressed its view that Nader's first press conference (*see* text accompanying notes 24-27 *supra*) may well have constituted a technical violation of rule 14a-3 since it was not accompanied or preceded by a proxy statement. The staff followed the long-standing Commission practice of warning counsel of a possible violation at this stage.

336. 360 F.2d 692 (2d Cir. 1966).

*Exchange Commission v. Okin*,<sup>337</sup> two Second Circuit cases, the court held that in order to constitute a solicitation a communication need not specifically request a proxy from the shareholder if it is part of a "continuous plan" intended to end in the solicitation of a vote, and is used to prepare the way for a successful proxy fight.

In context these Second Circuit decisions appear sound; in the context of a public-interest proxy contest, however, they encounter a policy clash that has long plagued the administration of the securities laws. If a communication is solely an attempt to influence a shareholder decision on voting or an investor decision to purchase, and is of no other interest or serves no other purpose, there is little difficulty in finding that the communication should comply with proxy or prospectus rules.<sup>338</sup> But if that same communication serves to inform others about facts or an event in which they have a legitimate interest, or is relevant to some other interest besides voting or purchasing, then the effect of forcing it to comply with such rules would be to shut off necessary or useful disclosure rather than to promote it. This latter problem arises when shareholders vote on a matter of general community interest, as they do in a public-interest proxy contest.

In *Brown v. Chicago, Rock Island & Pacific Railroad Company*,<sup>339</sup> the board of directors of the Rock Island Railroad had agreed with the board of directors of Union Pacific Railroad to merge the two companies, but the Chicago & North Western Railway Company opposed the plan. The latter made a tender offer to the Rock Island shareholders in an attempt to defeat the merger. Of course, the Interstate Commerce Commission (ICC) had to give its approval to any combination involving railroads.<sup>340</sup> In an attempt to sway the ICC decision and public opinion against North Western, the Union Pacific published advertisements opposing North Western's bid and supporting the proposed merger. A shareholder vote on the merger was three months away, but of course the control of the railroad was of community interest. North Western, supported by the SEC,<sup>341</sup>

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337. 132 F.2d 784 (2d Cir. 1943).

338. Under the Securities Act of 1933, the problem presented here is one of "gun jumping." Section 5(c), 15 U.S.C. § 77e(c) (1964), prohibits any "offer" of securities until a registration statement has been filed.

339. 328 F.2d 122 (7th Cir. 1964).

340. Interstate Commerce Act § 5(2), 49 U.S.C. § 5(2) (1964).

341. The Commission's *amicus* brief regarded any communication linked to an eventual shareholder vote as a solicitation. Brief for SEC as Amicus Curiae at 4-8, *Brown v. Chicago, Rock Island & Pacific Ry. Co.*, No. 63-C-1361 (E.D. Ill. Sept. 13, 1963), *aff'd.*, 328 F.2d 122 (7th Cir. 1964). This view is consistent with an earlier proposal made by the staff to amend the definition of "solicitation" in rule 14a-1(f), 17 C.F.R.

argued that the advertisements were proxy solicitations and hence illegal since they were not accompanied by a proxy statement. The court balanced the interests involved. Considering the fact that the advertisements were published three months before the shareholder vote, the fact that no votes were sought at that time, nor were intended to be sought, the fact that the communication was directed to the public, and the fact that there was a substantial public interest in the outcome of the struggle, the court found that there was no solicitation within the meaning of rule 14a-1.<sup>342</sup>

Thus the *Brown* case shows that it is too easy, and not correct, to assume that all communications connected with a plan for vote-seeking fall within the rigors of the proxy requirements. Arguably, *all* information about a company planning to issue securities is an "offer" of securities within the meaning of the Securities Act of 1933<sup>343</sup> and, therefore, cannot be uttered until a registration statement has been filed. But the SEC realizes that a strict prophylactic rule cannot work since the need to publish information about companies may sometimes outweigh an investor's interest in obtaining a prospectus.<sup>344</sup> The line is difficult to draw, and results may appear arbitrary in some cases.<sup>345</sup> The guides furnished by the *Brown* court, however, are helpful. By analogy to that case, at least the first Nader press conference should not be considered to be within the definition of "solicitation," although the later publicity may come within its scope.

More serious problems arose from the activities contemplated by Campaign GM that admittedly fell within the interpretation of "solicitation." Since the mass media were to be used to reach the public, clearly some General Motors shareholders who did not receive a

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§ 240.14a-1(f) (1969), to include "any statement made or used by or on behalf of any participant in a solicitation (i) in support of or in opposition to any matter to be acted upon by security holders . . . , whether addressed directly to security holders, or to a group of persons or *the general public* or (ii) which may facilitate, influence, aid or obstruct the giving or revoking of proxies by security holders." SEC Securities Exchange Act of 1934 Release No. 5212 (Aug. 23, 1955) (emphasis added). This proposal was not adopted by the Commission, however.

342. 328 F.2d at 124-26.

343. 15 U.S.C. § 77e(c) (1964). See note 338 *supra*.

344. See rule 135, 17 C.F.R. § 230.135 (1969), promulgated under Securities Act of 1933 § 5(c), 15 U.S.C. § 77e(c) (1964). SEC Securities Act of 1933 Release No. 3844 (Oct. 4, 1957) illustrated public communications that were not "offered." See F. WHEAT, DISCLOSURE TO INVESTORS: A REAPPRAISAL OF FEDERAL ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 ACTS—THE WHEAT REPORT ch. 5 (CCH ed. 1969), acknowledging the need to balance interests.

345. See, e.g., *Chris-Craft Indus., Inc., v. Bangor Punta Corp.*, 426 F.2d 569 (2d Cir. 1970).

proxy statement from Campaign GM would still be solicited by it, and, further, they would be given a chance to vote for Campaign GM on management's proxy statement. Campaign GM pointed out this problem to the SEC in its letter urging the includibility of its proposals.<sup>346</sup>

The SEC staff responded to Campaign GM on this point in a letter explaining that while advanced filing under the proxy rules was not required with respect to speeches, press releases, and radio or television scripts,

the use of this form of material is dependent upon compliance with Rule 14a-3(a) . . . . Thus, unless a proxy statement is sent to each shareholder entitled to vote at the meeting or is included in the advertisement or other forms of communication to the public, the requirements of Rule 14a-3(a) would not be met. Moreover, the fact that the communication may be addressed to the public generally as well as to stockholders does not of itself remove the solicitation from the requirements of the proxy rules.<sup>347</sup>

Campaign GM pointed out to the SEC that such an interpretation of the proxy rules would bar all public communication by Campaign GM because it would require sending a proxy statement to each shareholder—at a cost of about 100,000 dollars. Campaign GM then urged the staff to interpret "solicitation" to *exclude* a communication that does not seek votes, that occurs in a noncontrol contest, and in which there is a substantial interest by the nonvoting public. This interpretation was sought only for purposes of rule 14a-3 so that a communication would not have to be preceded or accompanied by a proxy statement; such a communication would still be subject to the antifraud provisions of rule 14a-9 and the filing requirements of rule 14a-6.<sup>348</sup> Campaign GM argued that a contrary interpretation would violate its first amendment right to communicate with the public.<sup>349</sup>

First amendment concerns about the proxy rules are not new to the SEC.<sup>350</sup> Internal memoranda from the Commission's staff have justified the rules as legitimate qualifications on communication both because they are reasonable and because they serve an important

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346. Letter from the author to the SEC, March 10, 1970, reprinted in 116 CONG. REC. E2147-51 (daily ed. March 17, 1970).

347. Letter to the author from Charles E. Shreve, Dir., Div. of Corp. Fin., SEC, March 25, 1970.

348. See notes 318-22 *supra* and accompanying text.

349. Letter from the author to Charles E. Shreve, Dir., Div. of Corp. Fin., SEC, April 9, 1970.

350. See Rostow, *To Whom and for What Ends Is Corporate Management Responsible?*, in *THE CORPORATION IN MODERN SOCIETY* 46, 304 n.13 (E. Mason ed. 1959).



policy of protecting investors by providing full and fair disclosure. Because most proxy contests offer commercial incentive to the contestants to deviate from the truth, the restraints embodied in the proxy rules have been upheld as serving a necessary regulatory objective.<sup>351</sup>

In general, regulation that narrows a fundamental constitutional right, such as free speech, will be examined by the courts to see if it serves a "compelling governmental interest."<sup>352</sup> The Government's interest in requiring a proxy statement to precede or accompany solicitations, presumably, is to protect the integrity of the regulation that seeks to make the proxy statement the basic soliciting document. If shareholders do not have to be shown the proxy statement before other communications constituting "solicitations" are made, they will not receive adequate information on which to base their vote because they will probably ignore the proxy statement itself—or at least form their opinions of its merit before they have seen it. In the context of the General Motors case many shareholders would not see the required proxy statement at all since Campaign GM could only afford to send out proxy statements selectively, but they would nonetheless receive a proxy from management on which they could vote for Campaign GM.<sup>353</sup> Thus, the SEC's interest in requiring a proxy statement with or before each solicitation was not insubstantial, but it had to be measured against its effect. If the SEC's view of its rules as communicated to Campaign GM did not impinge on any protected rights, it seemed fair to accept the view since it was that of the agency charged with devising rules for the implementation of congressional objectives.

Campaign GM argued that the effect of the SEC view would be to prevent any communication to the public.<sup>354</sup> That conclusion seems inescapable because one must accept the fact that Campaign GM did not have the funds available to send a proxy statement to all shareholders. At the same time, Campaign GM pointed out that none of its proxies would be distributed apart from its proxy statement.<sup>355</sup> Of course, a shareholder could vote on management's proxy

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351. See *SEC v. May*, 229 F.2d 123 (2d Cir. 1956); *Halsted v. SEC*, 182 F.2d 660 (D.C. Cir. 1950). Cf. *Curtis Pub. Co. v. Butts*, 388 U.S. 130 (1967).

352. See *Shapiro v. Thompson*, 394 U.S. 618 (1969); *Williams v. Rhodes*, 393 U.S. 23 (1968); *The Supreme Court, 1968 Term*, 83 HARV. L. REV. 7, 120 (1969).

353. Management's proxy statement does not comprise the proxy statement necessary for Campaign GM to furnish. See note 330 *supra*.

354. See text following note 347 *supra*.

355. Letter from the author to Charles E. Shreve, Dir., Div. of Corp. Fin., SEC, April 9, 1970, at 2-3.

and thus never see Campaign GM's proxy statement, or even if he did receive such a proxy statement he might not read it, or feel the need to read it. In either case, however, the shareholder would get his ballot either with the document he is supposed to get—Campaign GM's proxy statement—or, if he votes on management's proxy, with a document containing the other side's arguments.

The SEC's interest in requiring a proxy statement from a proponent in a public-interest proxy contest before media communications can be made to the shareholders seems far from compelling. It is seeking to protect too narrow an aspect of the proxy procedure. Considering that both the filing requirements and antifraud provisions remain applicable to the communication sought to be prevented, too little is gained to justify sanitizing the process. This view is limited to a contest that does not involve a pecuniary interest of the speaker but rather is related to a policy question that has social and political ramifications of interest to the general public.<sup>356</sup> While there was sufficient commercial interest in Campaign GM to sustain the requirement of furnishing a proxy statement to each shareholder if and when he was given a Campaign GM proxy, the noncommercial interests were present to such a greater degree that the added restraint proposed by the SEC seemed excessive.<sup>357</sup>

It is not clear whether the SEC agrees with this position. Following the exchange of correspondence between the Commission staff and the author on this question, Campaign GM held several press conferences and distributed press releases, which were filed with the Commission under the proxy rules. However, there was no response from the Commission concerning any of these activities. While this fact does not mean that the Commission or its staff agreed with Campaign GM in its interpretation of the proxy rules, it may indicate that they had some doubts about their earlier position. On the other hand, the Commission and its staff may have been unshaken in its views, but may not have viewed any "violation" as sufficiently serious to warrant enforcement.

### 3. *Shareholder List*

Proxy contests often begin with a request by the antimanagement forces for a shareholder list. Notwithstanding the opportunity af-

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356. *Halsted v. SEC*, 182 F.2d 660, 668 (D.C. Cir. 1950).

357. See Note, *Freedom of Expression in a Commercial Contest*, 78 HARV. L. REV. 1191 (1965). Cf. *Banzhaf v. FCC*, 405 F.2d 1082, 1101-03 (D.C. Cir. 1968).

forded by the proxy rules<sup>358</sup> to have management mail their material, most contestants prefer to mail it themselves and insist upon receiving the list. The availability of the shareholder list is a question of state rather than federal law.<sup>359</sup>

Generally, the law allows liberal access to the shareholder list. Under common-law principles, the right may be denied only if management can show that the contestant does not desire the list for a proper purpose.<sup>360</sup> Statutes often implement the right providing penalties for its wrongful denial,<sup>361</sup> but many such statutes limit access to the list to persons who own a specified percentage of shares, or those who have been shareholders for a specified period of time.<sup>362</sup> However, the statutory right does not preclude the older common-law right to inspect the list.<sup>363</sup>

"Proper purpose" is usually the focus of inquiry in any dispute over the right to obtain the shareholder list. It has been held proper to obtain the list for the purpose of communicating with shareholders about a proxy contest<sup>364</sup> or a tender offer,<sup>365</sup> for inquiry into the affairs of the company,<sup>366</sup> or for use in a derivative suit.<sup>367</sup> On the other hand, inspections that are meant to harass management,<sup>368</sup> to procure a list for resale,<sup>369</sup> or to assist a competitor<sup>370</sup> have been held not to be for a proper purpose. The weight of authority leans to the side of permissiveness on this issue; this fact would seem to indicate that ready access to the list can be had in a

358. Rule 14a-7, 17 C.F.R. § 240.14a-7 (1969), provides that management must either furnish a shareholder list or mail a security holder's soliciting material, at the latter's expense.

359. 2 L. Loss, *supra* note 330, at 890. But, enforcement of an order to provide a list may be obtained in federal court. *Stern v. South Chester Tube Co.*, 390 U.S. 606 (1968).

360. H. HENN, *LAW OF CORPORATIONS* 396 (2d ed. 1970).

361. *E.g.*, ILL. REV. STAT. ch. 32, § 157.45 (1967); ABA-ALI MODEL BUS. CORP. ACT § 46 (1966).

362. *E.g.*, ABA-ALI MODEL BUS. CORP. ACT § 46 (1966); N.Y. BUS. CORP. LAW § 624(b) (McKinney 1963).

363. *E.g.*, ABA-ALI MODEL BUS. CORP. ACT § 46 (1966). The statutes commonly preserve the "proper purpose" test. *E.g.*, DEL. CODE ANN. tit. 8, § 220 (1953).

364. *General Time Corp. v. Talley Indus., Inc.*, 43 Del. Ch. 531, 240 A.2d 755 (Sup. Ct. 1968).

365. *Hanrahan v. Puget Sound Power & Light Co.*, 332 Mass. 586, 126 N.E.2d 499 (1955).

366. *Durr v. Paragon Trading Corp.*, 270 N.Y. 464, 1 N.E.2d 967 (1936).

367. *State ex rel. Foster v. Standard Oil Co.*, 41 Del. 172, 18 A.2d 235 (1941). *See Note, Proper Purpose for Inspection of Corporate Stock Ledger*, 1970 DUKE L.J. 393, 398.

368. *Ochs v. Washington Heights Fed. Sav. & Loan Assn.*, 17 N.Y.2d 82, 215 N.E.2d 485, 268 N.Y.S.2d 294 (1966).

369. *Hagy v. Premier Mfg. Corp.*, 404 Pa. 330, 172 A.2d 283 (1961).

370. *Slay v. Polonia Publishing Co.*, 249 Mich. 609, 229 N.W. 434 (1930).

public-interest proxy contest. One court has ruled that a shareholder may obtain the list if his purpose is stated to relate to the solicitation of votes on a matter "which may properly come before a stockholder for deliberation or vote."<sup>371</sup> No real test of the availability of the shareholder list to public-interest contestants was achieved in the General Motors contest since a request for the list was not made until April 28, 1970—less than a month before the annual meeting. Management proceeded to deposit the 133 large volumes comprising the General Motors shareholder list in Cobo Hall, Detroit, by May 12, as it was required to do under Delaware law.<sup>372</sup>

However, some doubt was cast on the issue whether the courts will afford public-interest advocates ready access to the shareholder list by the decision in *Pillsbury v. Honeywell, Incorporated*.<sup>373</sup> In that case a Minnesota court denied a shareholder's request for a writ of mandamus to permit inspection of the list based on his intention to communicate with his fellow shareholders concerning the corporation's policies and practices in the sale of war items. No proxy contest was in progress when the request for the list was made, and it was unclear what use the shareholder proposed to make of the list. Aside from these factors, however, the court stated that the purpose for which the shareholder wanted the list was improper under the Delaware statute because he was motivated by an interest in his social and political views, and, further, that the shareholders' meeting was the wrong forum in which to raise these questions.

Doubt was also cast on the issue by the Delaware supreme court in *Northwest Industries, Incorporated v. B.F. Goodrich Company*.<sup>374</sup> In that case, the court affirmed a refusal to produce a shareholder list when the shareholder declared that his purpose was to "communicate" with other shareholders, but the grounds for the court's decision were not made clear. The court did observe that the shareholder had owned his stock for only a short time, that it was not acquired for investment, and that it would be difficult to relate the purpose of the demand to an interest "as a stockholder," which is the statutory requirement.<sup>375</sup> But it is clear from both earlier<sup>376</sup> and later<sup>377</sup>

371. *NVF Co. v. Sharon Steel Corp.*, 294 F. Supp. 1091, 1094 (W.D. Pa. 1969).

372. DEL. CODE ANN. tit. 8, § 219 (1953). The more significant problem in a public-interest proxy contest may be one of expense. To be of most value, the list must be copied, or a copy obtained, and this process is costly.

373. No. 663,410 (Dist. Ct. Hennepin County, Minn. April 8, 1970) *appeal filed*, No. 42,541, Minn. Sup. Ct., May 6, 1970.

374. 260 A.2d 428 (Del. Sup. Ct. 1969).

375. DEL. CODE ANN. tit. 8, § 220(b) (1953).

376. *E.g.*, *General Time Corp. v. Talley Indus., Inc.*, 43 Del. Ch. 531, 240 A.2d 755 (Sup. Ct. 1968).

377. *Kerkorian v. Western Air Lines, Inc.*, 253 A.2d 221 (Del. Ch. 1969).

Delaware cases that a demand for a shareholder list is proper if it relates to the solicitation of proxies. Further, if the demand relates to an issue with which shareholders are properly concerned under state law, such as company policy, then the *reason* for shareholder concern is not important.<sup>378</sup> The General Motors and Dow decisions point to the error in the Honeywell case, in which the court looked to motive rather than effect. If the solicitation relates to a matter that will properly come before the meeting, the shareholder should be able to obtain a shareholder list.

#### D. *The Institutional Response*

Campaign GM designed its proxy solicitations to garner maximum votes and attention at minimum cost. Therefore, it directed its appeal mainly to the financial institutions<sup>379</sup>—the largest group of General Motors shareholders, and the largest holders of common stock in general.<sup>380</sup> For some time institutions have been recognized as a powerful factor in corporate politics, and they have more recently come under public and scholarly scrutiny for activities

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378. "If a plaintiff establishes a proper purpose then all others are irrelevant . . . . It follows then, that if a plaintiff tenders a purpose which is proper the corporation cannot defeat his claim to the list by showing that he has another purpose, or that he is really more interested in the list for other reasons" (emphasis in original). *Mite Corp. v. Heli-Coil Corp.*, 256 A.2d 855, 858 (Del. Ch. 1969).

379. As used here, the term "financial institutions" includes those institutions controlling large amounts of money that they manage either for themselves (universities, foundations) or for others (pension and welfare plans, trust companies, investment companies). Insurance companies are not included although the general principles regarding institutional investing also apply to them.

380. As of 1968, according to the NEW YORK STOCK EXCHANGE, PERSPECTIVES ON PLANNING No. 5, at 2 (1970), institutional common stockholding, in billions of dollars, was as follows: Noninsured pension funds, 64.5; investment companies, 54.8; life insurance companies, 14.3; property and casualty insurance companies, 20.5; state and local trust funds, 3.7. As of 1966, in billions: personal trust funds, 56; foundations, 8.8. *Hearings on H.R. 9510 and H.R. 9511 Before the Subcomm. on Commerce and Finance of the House Comm. on Interstate and Foreign Commerce*, 90th Cong., 1st Sess., pt. 2, at 554-55 (1968). Universities, as of June 30, 1969, held \$7.7 billion. Glenn, *Degree of Difference*, BARRON'S, May 11, 1970, at 9 (survey of seventy-one colleges and universities).

General Motors presents an atypical example of institutional power. It has 287,000,000 shares outstanding, and all institutions combined own only a small percentage of the stock. For example, all mutual funds as of 1969 held only 1.5% of General Motors stock and the largest single fund holder held .3%. See Maseritz, *The Investment Company: A Study of Influence and Control in the Major Industrial Corporations*, 11 B.C. IND. & COM. L. REV. 1, 24 (1969). None of the forty-nine banks covered in the House report on commercial banking have sole or partial voting rights over even 5% of General Motors stock. 1 STAFF OF SUBCOMM. ON DOMESTIC FIN., HOUSE COMM. ON BANKING & CURRENCY, 90th CONG., 1st SESS., COMMERCIAL BANKS AND THEIR TRUST ACTIVITIES: EMERGING INFLUENCE ON THE AMERICAN ECONOMY 93 table 16 (Subcomm. print 1968) [hereinafter Patman Report]. Universities own 1,560,000 shares. Glenn, *supra* at 9. Figures for foundations are unavailable, but a list of some of the largest foundation holders in the N.Y. Times, May 3, 1970, at 31, col. 1, shows holdings of approximately 5,200,000 shares.

affecting corporate control.<sup>381</sup> In general, however, institutions have been loath to use their influence in this area, observing instead the "Wall Street Rule": to invest in a company is to invest in management and if one does not like what management is doing, one sells the stock.<sup>382</sup> While large-scale institutional selling could affect management policy,<sup>383</sup> this "love it or leave it" approach will rarely exert a positive influence. The "Wall Street Rule," however, may not be wholly feasible for institutions holding large blocks of stock that cannot be freely sold; such institutions may thus be compelled to take an interest in managerial conduct.<sup>384</sup>

What few deviations there have been from this pattern have usually occurred in proxy contests for control or in express opinions (usually directed to management rather than through voting) on dividend policies or prospective merger activity.<sup>385</sup> Campaign GM asked the financial institutions to violate the "Wall Street Rule" by supporting its admonitions to management. Only a handful of institutional holders of General Motors stock actually gave their proxies to Campaign GM, but the debate generated within their community led at least one observer, Jay Rockefeller, himself an institutional trustee, to predict that "next time around it may be different."<sup>386</sup>

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381. See generally Patman Report, *supra* note 380; WHARTON SCHOOL OF FIN. & COMM., A STUDY OF MUTUAL FUNDS, H.R. REP. No. 2274, 87th Cong., 2d Sess. (1962) [hereinafter Wharton Report]; D. BAUM & N. STILES, *THE SILENT PARTNERS* (1965); Enstam & Kamen, *Control and the Institutional Investor*, 23 BUS. LAW. 289 (1968).

382. See Sobieski, *In Support of Cumulative Voting*, 15 BUS. LAW. 316, 321 (1960). There were many references to this rule, if not all by name, in replies from institutions contacted in this study. A full expression of the rule is as follows:

The basic reason for this policy is that the corporation is engaged in investing and not in the management of companies or the reorganization or revamping of business or corporate managements. One obvious investment criterion is how well managed is a candidate for investment, a qualification which is carefully scrutinized and weighed. Without reasonable confidence in a management, no investment will be made. Action in supporting that management at annual meetings is a normal and natural expression of that confidence. Only a marked departure from proper corporate practice warrants a deviation from this policy. When confidence in a management has been shaken or lost the investment involved is reduced or liquidated.

Wharton Report, *supra* note 381, at 418-19.

383. See Brown, *Institutional Investors as Shareholders*, in DUKE UNIVERSITY SCHOOL OF LAW, CONFERENCE ON SECURITIES REGULATION 207, 228 (R. Mundheim ed. 1965), describing how large-scale selling of stock by institutions affected the wage-dividend policies of Eastman Kodak Company.

384. Landau, *Do Institutional Investors Have a Social Responsibility?*, INSTITUTIONAL INVESTOR, July 1970, at 25, 26-27.

385. See Clarence A. Galston, *Fiduciary Responsibilities of Institutional Investors, A Paper Presented to the Association of Life Insurance Counsel, Dec. 10, 1968*, in PROCEEDINGS OF ASSN. OF LIFE INSURANCE COUNSEL 835, 853 (1968) (describing Metro-Goldwyn-Mayer proxy fight). See also Louis, *The Mutual Funds Have the Votes*, FORTUNE, May, 1967, at 150; Sobieski, *supra* note 382.

386. Mintz, *Campaign GM Likely To Stir New Conflict on Campus*, Washington Post, May 24, 1970, § A, at 3, col. 2.

With Earth Day as a backdrop, the greatest controversy centered around the universities, collectively holding only 1½ million shares of General Motors stock.<sup>387</sup> The issues raised by Campaign GM, publicly debated on the university campuses and then privately decided in board rooms, also reached the less "open" institutions.<sup>388</sup> As a fundamental question, institutions were forced to examine their role as stockholders and to decide whether the lack of social responsibility in a corporation could be justified by higher profits. The directors and trustees of financial institutions had to consider whether their social duty permitted or dictated to them that they vote the stock of portfolio companies in accordance with social considerations.<sup>389</sup> These questions involve legal and economic problems that are at the core of the viability of the public-interest proxy contest.

### 1. *The Legal Position of the Institutions*

The major legal obstacle to institutional participation in Campaign GM was raised at the General Motors annual meeting in a shareholder's objection to the New York City Pension Funds' voting their shares for the shareholder proposals. Mrs. Wilma Soss, a well known advocate of shareholder democracy, citing the Campaign GM proxy statement which read: "It is possible that adoption of these proposals could cause a reduction in the Corporation's profits,"<sup>390</sup> challenged the vote on the grounds that the "sole responsibility or the primary responsibility facing the fiduciaries is the responsibility to act for the benefit exclusively of the pensioners."<sup>391</sup> Since Mrs. Soss was not a beneficiary of the fund, however, she lacked standing to raise the issue.<sup>392</sup> But suppose beneficiaries of a pension fund,

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387. See note 380 *supra*.

388. One of the problems facing Campaign GM and any other low-budget public-interest proxy contest is finding out which institutions hold stock in the target company. The only holdings readily available to the public for inspection are those of mutual funds. See notes 396-97 *infra* and accompanying text. Since General Motors is so large, however, it was a reasonable assumption that nearly every large institution held at least some shares.

389. This question was repeatedly raised in editorial comment throughout Campaign GM. See, e.g., Washington Post, April 1, 1970, § A, at 1, col. 3; Smith, *Will General Motors Believe in Harmony? Will General Electric Believe in Beauty?*, NEW YORK MAGAZINE, June 15, 1970, at 36, 37.

390. Campaign To Make General Motors Responsible, Proxy Statement, March 25, 1970, at 2.

391. Transcript, *supra* note 44, at 115.

392. *Market Street Ry. Co. v. Hellman*, 109 Cal. 571, 590-91, 42 P. 225, 231 (1895). See A. SCOTT, *THE LAW OF TRUSTS* § 193.1, at 1598 (3d ed. 1967). The vote of the trustee cannot be rejected by the corporation on the ground that he is guilty of a violation to his duty to the beneficiaries since they alone can object. See notes 406-10 *infra* and accompanying text.

prior to the meeting, had asked a court to enjoin the trustees from voting for Campaign GM, claiming that the threatened vote was a breach of trust, or failing that argument, suppose that they threatened to sue for damages if as a result of a Campaign GM victory the stock price declined.<sup>393</sup> To deal with this objection, we must first examine the voting procedures of the financial institutions and the fiduciary responsibilities of the institutional trustees to their beneficiaries and shareholders with respect to voting the stock owned by institutions.

## 2. *The Financial Institutions*

Universities and foundations are similar in that they manage money for themselves. The trustees of these institutions have ultimate responsibility for investment decisions—usually made by an investment committee—and, as do all trustees, they owe a fiduciary duty to their institutions.<sup>394</sup> Neither universities nor foundations are required to report publicly their holdings.

Investment companies include face amount certificate companies, unit investment trusts, and open- and closed-end management companies. The major holders of common stocks in the United States are the open-end companies (mutual funds).<sup>395</sup> Mutual funds are required to report publicly their holdings,<sup>396</sup> and this information is easily obtainable.<sup>397</sup> Mutual-fund directors are essentially like any other corporate directors, and in the same manner they are responsible to their shareholders as fiduciaries.<sup>398</sup> Often the investment decisions of mutual funds are made by investment advisors to whom management functions have been delegated, but these decisions are reviewable by the directors of the fund.

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393. A variation of this theme occurred in California where a group of concerned citizens consisting of the Southern California Chapter of The American Institute of Architects, S.O.S. (Stamp Out Smog), GASP (Group Against Smog Pollution), and several individuals filed suit for injunctive relief to prevent the regents of the University of California from voting for General Motors management. *Southern Calif. Chapter, Am. Institute of Architects v. Regents of Univ. of Calif.* No. 400,270, Super. Ct. Alameda County, Calif., filed May 6, 1970.

394. A. SCOTT, *supra* note 392, § 2.5; RESTATEMENT (SECOND) OF TRUSTS § 8 (1959).

395. Open-end investment company securities are redeemable—that is, upon presentation to the issuer the holder is entitled to his share of the net asset value of the issuing company. The total of common stockholdings for open-ended funds in 1968 was \$54.8 billion compared to \$7.1 billion for closed-end investment companies. NEW YORK STOCK EXCHANGE, PERSPECTIVES ON PLANNING No. 5, at 2 (1970).

396. Investment Advisers Act of 1940 § 30(b), 15 U.S.C. § 80a-29(b) (1964).

397. See 17 C.F.R. §§ 270.30b1-1, 274.106 (1969), which prescribe the forms required to be filed with the SEC pursuant to 15 U.S.C. § 80-29(b) (1964).

398. See *Brown v. Bullock*, 194 F. Supp. 207 (S.D.N.Y.), *affd.*, 294 F.2d 415 (2d Cir. 1961).



Banks and trust companies, when investing as fiduciaries, are subject to state and federal laws enacted for the protection of investors.<sup>399</sup> Basically there are two types of trust accounts—personal-trust accounts and pension plans. Since there are no reporting requirements for personal-trust accounts, and since banks have varying degrees of voting discretion depending on the trust agreement, which they regard as confidential, little can be said about their voting procedures.<sup>400</sup> Banks, however, also act as corporate trustees for most of the employee pension funds<sup>401</sup>—the largest institutional common stockholders, and the most complex from the standpoint of fiduciary responsibilities.

Most pension plans are administered by management-appointed committees; few of these committees have union representation.<sup>402</sup> However, the committees usually handle only the administrative matters of the fund, such as determining who is entitled to receive benefits. Investment decisions are delegated by the committee to corporate trustees, usually commercial banks. These trustees generally have authority to make investment decisions and to vote the shares held by the pension fund, unless that power is expressly limited in the trust indenture. Information regarding the powers of the trustee and the extent of his discretion is publicly reported,<sup>403</sup> but holdings by pension funds in listed stocks do not have to be reported.<sup>404</sup>

There is a double management orientation to the pension funds

399. Galston, *supra* note 385, at 839.

400. One estimate, that the bank had to consult with other individuals on voting in 52% of its personal-trust accounts, came from the president of the United States Trust Company of New York. Buck, *Trust Companies and Banks as Institutional Investors*, in DUKE UNIVERSITY SCHOOL OF LAW, CONFERENCE ON SECURITIES REGULATION 147, 155 (R. Mundheim ed. 1965).

401. Some 80% to 90% of all pension plans of this type (welfare and pension plans) use a bank as corporate trustee to hold and invest the funds in accordance with the trust agreement. S. REP. NO. 1734, 84th Cong., 2d Sess. 48 (1956), cited in P. HARBRECHT, *PENSION FUNDS AND ECONOMIC POWER* 64 (1959).

402. According to the New York State Insurance Department report, M. HOUSE, *PRIVATE EMPLOYEE BENEFIT PLANS, A PUBLIC TRUST* 92-93 table 5 (1956), only 5% of 271 single-employer plans studied provided for union representation in their management. Single-employer plans represent 86% of all employees covered by pension plans. S. REP. NO. 1734, 84th Cong., 2d Sess. 14 (1956), cited in P. HARBRECHT, *supra* note 401, at 43, 45.

403. Welfare and Pension Plans Disclosure Act, 29 U.S.C. §§ 301-09 (1964). According to the New York State Banking Department, seven out of ten pension funds managed in the state gave full investment authority to the trustee. Patman Report, *supra* note 380, at 23, citing P. HARBRECHT, *supra* note 401, at 64. "One of the largest investment banks in this field enjoys full investment control in 88.6% of its accounts . . . ." *Id.* at 103.

404. 29 U.S.C. § 306(f)(1)(C) (1964). There is no reporting requirement for the securities of any corporation other than those who are parties of interest.

structure—first in using employer-dominated administrators, and second in designating commercial banks as trustees, with power reserved by the administrators to remove them. The situation is slightly different for state and municipal retirement funds. There, investment decisions rest ultimately with public officials, although investment advisors may handle money management.<sup>405</sup>

There is considerable confusion on the question to whom the corporate trustees of pension funds owe fiduciary duties.<sup>406</sup> Representative trust indentures usually contain the following clause: "No person other than the company or the committee may require an accounting or bring any action against the trustee with respect to the trust or its actions as trustee."<sup>407</sup> In light of this clause, can the employee beneficiaries bring any action against the trustee? Courts have held union-operated pension trusts to be trusts with the beneficiaries having an individual right to sue,<sup>408</sup> but courts are less clear on this question with regard to employer funds. The leading case, *Hurd v. Illinois Bell Telephone Company*,<sup>409</sup> has indicated by dictum that trust principles will apply, and it is reasonable to assume that a beneficiary who has already completed the age and service requirements—and has a vested interest in the pension fund—would have standing to sue the corporate trustee for misconduct or abuse of discretion in the voting of the shares held by the pension trust.<sup>410</sup>

Therefore, with the exception of mutual-fund directors, who are held to the slightly lower standard of corporate directors, the powers and responsibilities of most financial institutions in the voting of their stock are found in the law of trusts.

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405. Galston, *supra* note 385, at 843. In the three New York City pension systems, the Teachers' Retirement Board, the NYC Employees Retirement System, and the Police Pension Fund, authority to vote the stock held is vested in a board of directors for each system. All pension boards have representatives from the city and from those labor organizations that engage in collective bargaining between the city and a specific employees group (*e.g.*, teachers are represented by the United Federation of Teachers). Letter to the author from Michael J. Dontzin, Counsel to the Mayor of New York City, July 22, 1970.

406. For a thorough discussion of all the implications of the trust status of pension funds see P. HARBRECHT, *supra* note 401, at 163-90.

407. Specimen Form of Trust Agreement, Chase Manhattan Bank, in *id.*, app. B., at §18.

408. See *Booth v. Security Mut. Life Ins. Co.*, 155 F. Supp. 755 (D.N.J. 1957); P. HARBRECHT, *supra* note 401, at 173-77.

409. 136 F. Supp. 125, 134-35 (N.D. Ill. 1955), *aff'd.*, 234 F.2d 942 (7th Cir. 1956).

410. The right is probably even broader, and one would expect employees who are contributing to a plan, but whose rights have not yet vested, to be able to sue for mismanagement of a pension trust. See *Employing Plasterers' Assn. v. Journeyman Plasterers' Local 5*, 279 F.2d 92, 97 (7th Cir. 1960).

### 3. Voting Powers and Duties of Trustees

In choosing and managing investments, trustees are required to preserve the best interests of the beneficiaries. It is fundamental that "[i]f there is one word which summarizes a trustee's duty regarding investments, that word is prudence";<sup>411</sup> it is the recognized standard of care, skill, and caution in the making and managing of investments.<sup>412</sup> The Model Prudent Man Investment Statute states the rule in the following manner:

In acquiring, investing, reinvesting, exchanging, retaining, selling, and managing property for the benefit of another, a fiduciary shall exercise the judgment and care under the circumstances then prevailing, which men of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as probable safety of their capital.<sup>413</sup>

Loyalty, good faith, openness and disclosure, and abstention from self-dealing are demanded from all types of fiduciaries, and these duties extend to the voting of stock.<sup>414</sup> Thus, the trustee's duty, in voting stock over which he has control, is to promote the best interests of the beneficiaries.<sup>415</sup> Except in clear cases of abuse of discretion, the courts will not interfere with the trustee's judgment,<sup>416</sup> although the court's power to restrain the trustee<sup>417</sup> or to impose damages for breach of fiduciary duty is well recognized.<sup>418</sup>

There are no reported instances of beneficiaries challenging a trustee's right to vote in favor of continued charitable contributions by corporations. Traditionally, this issue has presented the only opportunity trustees have had to vote for social activity that might be construed to be inconsistent with the shareholder's interest. Certainly such conduct can be justified as related to the interests of the corporation and therefore consistent with trustees' duties. Presum-

411. Subcomm. on Trust Administration and Accounting, *Report: Trustee's Duties Regarding Investments*, 4 REAL PROPERTY, PROBATE & TRUST J. 604, 622 (1969).

412. A. SCOTT, *supra* note 392, § 227, at 1806.

413. Subcomm. on Trust Administration and Accounting, *supra* note 411, at 608. See McSwain, *The Prudent Man Rule*, 106 TRUSTS & ESTATES 742, 743 (1967).

414. See Spotts, *Duty of Fiduciary To Vote Stock*, 79 TRUSTS & ESTATES 289, 291 (1944).

415. A. SCOTT, *supra* note 392, § 193.1, at 1594-95.

416. *Id.* § 193, citing *Myers v. Pink*, 42 Ill. App. 2d 230, 191 N.E.2d 659 (1963), and *In re Connor's Estate*, 153 N.Y.S.2d 185 (Sur. Ct. N.Y. County 1956).

417. A. SCOTT, *supra* note 392, § 193.1, at 1595.

418. *Id.* § 193.3, at 1602-03, citing UNIFORM TRUSTS ACT § 8.

ably, a vote by a trustee for the resolutions supported by Campaign GM could be defended by the same reasoning, but the problem becomes more complex if the trustee believes that the socially useful project, of which he approves, entails a long-term reduction of corporate profitability. Would he then be precluded from voting in favor of such a proposal?

The trustee's obligation remains that of advancing the best interests of his beneficiaries, but that is not to say that the law requires that profits be maximized. The law makes no such requirement of corporate directors, as has been discussed earlier,<sup>419</sup> because it is impossible to calculate "maximum profits." In determining the best interests for the beneficiary, it is probably necessary for the trustee to limit his consideration to the pecuniary aspect of "best interest" and not to take into account aesthetic or other nonmonetary values. The trustee, after all, is not given dominion over all aspects of the beneficiary's life, but only those that relate to his pecuniary interest.

But, just as the corporation cannot realistically ignore social implications in determining what are its best economic interests, neither can a shareholder, nor a trustee acting on his behalf.<sup>420</sup> The trustee, in many cases, is as concerned with generating long-term value as he is with current profits. Further, society restricts the trustee with respect to the zeal with which he can pursue the pecuniary interest of his beneficiaries. For instance, a fiduciary cannot take advantage of inside information about a company to make greater stock market profits for his beneficiary.<sup>421</sup> The possible conflict of duties is settled in society's favor.

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419. See text accompanying notes 223-71 *supra*.

420. A shareholder, as well as the corporation, should heed the reasoning of *Theodora Holding Co. v. Henderson*, 257 A.2d 398 (Del. Ch. 1969) (see text accompanying notes 243-44 *supra*), or the passage of the National Traffic and Motor Vehicle Safety Act of 1966, 15 U.S.C. §§ 1381-1425 (Supp. V, 1965-1969), as warnings that corporations best protect their position by social involvements. One college trustee wrote to Mr. Roche: "From an investment point of view the Committee is concerned that if General Motors does not move to discharge its full public responsibility as rapidly as possible, the public will begin to withdraw the premier acceptance which it has accorded the company's products in the past." Letter from a college investment committee to James M. Roche, Chairman, General Motors Corp., May 1, 1970.

In its proxy statement, immediately after the warning Mrs. Soss read (see text accompanying note 390 *supra*), Campaign GM stated its belief "that in the long run only those companies which conduct their business in a manner more responsible to the large community needs will be able to profitably survive." Campaign To Make General Motors Responsible, Proxy Statement, March 25, 1970, at 2.

421. *In re Cady, Roberts & Co.* 40 S.E.C. 907, 916 (1961); DISCLOSURE REQUIREMENTS OF PUBLIC COMPANIES AND INSIDERS 172-73 (J. Flom, J. Freund & B. Garfinkel ed. 1967) (remarks of D. Schwartz). *But see Black v. Shearson, Hammill & Co.*, 72 Cal. Rptr. 157 (Ct. App. 1968).

A clash between society's interests and the beneficiary's interests could ensue if the trustee were required by law to vote against a proposal simply because it might reduce profits. Clearly, an individual shareholder could vote for such a proposal, despite the adverse effect on profits. If the existence of a trust arrangement somehow prevented trustees from voting their beneficiaries' stock in favor of the pursuit of a social goal, then it would be that device, rather than an uncoerced shareholder decision, which would be frustrating the corporate use of resources for social purposes. If such were the legal duties of trustees, the courts might, in turn, find that ownership of corporate stock by trustees is against public policy. A more likely result—and a better one from the social standpoint—is to find that the trustee has greater freedom in considering how to vote the stock he manages.

The law seems to point toward this view that enables institutions to favor public-interest proposals; certainly there is scant evidence that they do not enjoy this freedom. But this conclusion is only the beginning of the inquiry, for the law does not compel institutions to act in any prescribed manner. The pressure on institutions to derive necessary income from their portfolio, the competition for capital—sometimes on the basis of performance—and the “Wall Street Rule” are all strong factors militating in favor of votes for management. The reaction of the institutions to Campaign GM's solicitation may be indicative of the response future public-interest proxy contests may encounter.<sup>422</sup>

#### 4. *The Universities*

Campaign GM won few votes from universities, but it probably achieved its most significant victory on the campuses by virtue of the attention students gave to the problems it raised. From most university trustees, Campaign GM had to contend with the attitude expressed in Harvard President Nathan Pusey's 1967 statement that “[o]ur purpose is just to invest in places that are selfishly good for Harvard. We do not use our money for social purposes.”<sup>423</sup> It was

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422. Because proxies are not available for inspection unless contested—the actual number of votes was not crucial for this study—institutional responses other than those reported in the press had to be privately solicited. Questionnaires were sent to twenty representative mutual funds and to twelve of the largest commercial banks. Five questions were asked: How were the General Motors shares held by the institution voted? What were the reasons for the decision? Were beneficial owners' opinions solicited? Was splitting of votes or abstention considered? What was the voting procedure? Many of the more revealing replies were either confidential or not for attribution and in those cases the identity of the source has been withheld.

423. Quoted in J. RIDGEWAY, *THE CLOSED CORPORATION* 41 (1968). This statement was

also evident that universities did not use their *votes* for social purposes either.<sup>424</sup> The final tally found only Amherst, Antioch, Boston University, Iowa State, and Tufts announcing support for any of the three Campaign GM proposals. Yale, Stanford, Rockefeller, Swarthmore, and Williams abstained. The major stockholders, Massachusetts Institute of Technology (290,342 shares), Harvard (287,000 shares), Princeton, Michigan, Pennsylvania, and Columbia all rejected the counsel of advisory groups and voted for management.<sup>425</sup>

The pattern of solicitation was similar at almost all of the universities. After campus leaders were contacted by member of Campaign GM or through the news media, ad hoc committees, composed mostly of students, were formed on campuses. These committees gave recommendations—generally favorable to Campaign GM—to the trustee committee in charge of voting the shares, and then after much ballyhoo and support for Campaign GM in the campus presses, the trustees voted with management.

The largest and most publicized debate took place at M.I.T. Representatives from General Motors and Campaign GM debated and answered questions for more than three hours before the M.I.T. Corporation Joint Advisory Committee, which later overwhelmingly endorsed Campaign GM's proposals. Although the trustees of M.I.T. eventually voted the school's shares with management, the information brought out in the debates was used by other, more sympathetic institutions.

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made in response to student protest over holdings in southern companies that allegedly were managed by racists. Dr. Pusey answered by saying, "if there are discriminatory practices, then the companies should be prosecuted under federal law." *Id.* He then added the statement quoted in the text.

424. Harvard's treasurer, George F. Bennett, was quoted in Jacobs, *General Motors Proxy Challenge Catches Harvard in the Middle*, Harvard Crimson, March 3, 1970, at 8, col. 1, as stating that "I only do as treasurer what is in the best interest of Harvard—and that means the students, alumni, and faculty." Later, in Rowan, *'Project GM' Seen as Business Challenge*, Washington Post, May 6, 1970, § D, at 8, col. 6, he was reported as saying that he rejected the notion that a school's investments should be managed for any purpose other than growth and income.

425. Mintz, *'Campaign GM' Likely To Stir New Conflict on Campus*, Washington Post, May 24, 1970, § A, at 3, col. 1. The most complete list of supporters for Campaign GM, although itself incomplete, is the Campaign GM Scorecard printed by the Campaign To Make General Motors Responsible and presented at the meeting. This scorecard includes all institutions voting on the Campaign GM proxy and those voting on the management proxy who informed Campaign GM of their vote. The other colleges listed as supporting one or more of the proposals are Park College, Kansas City, Missouri (1,770 shares); University of Oregon (139 shares); Pepperdine College, Los Angeles (130 shares); Andover Newton Theological Seminary (1,549 shares); and Southern Education Foundation (6,930 shares). GM Scorecard, *supra* at 3.

Several observations can be made from the responses and behavior of universities.

First, nearly all of the universities were in sympathy with the *concept* of greater corporate social responsibility and the proposition that all institutions should take into account their impact on the health, safety, and welfare of the country.

Second, the public debates—and as far as one can tell, the private discussions—were on the merits of the proposals. However, the trustees who actually cast the votes did not seem to recognize the symbolic nature of the specific proposals. Harvard's reasons for voting with management, stated in a press release, were perhaps representative. The Harvard trustees felt that too much management time would be expended educating the Committee for Corporate Responsibility on the operations of General Motors, and that there was no satisfactory procedure for resolving differences between the committee and the directors. Even conceding that a stockholders committee might be desirable, the Harvard Corporation objected to the procedure for selecting members of the committee and the fact that stockholders would have no way of knowing who would be on it.<sup>426</sup>

Third, the decision-making bodies were not influenced by the members of the university communities. Campaign GM, thinking in political terms, expected to influence trustees by gaining student support. In all cases student opinion was sympathetic to Campaign GM, and wherever polls or referendums were held students supported the proposals.<sup>427</sup> At Harvard, for example, the decision on how to vote the university's General Motors shares was delayed pending an expression of opinion of the students and faculty. A majority of students signed petitions supporting Campaign GM, the Faculty Council and the Faculty of Arts and Sciences endorsed the proposals, and an alumni poll showed about seventy-five per cent support for Campaign GM. The administration, however, stating that the issues were not to be decided by head count, proceeded to support management.<sup>428</sup> University of Michigan President Robben Fleming initially disclosed a plan for dividing the vote of his school's

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426. Statement by the President and Fellows of Harvard College on the General Motors Proxy, Harvard University Press Release, May 18, 1970, at 2-3.

427. Support was evidenced by favorable student editorials at Harvard, Princeton, and Pennsylvania, among others, *see, e.g., Proxies Against GM*, *The Daily Pennsylvanian*, March 20, 1970, at 4, cols. 1-2, yet all of these schools voted for management. *See* note 425 *supra* and accompanying text.

428. Mintz, *supra* note 425, § A, at §, col. 2.

shares in accordance with the results of a referendum, but the university's governing board rejected that procedure.<sup>429</sup>

Finally, those universities that voted for the proposals, and even one college that did not, expressed a willingness to accept lower returns on their holdings in the public interest. One college, in a letter to Chairman James M. Roche of General Motors, stated:

The Committee recognizes that acceptance of the concept of involvement with the public interest and the shouldering of responsibility for promoting rapid progress toward pollution reduction and safety improvement would introduce added elements of cost for General Motors. The Committee regards such costs as being no less fundamental and important than the costs of raw materials and labor. It is prepared to have such costs impinge on profits on shares of the corporation which it owns. It does not believe that failure to accept social responsibility can be justified on the bottom line of an operating statement.<sup>430</sup>

### 5. *Foundations*

Foundations voted unanimously with management, but two of Campaign GM's most sympathetic responses—as expressed directly to management—were from the Carnegie and Rockefeller Foundations. The Rockefeller Foundation agreed with the goal and spirit of Campaign GM's proposals and was highly critical of General Motors' response to them. It also clearly stated a belief that corporations must help to solve the social problems of our time. In examining its investment policy in light of Campaign GM, the Foundation stated:

The responsibility of the Foundation as a stockholder requires us to consider the needs and problems of management. But the responsibility of the Foundation, committed in its charter to the mission of serving the well-being of mankind, requires us to recognize that more is at stake than our role as a stockholder.<sup>431</sup>

The Carnegie Foundation was critical of both General Motors and Ford Motor Company for unsatisfactory progress in pollution control. It declared its willingness to accept a reduced return on investment because the problem demanded high priority and because the consequences of inaction were too dire. It said:

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429. See *Wall St. J.*, April 20, 1970, at 10, col. 4.

430. Letter from a college investment committee to James M. Roche, Chairman, General Motors Corp., May 1, 1970.

431. A Statement by the Rockefeller Foundation, May 12, 1970, at 3. The statement was the text of a communication sent earlier by the foundation to General Motors.



We also believe that, such is the growing state of public opinion on this issue today, GM and other car manufacturers will avoid onerous and possibly quite damaging new controls by public authorities or future loss of public confidence or both only by radically stepping up their efforts. We would, therefore, in regard to our stock in GM, consider any short-run loss of earnings resulting from such efforts as a small price to pay for assurance of the longer-term viability and profitability of the company.<sup>432</sup>

Both foundations, however, voted with management: Rockefeller because it believed the proposals were unwieldy and impractical,<sup>433</sup> and Carnegie because it believed that they were not a reasonable means for stopping pollution, and because it disliked singling out and pressuring one corporation when many others were also involved.<sup>434</sup> Other foundations were far less sympathetic, generally feeling that General Motors had done an adequate job of furthering the public interest and that the Campaign GM proposals were unreasonable.<sup>435</sup>

### 6. Pension Funds

Campaign GM's major success in soliciting institutional proxies came when the New York City Pension Funds voted for and vocally supported its proposals at the annual meeting.<sup>436</sup> By contrast with other institutions, the trustees for the funds made no mention of long-term viability or profitability despite short-term loss; rather they declared that the proposals were in the best interests of the beneficiaries. The trustees also grasped the symbolic significance of the proposals. The chairman of the City Pension Funds said at the meeting:

We [the trustees] debated this issue; fiscal [and] financial responsibilities . . . were fully considered by the trustees, despite the fact they

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432. Letter from Alan Pifer, President, Carnegie Corp., to James M. Roche, Chairman, General Motors Corp., May 6, 1970, at 2.

433. A Statement by the Rockefeller Foundation, May 12, 1970, at 2.

434. Letter from Alan Pifer, President, Carnegie Corp., to James M. Roche, Chairman, General Motors Corp., May 6, 1970, at 1.

435. N.Y. Times, May 3, 1970, § 1, at 31, col. 1. Four of the largest foundation holders of General Motors stock, the Charles Stewart Mott Foundation (2,700,000 shares), Alfred P. Sloan Foundation (1,540,000 shares), Charles F. Kettering Foundation (850,000 shares), and the Richard King Mellon Foundation (54,000 shares), were all established by officers or directors of General Motors. *Id.*

436. See Transcript, *supra* note 44, at 126. The Boston funds (city hospital and library—4000 shares), the San Francisco Pension Fund (4500 shares), the Iowa State Pension System (1000 shares), and the State of Wisconsin State Investment Board (68,000 shares) also supported one or more of the proposals. See GM Scorecard, *supra* note 425, at 1.

thought that [a vote for Campaign GM] may have some adverse effect on the equity of their stock, they felt the bigger issue was more important than the fiscal issue . . . .<sup>437</sup>

The trustees felt that the employee beneficiaries "have a right to live in a decent environment."<sup>438</sup>

Other pension fund trustees were generally reluctant to reveal how and why they voted.<sup>439</sup> It is clear from the vote that no other major pension funds backed Campaign GM. However, two inter-related funds did comment directly on the issue in letters to Chairman Roche accompanying their proxies. The College Retirement Equities Fund (CREF) and Teachers Insurance and Annuity Association of America (TIAA) challenged the General Motors view that a corporation "can only discharge its obligation to society if it continues to be a profitable investment to its shareholders"<sup>440</sup> by claiming that the priority should be reversed and that "[a] corporation can only continue to be a profitable investment for its stockholders if it discharges its obligations to society."<sup>441</sup> Stressing an interest in "long term investment of pension funds,"<sup>442</sup> a representative for the funds wrote that they expected their portfolio companies to take a leading role in solving social problems as a route to long-range profit.

The New York City Funds and CREF and TIAA are of a special character, however. Municipal retirement plans have public and not management-appointed trustees, and they are more responsive to the

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437. Transcript, *supra* note 44, at 123 (statement by Michael J. Dontzin). See N.Y. Times, May 20, 1970, at 1, col. 1, quoting Dontzin conceding that the funds' share of General Motors was insignificant but that the vote would be "a symbolic gesture" that "will awaken people to get one of the largest corporations more socially responsible to the country." As to the problem of diminished earnings, Mr. Dontzin expressed the following view:

The heart of the arguments at [the trustees'] meeting was centered on the extent to which the proposals of the Nader group would affect General Motors' earnings. Our most persuasive arguments centered on the public interests and the belief that the value of the holding would not be substantially diminished if the proposals were to be adopted.

Letter to the author from Michael J. Dontzin, July 22, 1970.

438. N.Y. Times, May 20, 1970, at 1, col. 1 (statement by Jerome Kretchmer, New York City Environmental Protection Administrator).

439. Only two of the commercial banks replied to the questionnaire sent by this writer. They were two of the largest corporate trustees for pension fund accounts. One voted for management and the other refused to reveal how it voted.

440. Statement by Roger Smith, Treasurer, General Motors Corp., at the debate between Campaign GM and General Motors held at M.I.T., April 13, 1970, reported in Harvard Crimson, April 24, 1970, at 1, col. 1.

441. Letter from William C. Greenough, Chairman, Teachers Insurance and Annuity Assn. of America, College Retirement Equities Fund, to James M. Roche, Chairman, General Motors Corp., May 13, 1970, at 2.

442. *Id.*

political implications of an issue such as pollution.<sup>443</sup> CREF and TIAA, which consider themselves more like educational institutions than pension funds, have been atypically concerned with responsible shareholding by institutions.<sup>444</sup>

### 7. Mutual Funds

Little effort was made actively to solicit the votes of mutual funds. No funds are known to have voted for Campaign GM, but responses to a questionnaire indicated that some may have given serious thought to the idea. Some funds referred the proposals to a special committee or to existing executive committees for consideration. The major objections to the proposals were the potential they created for harassment, their impracticality, and the feeling that General Motors was a responsible corporation.<sup>445</sup>

Some responses did express concern for the mutual funds' role as responsible shareholders. One fund president, commenting on the inadequacy of the "Wall Street Rule," expressed the following view:

We believe that mutual funds—and indeed, all types of financial institutions—have a responsibility to consider these issues [public policy], and to vote proxies accordingly.

Traditionally, institutional voting responsibilities have all too often been handled by automatically endorsing management, on the theory that, "if you don't like the management, sell the stock." I believe this relatively simplistic response is no longer appropriate. Rather, in fulfilling our responsibilities to the shareholders of our

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443. See note 438 *supra*. Mayor John Lindsay took an active role in support of Campaign GM. Just two months prior to the General Motors annual meeting, New York City lost its legal campaign to prevent the federal government from settling its antitrust suits against the major automobile manufacturers, when the Supreme Court affirmed the decision handed down by a federal judge in Los Angeles holding that they and ten other governments and private parties lacked standing to intervene. *United States v. Automobile Mfrs. Assn.*, 307 F. Supp. 617 (C.D. Cal. 1969), *affd. sub nom. City of New York v. United States*, 397 U.S. 248 (1970) (per curiam). See *N.Y. Times*, March 17, 1970, at 28, col. 3.

444. See Galston, *supra* note 385, at 844. Mr. Galston is Executive Vice President, General Counsel, and Secretary of TIAA.

445. Letters to the author from various mutual funds. One letter expressed the belief that "the specific shareholder proposals would not be effective to advance the objectives of Campaign GM, and that . . . they might well interfere with effective management of the company." Another said, "While it is difficult to make an accurate appraisal of the 'social conscience' of a corporation's management, in this particular case we were not overly impressed with the credentials of the people proposed for election nor do we have any means of judging their 'social conscience.'" A third letter, in addition to feeling that the proposals were "somewhat inartfully drawn," said that the fund voted for management premised "on our belief that they had made significant progress in the areas in issue and were irrevocably committed to an appreciation of a proper balance between their responsibilities to GM shareholders and the general public."

mutual funds, we must continue to carefully examine each proxy, not only with respect to items with financial and corporate implications, but also with respect to public policy implications.<sup>446</sup>

And an officer of one of the largest mutual-fund management companies, in response to an inquiry about Campaign GM, closed with the following observation: "I would not close without assuring you that I do agree . . . that the future of financial institutions in America is best served by a greater acceptance of social responsibility and awareness."<sup>447</sup>

### 8. *Contrasts Among Institutions*

What institutions have in common is large ownership of securities. But the differences among them should also be recognized. First, they accumulate their wealth from different sources. Universities receive donations from private individuals—primarily a few generous donors. Foundations are usually created by the contributions of a single wealthy donor. Pension funds, on the other hand, vary widely in their source of wealth, but the large employee trusts obtain their money in conformity with a contract between the union and the employer. These funds may be either contributory or noncontributory. Mutual funds receive their wealth from shares sold to investors.

Furthermore, the supporters or creators of financial institutions obviously have different expectations for them. Universities and foundations have purposes to fulfill that require vast expenditures of money, but their goals are not financially oriented. Pension funds, on the other hand, are solely concerned with providing adequate retirement funds for their beneficiaries. Mutual funds have various investment objectives, but in all cases the investor seeks either growth of principal or high income. Thus, the goals of pension plans and mutual funds are entirely financially oriented while those of universities and foundations are not.

The competition among institutions for funds, then, relates to the institution's performance vis-à-vis its objective. Universities may compete against each other for money, not on the basis of providing a return on invested capital, but rather on the basis of how well they perform their educational or research functions. The sharpest contrast is between competing mutual funds, which are sold on the basis

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446. Memorandum to directors, officers and department heads of an investment advisory company from the president, April 27, 1970 (confidential).

447. Letter to the author from senior vice president of a mutual-fund organization, May 12, 1970.

either of growth or income, with growth receiving the major attention in recent years. Pension funds do not have to compete for funds since they are committed contractually, but there is competition for management of the pension plan. As was noted earlier,<sup>448</sup> most pension fund portfolios are managed by corporate trustees who can be replaced by the committee managing the plan. Therefore, this threat of replacement creates a pressure on such trustees to perform financially which is of the same type as that felt by mutual-fund managers.<sup>449</sup> This reality often keeps the pension plans out of such poor profit investments as low-income housing.<sup>450</sup> While universities and foundations do not have to compete for money or impress anyone with their financial performance, they must obtain the funds to do their job and they must in turn do their job well in order to attract funds. This problem is practical, not legal. But another aspect of the practical problem is the existence of a student body concerned with social action.<sup>451</sup>

All of the institutions, except mutual funds, enjoy tax-free status.<sup>452</sup> They pay no tax on their capital gains or on their dividend income; mutual funds typically pay no tax because their taxable income is passed along to their shareholders on a conduit theory.<sup>453</sup> The theory behind the tax-free status for universities and foundations is that they perform good works, and that their ability to do so should not be diminished by the expense of paying taxes. In short, they are recognized as social instrumentalities. Pension funds to which employers contribute must observe the requirement that the funds be managed "for the exclusive benefit of . . . employees" in order that contributions may lawfully be made and that the trust

448. See notes 401-02 *supra* and accompanying text.

449. Ironically, some of this pressure is coming from the companies themselves . . . They find out that their pension fund is not growing as fast as someone else's. So they put the heat on their banks.

Sometimes, they do more than put on the heat. I know of one major New York City bank that has lost several pension fund accounts because other banks have performed better.

Sherwood, *The Growing Power of Institutional Investors*, BUS. MANAGEMENT, July 1968, at 23, 27, quoting Edward A. Merkle, president of Madison Fund.

450. See *Hearings on Investment Policies of Pension Funds Before the Subcomm. on Fiscal Policy of the Joint Economic Comm.*, 91st Cong., 2d Sess., 118 (1970) (statement of Roy A. Schotland).

451. Landau, *Do Institutional Investors Have a Social Responsibility?*, INSTITUTIONAL INVESTOR, July 1970, at 25, 27-28.

452. INT. REV. CODE of 1954, §§ 501(a), 501(c)(3). Eventually, beneficiaries of a pension plan have to pay tax on distributions they receive. INT. REV. CODE OF 1954, § 402.

453. INT. REV. CODE of 1954, § 852.

to which it is made may maintain its tax-exempt status.<sup>454</sup> Either a beneficiary of the trust or the Internal Revenue Service can complain about conduct inconsistent with this standard. Upon such a complaint, the trustee is then required to show that investment decisions are related to the fund's objectives of providing income or other benefits for employees or their families. The trustee of such a fund, more than most trustees, may properly take a long-range view of the portfolio. Voting to sacrifice short-term gains for long-term profitability or survival in a free-enterprise system of the corporations whose shares are held in the portfolio should be considered action in the best interests of the beneficiaries.

The distinctive features of the different types of institutions that have large portfolios point to an easier and more natural role for universities and foundations in voting shares to support social responsibility than for other institutions. Their financial performance is not so closely scrutinized as that of the other institutions, and their beneficiaries are quite unlike investors and pensioners. Still, monitoring the social responsibility of their portfolio companies is not their main job. And their main job—providing education or philanthropy—is financed in part by an endowment fund, which they would not wish impaired by unwise business management of companies in their portfolio.<sup>455</sup> However, this risk of portfolio impairment may not be so great as it seems since if universities and foundations find that an investment has turned sour by reason of lower profits, they are not locked in to the investment by the fear of potential capital gains tax liability.

### 9. Institutional Responsibility in Voting Shares

As institutional ownership of securities increases in importance, it becomes more important to define the role of the institutional

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454. Labor Management Relations Act of 1947 § 302(c), 29 U.S.C. § 186(c)(5) (1964); INT. REV. CODE of 1954, § 401(a). See Rev. Rul. 70-536, 1970 INT. REV. BULL. No. 42, at 16, which held that an amendment to a supplementary-unemployment-benefit trust permitting low-risk income-producing investments providing a lower rate of return than normal, that served social purposes, did not accrue to the benefit of related parties, and were not contrary to the employees' interests, will not affect the tax-exempt status under INT. REV. CODE of 1954, § 501(c)(17).

455. See Editorial, *Campaign GM*, Washington Star, June 11, 1970, § A, at 12, col. 2. While generally approving of Campaign GM, the editorial concluded, "there is, however, a point that universities and other major investors must consider before they buy shares—or vote them—for social or moral purposes. Universities don't run on donations and tuition alone. Their endowment funds provide much of the financing. Endowment funds based on profitless corporations don't finance much education."

shareholder as it relates to the social responsibility of corporations.<sup>456</sup> Some suggest that the institution be treated as a controlling shareholder, owing a fiduciary duty to the other shareholders.<sup>457</sup> Others see for the institutions no such formal role, but rather the obligation to act as informed and alert shareholders, thereby benefiting other shareholders.<sup>458</sup> Still others see the institution as reviving expectations for shareholder democracy—in the sense of owners reasserting dominion over their property.<sup>459</sup>

Campaign GM raised the question of the institutional shareholder's responsibility in a different context, compelling owners to weigh the significance of considerations other than growth and profits. Since institutions can forego an interest in profits only at some potential cost to others, they must determine whether any rationale would justify voting their stock in favor of socially responsible corporate action.

The special position of the universities and foundations again should be noted. While investments are only an ancillary consideration for them, the primary university-foundation function relates to social responsibility. It would be unconscionable, in the management of their investments, for such institutions to support a policy of paying substandard wages or maintaining migrant workers in unlivable conditions merely because it would be more profitable to do so. Few policy questions will ever take that form, however. Investors have the privilege to think that the corporation is ultimately better served by strengthening the community, even at the risk of momentary profit reduction. This view does not *abandon* profits as a yardstick, but it measures them over a longer period. Universities and foundations, whose concerns need not be of the moment, are perhaps more privileged than most to take this longer perspective. More than a privilege, this should be their normative behavior.

This norm relates to shareholder conduct; it does not dictate that an institution should not invest in a particular company because of its existing policies. Thus, Nathan Pusey's 1967 statement that

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456. An interesting analysis of the problem in the light of Campaign GM is found in Landau, *supra* note 451.

457. See D. BAUM & N. STILES, *THE SILENT PARTNERS* 159 (1965). But see Enstam & Kamen, *Control and the Institutional Investor*, 23 *BUS. LAW.* 289, 299 (1968), in which the authors argue that smaller investors hold no such expectations and seek no such protection.

458. See Galston, *supra* note 385, at 351-54. See also Executive Comm. of Trust Div. of Am. Bankers Assn., *A Statement of Policies for Voting Shares of Stock Held in Trust Accounts*, Feb. 7, 1944, in A. SCOTT, *supra* note 392, § 193.3, at 1603-04.

459. See J. LIVINGSTON, *THE AMERICAN SHAREHOLDER* (1958).

Harvard invests on the basis of what is selfishly best for Harvard<sup>460</sup> is valid under the norm. However, the decision to vote shares to support management policies without regard to the social impact of those policies is not valid.<sup>461</sup> Buying stock in a racist corporation, for example, does not promote racism. Indeed, racism may be strengthened if all those who oppose it avoid buying stock in a racist corporation. But the decision to favor management when its policy of racism is challenged does implicate the shareholder in the decision, and, worse, it strengthens the objectionable policy. Thus, Harvard's treasurer's statement during the General Motors proxy contest that investments were managed only for income and growth is an extension of Pusey's policy, which, so extended, has the effect of choosing irresponsible conduct because it is profitable.<sup>462</sup>

Hard calculations may be needed with respect to any particular issue. It is probably an oversimplification to regard all policy that favors social involvement by the corporation as diminishing profits, dividends, or capital gains. Even if that view were accurate, it is not a close enough calculation. How much the involvement would cost and how much benefit it would confer on society are appropriate questions. Institutional investors, particularly, should consider the value of corporate social responsibility in light of its effect on dividends or stock market prices.<sup>463</sup>

Some institutions have constituencies who often demand a voice in organizational policy. Universities particularly have experienced this response, but the pension fund has also, probably because it is an outgrowth of union activities in which the rank and file often participate. The concern of the managers of such institutions, in any event, is the best interest of their constituency, and frequently constituencies play a role in the actual decision-making process. The university authorities polled the opinion of their constituents regarding Campaign GM by consulting students and faculty at Harvard, M.I.T., and Michigan, but the solicited views were ultimately disregarded. And while university communities may not have been heeded in Campaign GM, pension fund beneficiaries were neither seen nor heard.<sup>464</sup>

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460. See text accompanying note 423 *supra*.

461. Cf. the statement of Harvard's treasurer, George F. Bennett, in note 424 *supra*.

462. See note 424 *supra*. In all fairness to Mr. Bennett, he did express the belief that General Motors was acting responsibly, and he did not believe that he was supporting irresponsible conduct. Jacobs, *supra* note 424, at 1, cols. 3-4.

463. See Rose, *The Economics of Environmental Quality*, FORTUNE, Feb. 1970, at 120.

464. Banks that manage investments so automatically voted their shares for management against Campaign GM that they frustrated the desire of some of their bene-



What is being suggested, then, as the institutional approach to public-policy questions, is the development of a norm, or a bias, in favor of responsible corporate conduct. At the same time there should be a broadening of the institutional decision-making process so that the constituencies can play a larger role in the determination of what is in their best interests.

Several reforms appear to be appropriate. At present, only mutual funds report their common stockholdings in a public place.<sup>465</sup> Other institutions should likewise be required to do so because of the important effect their votes can have in the affairs of public companies. This is especially so with regard to pension funds because of the size of their holdings. This proposed reform is significant not only because the shareholders of the companies involved should be aware of this sizable force within their ranks, but also because it would give the constituencies of institutions an opportunity to influence the decision makers. It would enable those waging a public-interest contest to discover which groups have an opportunity to affect the campaign. Of course, the same information could be obtained from a shareholders list, but there may be obstacles to obtaining the list.<sup>466</sup> Furthermore, the information should be available at the earliest planning stages of a campaign, perhaps before it is possible to compel the production of the list.

Second, institutions should be required to report publicly how they voted in a proxy contest. Senator Lehman once asked the SEC if it saw merit in such a proposal, and the Commission responded that it felt that it was important only if there existed some undisclosed understanding regarding the voting of the shares.<sup>467</sup> Of course, that response, understandably, was made with only the election contest in mind. But there are other factors to be considered. Institutions are powerful as independent forces and should operate less clandestinely. There does exist the feeling, as C. Wright Mills has described it,<sup>468</sup> that there is a power elite—a ruling class—in America. There may be nothing sinister in this fact, but the men who dominate universities, banks, corporations, and government share the same

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ficiaries to vote for the other side. Campaign GM coordinators were told by persons whose trust funds were managed by the United States Trust Company in New York and by the Girard Trust Company in Philadelphia that the banks had already voted the stock for management, as presumably they were entitled to do under the trust agreements. However, at least in the case of United States Trust Company, new voting instructions were subsequently given to the trustees.

465. See notes 396-97 *supra* and accompanying text.

466. See notes 360-78 *supra* and accompanying text.

467. 1957 Hearings, *supra* note 64, at 116.

468. C. MILLS, *THE POWER ELITE* (1956).

viewpoint on life because they are drawn from the same small group. Indeed, they are often the same people. General Motors' board included two university trustees and several bankers. These are the same people who decide how stock held by institutions will be voted. And, if they are honest men, they will think the same regardless of the capacity in which they act. Under these circumstances, it is particularly important that their decisions be more open. Disclosure of their voting record is hardly enough to democratize powerful institutions, but it is the minimum that can be expected of them.

#### E. *The Annual Meeting*

Nothing happens at annual meetings. Despite the nod to the chairman that "one day in the year you earn the money, and that is when you preside at this annual meeting,"<sup>469</sup> less is done for the corporation by management on that day than on any other day. Votes are announced—but they have already been cast and most of them have even been counted.<sup>470</sup> But the annual meeting was central to Campaign GM's planning and probably will be in any other public-interest proxy contest. In the first place, it is the event to which all prior activities are directed. It furnishes a framework for the discussion of the issues. Second, because it is a large gathering of people who will confront each other—often in heated dialogue—the annual meeting can become a newsworthy event. The opinions expressed there may appear in the newspapers and on television.<sup>471</sup>

Campaign GM's objectives for the annual meeting were as follows: (1) to place its issues on the agenda, with time allocated to discuss the questions; (2) to assure entry to the meeting for sufficient numbers of its supporters; (3) to repeat its charges against General Motors and to question management on the issues; (4) to accomplish these first three objectives in such a way that Campaign GM's actions would stand out in sharp contrast to the unruly behavior that had characterized annual meetings in other public-interest proxy contests.

Both sides made efforts prior to the meeting to agree on procedure. Thus, Campaign GM and General Motors' general counsel agreed on the content of the agenda. They also agreed that Campaign

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469. Transcript, *supra* note 44, at 93 (Mr. Lewis D. Gilbert).

470. "Decisions which, in theory, are taken at meetings after discussion, are in practice taken before the meeting is even held, so that it becomes a solemn farce." L. GOWER, *MODERN COMPANY LAW* 456 (2d ed. 1957).

471. The General Motors meeting was reported on the front pages of the Detroit papers and the *Washington Post*, and in the *New Yorker* magazine and the *New Republic*, and extensively reported on television. It was attended by 130 journalists. Carter, *Commotion at GM*, *NEW REPUBLIC*, June 6, 1970, at 8.

GM would be allowed an uninterrupted fifteen minutes to present speakers on behalf of each proposal that was part of the formal agenda, and that it would have an opportunity at least to present the proposals that had been excluded from the proxy statement. Advance agreement was also reached on issuing admission passes to, and providing an area in the hall for, Campaign GM supporters.

Problems of admission to the meeting are likely to confront every public-interest proxy contest. Management has a legitimate concern in preventing disruption of the meeting and imposing reasonable limitations on admission. Limiting the membership of a proxy committee to three or four persons is reasonable, for example. Requiring admission cards is also reasonable.<sup>472</sup>

The meeting should be conducted in a manner consistent with its main purpose, which is to convey information. It is not a legislative session, since decisions are not made after due deliberation. The analogy to a parliamentary body or a political convention is not accurate. Votes are not cast to decide the questions presented; the speeches that are made do not reach those who actually vote on the proposals.

The responsibility for planning and conducting the meeting necessarily falls on the board and the chairman of the meeting. Bylaws frequently designate the presiding officer, while the agenda is determined in advance by the board of directors. For the agenda to be fair, public-interest proposals cannot automatically be deferred to the end of the meeting when patience has worn thin; rather, dealing with proposals in the order in which they were presented to management would be fair.

The rules of the meeting are most often informal. Robert's Rules of Parliamentary Order are simply inappropriate, as is generally recognized,<sup>473</sup> because the function of the meeting is to inform, not to decide. But a public-interest proxy contest contains elements that

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472. The letter from the chairman and the president that accompanied General Motors' proxy material stated, "[I]f you wish to attend [the meeting] please enclose a note *with your proxy*" (emphasis added). Letter to the Stockholders from James M. Roche, Chairman, and Edward N. Cole, President, General Motors Corp., April 6, 1970. Requiring notice of a shareholder's intention to attend the meeting to accompany management's proxy would be an unreasonable condition. It would in effect force all shareholders who wished to attend the meeting to vote on management's rather than Campaign GM's proxy. But General Motors did not really intend this result, as was made clear in the formal notice of meeting in which it was stated that passes would be sent on request. Notice of Annual Meeting and Proxy Statement of General Motors Corp., April 6, 1970, at 2. Nevertheless, the letter was unnecessarily confusing.

473. Monaghan, *Annual Stockholders' Meetings: Some Legal and Practical Problems*, 16 BAYLOR L. REV. 129, 140 (1964); Wetzel, *Conduct of a Stockholders' Meeting*, 22 BUS. LAW. 303, 306 (1967). But see L. GILBERT, THIRTIETH ANNUAL REPORT OF STOCKHOLDER ACTIVITIES AT CORPORATION MEETINGS 22 (1969).

may impair the conduct of a shareholder meeting. Long speeches are more likely to occur and the language may tend to become more inflammatory because of the liveliness of the issues. Demonstrations and disruptions may also occur. Should any attempt be made to prevent these occurrences? Are there any feasible ways to do so?

Most corporate chairmen will tolerate the long speeches and the occasional antics of the professional shareholders.<sup>474</sup> At the General Motors meeting Chairman Roche only occasionally tried to curtail the length of speeches. A rule that would limit either the content or the duration of anyone's remarks could be used to silence the outnumbered dissenter, and thus should not be the practice. Even a rule requiring germaneness could be abused, although certainly germaneness is a desirable goal. In essence, it may be difficult to formulate any rules regarding content or duration of speeches that are not subject to abuse. The proponents of public-interest proxy contests may thus have to rely on the sense of fairness of the chairman of the meeting to assure their right to be heard.

Conduct that prevents speech may require a less tolerant attitude. While it is true that a long presentation holds other speech in abeyance, our society recognizes value in words that it does not recognize in demonstration, even acknowledging that demonstrations are symbolic speech and may convey feelings.<sup>475</sup> Management has, in some instances, had demonstrators evicted from the meetings,<sup>476</sup> but there is a disinclination to use this police power. Probably the organized use of disruptive tactics would prompt stern action, but admittedly calling in the police may merely serve the purposes of some dissenters who seek physical rather than intellectual confrontation. Keeping the meeting on a verbal level is especially important in a public-interest proxy contest because the issues are complex and there is a great need to educate people. Again, the chairman of the meeting must in his fairness determine when the limits of propriety have been passed.

### III. LOOKING AHEAD

#### A. *Possible Public-Interest Questions*

What other public-interest questions are likely to arise in the future and present similar issues—especially inclusions—in proxy contests? The experience of Campaign GM may provide a clue.

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474. J. BROOKS, *BUSINESS ADVENTURES* 91 (1968).

475. Savoy, *Toward a New Politics of Legal Education*, 79 *YALE L.J.* 444, 453 (1970).

476. See, e.g., *N.Y. Times*, April 15, 1970, at 63, col. 4.

### 1. *Questions Dealing with the Indochina War and Particular Weapons*

At the General Motors meeting, a shareholder suggested to Mr. Roche that the shareholders be polled to determine their willingness to donate all of the company profits derived from the sale of weapons and the war to rehabilitate civilian war victims.<sup>477</sup> Dow Chemical Company was also a target of this type of attack by shareholders for a number of years because of its sale of napalm, and a resolution was proposed in 1968 and 1969 that would have had the effect of preventing the company from selling napalm to the military.<sup>478</sup> It is clear that the objection to these weapons relates not to profitability but to the moral issue of war because opponents of the war believe that American involvement results from policy shaped by leaders in and out of government. In any event, it is clear that corporate acquiescence enables the United States to wage the war. One could imagine a shareholder of a German corporation objecting to the sale of gas chamber apparatus to be used at Auschwitz, and that would approximate the attitude of an unhappy Dow shareholder.

### 2. *Questions Dealing with Foreign Policy*

Shareholders have objected to certain overseas operations by corporations, which they contend support immoral policies of particular governments. The most common targets are corporations dealing with South Africa, but those dealing with Angola have also been a target. At the General Motors meeting, a shareholder asked Mr. Roche to inform shareholders about the company's efforts to effect a change in South African racial policy or at least to state General Motors' opposition to government policy; Mr. Roche replied that this information could be supplied.<sup>479</sup>

### 3. *Questions Dealing with Race Relations*

Company policy on race relations has been a concern of shareholders at annual meetings for years, the best example being the clash several years ago between Eastman Kodak and a group called FIGHT. The issue was whether the corporation should employ a stated number of black persons in its Rochester plant, pursuant to an agreement between a company vice president and a local com-

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<sup>477</sup> Transcript, *supra* note 44, at 210.

<sup>478</sup> See *Medical Comm. for Human Rights v. SEC*, 432 F.2d 659, 661-63 (D.C. Cir. 1970).

<sup>479</sup> Transcript, *supra* note 44, at 202.

munity group.<sup>480</sup> No resolution was offered to that meeting, but a variety of types of resolutions could be presented on the issue.

A widely reported confrontation at the General Motors meeting occurred when a shareholder persisted in finding out why no blacks or women were on the board of directors. Unsatisfied with the answer that none had been elected or nominated, she said, "We will be back with that same question next year and we expect you to have done something about it."<sup>481</sup>

#### 4. Questions Dealing with the Environment

Resolutions dealing with environmental pollution are likely to be presented in future proxy contests in light of the deep concern for the problem at last year's annual meetings.<sup>482</sup> In fact the relationship between corporations and the environment may prove to be the most significant public-interest proxy issue of the 1970's.

The substantive proposals of public-interest issues are of two basic types: the first demands affirmative undertakings of the corporation, such as improving race relations and adopting antipollution measures; the second points out things that the company should not do, such as making war matériel or doing business in a country that engages in objectionable activities. In both instances shareholders ask to perform of their own initiative a function that is capable of being performed by the board of directors.

Shareholders concerned with public-policy questions might also seek to effect a structural reform of the government of the corporation from within.<sup>483</sup> Thus, one of the areas of inquiry for the proposed General Motors Committee for Corporate Responsibility was to study "[t]he manner by which the participation of diverse sectors of society in corporate decision-making can be increased including

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480. Gottschalk, *Kodak's Ordeal—How a Firm That Meant Well Won a Bad Name for Its Race Relations*, Wall St. J., June 30, 1967, at 1, col. 1.

481. Transcript, *supra* note 44, at 163. Possibly in anticipation of that same question at the 1971 meeting, General Motors recently announced the appointment of a black director, the Rev. Leon H. Sullivan, described as an "aggressive advocate of black self-help." Wall St. J., Jan. 5, 1971, at 8, col. 3.

482. See notes 5 & 12 *supra* and accompanying text.

483. Round II of Campaign GM, which was announced on November 19, 1970 (see Wall St. J., Nov. 20, 1970, at 4, col. 3), proposes resolutions dealing with the decision-making structure of General Motors. The first proposal would revise the method of nominating candidates for director by permitting shareholders to nominate candidates and include them on the corporation's proxy statement, and would require shareholders, whether voting in person or by proxy, to specify individual choices for director. Proposal 2 would allow three so-called constituency groups—consumers, dealers, and employees—the opportunity to nominate three candidates for director, although a majority vote of the shareholders would still be required to elect them. The third proposal would require the corporation's annual report to include certain information concerning pollution, safety, and minority opportunities. See BNA SEC. REG. & L. REP. No. 77, at A-13 to -14, K-1 (Nov. 18, 1970).

nomination and election of directors and selection of members of the committees of the Board of Directors."<sup>484</sup>

A number of commentators have seen political and structural questions as central to the involvement of the corporations in society.<sup>485</sup> Proposals dealing with the political organization of the corporation could well be a major concern to shareholder groups. Structural questions are not peculiar to public-interest campaigns, however, as witnessed by the many resolutions dealing with cumulative voting that arise each year.<sup>486</sup>

### B. Suggested Changes in the Proxy Rules

The experience of Campaign GM has already given rise to suggestions for a change in the proxy laws.<sup>487</sup> On June 23, 1970, Senator Muskie introduced the Corporate Participation Bill,<sup>488</sup> which would amend section 14(a) of the Securities Exchange Act of 1934 to add the following language:

Inclusion in such solicitation of a proposal submitted by a security holder shall not be prohibited on the ground that such proposal may involve economic, political, racial, religious, or similar issues, unless the matter or action proposed is not within the control of the issuer.<sup>489</sup>

Senator Muskie explained that the bill was designed to "increase

484. See Appendix B *infra*, proposal 3, para. 3(E).

485. See notes 285-316 *supra* and accompanying text.

486. Another area of possible shareholder concern beyond the scope of this Article concerns savings and loan associations. These companies are mutual companies, owned by their depositors who convey a proxy to management when they open an account—although it is highly unlikely that depositors realize what they have done. In response to criticism by a special outside panel (see Herman, *Conflicts of Interest*, in 2 A STUDY OF THE SAVINGS & LOAN INDUSTRY 763 (L. Friend ed. 1969)), the Federal Home Loan Bank Board proposed proxy rules on July 21, 1970, which would facilitate dissident challenges to management (proposed new 12 C.F.R. § 569). 35 Fed. Reg. 12,219 (1970). If the rules are adopted, one can expect public-interest groups to attempt to push savings and loan management more in the direction of community concern in their loan policy. Thus, 12 C.F.R. § 569.4 (1970) requires proxies to be revocable and prohibits a proxy from being part of another document (such as an account card). The institution is required to mail soliciting material of dissident security holders, unless certain defenses are available to it. 12 C.F.R. § 569.6 (1970). In many respects, the proposed rules reflect the rules existing under the 1934 Securities Exchange Act. The Federal Home Loan Bank Board has given indications, however, that it does not intend prompt adoption of the rules. See *Washington Post*, Sept. 17, 1970, § G, at 9, col. 1.

487. In Remarks of Sen. Edmund S. Muskie, at the Advanced Management Institute, New York City, June 22, 1970, at 14-15, Senator Muskie explained that his bill (see notes 488-89 *infra* and accompanying text) was inspired by the difficulties faced by Campaign GM in light of the SEC's interpretation of the proxy rules.

488. S. 4003, 91st Cong., 2d Sess. (1970).

489. S. 4003, 91st Cong., 2d Sess. § 2 (1970), reprinted in 116 CONG. REC. S9547 (daily ed. June 23, 1970).

the effectiveness with which corporations serve society"<sup>490</sup> by increasing the shareholders' voice in deciding issues that affect them. The bill would provide "another channel for shareholders to direct their corporations to advance the general welfare."<sup>491</sup> Senator Muskie acknowledged, in light of Campaign GM, that the likelihood of shareholder acceptance of socially motivated proxy proposals was not great, but that "the value of shareholder proxy proposals rests not alone in their immediate hope for success but also in their ability to apprise management of the intensity of stockholder concern over the manner in which the corporation is conducting business."<sup>492</sup> He saw the shareholder proposal as the only viable method for shareholders to communicate with each other and to challenge management. Moreover, he saw his proposed amendment as a return to the earlier interpretation of the shareholder proposal rule<sup>493</sup> since it excluded only those proposals on which the corporation could not take any action. The measure was intended to halt the recent practice of preventing shareholder consideration of proposals that were within the corporation's control—such as whether it should discontinue manufacture of a product—because the purpose of the proposal was to promote a social or political cause.<sup>494</sup>

To some extent, Senator Muskie describes a larger role for the bill than it is capable of playing. While he may intend to increase the shareholder voice in these issues, this end can only be achieved by changing the decision-making structure of the corporation. But the bill does not and cannot do this; the government of the corporation is not a matter of federal securities law, but is instead structured by state law. Thus, a shareholder resolution that the corporation build a pollution-free vehicle could not constitute corporate action until the board of directors approved it. But Senator Muskie seems less concerned with actual decision-making than with influencing policy through public opinion. And this, he argues, should be permitted without regard to whether there are social or political implications in the proposal. His supporting statement shows clearly that he does not regard the motive of the sponsor of the resolution to be a pertinent consideration.<sup>495</sup>

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490. *Id.* (Remarks of Senator Muskie).

491. *Id.*

492. *Id.*

493. See text accompanying notes 98-99 *supra*.

494. See text accompanying notes 116-26 *supra*.

495. Senator Muskie's supporting statement indicated approval of the early interpretation of rule 14a-8 (presumably Release No. 3638; see text accompanying notes



One problem with the proposal is that it leaves untouched the first clause of subparagraph (c)(2) of rule 14a-8, which permits exclusion of a proposal if submitted "primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the issuer or its management . . ."<sup>496</sup> Experience has shown that the SEC has allowed the exclusion of social-policy issues because they were advanced for an objectionable personal motive.<sup>497</sup> While it is true that the administration of the rule on this point is likely to become far more liberal as a result of the Dow and General Motors cases, there can be no assurance that the Commission would not allow this most subjective of exceptions to undercut seriously the thrust of Senator Muskie's proposal, should it be enacted.<sup>498</sup>

It is submitted that another approach to proxy rule reform can and should be adopted, namely, rule changes by the SEC. This procedure would enable a wider area of reform than that proposed by Senator Muskie, who, understandably, was largely unaware of the other problems faced in a public-interest proxy contest, and it would also allow for greater flexibility in further revisions. The proxy rules have been amended frequently and they are reviewed "continuously."<sup>499</sup> If their major provisions were hardened into the legislation, they would probably be far less workable than they are now. Accordingly, the following proposals for rule changes are suggested.<sup>500</sup>

#### 1. *Repeal Subparagraph (c)(2) of Rule 14a-8*

Repeal of subparagraph (c)(2) would turn the clock back to the original interpretation of rule 14a-8,<sup>501</sup> thus achieving the result intended by the Muskie bill. This procedure would still permit management to exclude questions for which the corporation is the wrong forum because they are "general" social questions. The comments

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98-99 *supra*), and implied disapproval of the SEC action in the Dow Chemical Co. case (see text accompanying notes 59-60, and note 74 *supra*). 116 CONG. REC. S9547 (daily ed. June 23, 1970) (remarks of Senator Muskie). He later wrote to Chairman Budge to praise the court's decision in that case. Letter to Hamer H. Budge, Chairman, SEC, from Sen. Edmund S. Muskie, July 8, 1970, in BNA SEC. REG. & L. REP. No. 59, at A-12 to -13 (July 15, 1970).

496. 17 C.F.R. § 240.14a-8(c)(2) (1969).

497. See text accompanying notes 141-43 *supra*.

498. The bill does not specifically mention all of the areas contained in subparagraph (c)(2), since it omits reference to proposals that involve "social" issues. However, because of the reference to "similar" issues, it would probably be coextensive with subparagraph (c)(2).

499. Remarks of Hamer H. Budge, Chairman, SEC, Before the Am. Soc. of Corporate Secretaries, White Sulphur Springs, W. Va., June 12, 1970, at 12.

500. These proposals were submitted to the SEC on September 10, 1970, and on November 13, 1970, the author appeared before a specially created task force to discuss reform of the proxy rules.

501. See text accompanying notes 174-75 *supra*.

of Senator Muskie,<sup>502</sup> and of the court in the Dow case,<sup>503</sup> not to mention those of the SEC in the General Motors decision,<sup>504</sup> indicate that such is the correct interpretation of the statute. Repeal of subparagraph (c)(2) is preferable to Senator Muskie's bill because it accomplishes the result with less ambiguity. The remaining subparagraphs would continue to screen those questions that are not the proper concern for shareholder action, or that impair the workings of the corporate machinery.

## 2. *Allow a More Substantial Supporting Statement To Accompany Management's Proxy*

Shareholder proposals are often complicated. This is particularly true of those that deal with public-interest questions since their economic relationship to the company is not readily apparent. For example, the Project used three pages in its own proxy statement to explain the proposal to create a shareholder's committee; management likewise used almost three pages to argue against it in its own proxy statement. Yet the proxy rules limit the proponents to one hundred words in management's proxy statement to support its proposal, while they do not so limit management.<sup>505</sup> This rule is neither adequate nor reasonable. It compels proponents to seek other means to describe and support their proposals, but often such means will be prohibitively expensive. I propose, therefore, that rule 14a-8(b) be amended to permit the proponent to use both sides of a printed page in support of his proposal.<sup>506</sup>

By allowing the proponent adequate space to support his proposal, the proxy rules can accomplish a result equivalent to the proponent's use of his own proxy statement. Thus, under this pro-

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502. See text accompanying notes 490-94 *supra*.

503. See text accompanying notes 186 & 211 *supra*.

504. See text accompanying notes 166-73, 179-82, & 190-208 *supra*.

505. Rule 14a-8(b), 17 C.F.R. § 240.14a-8(b) (1969). Chairman Purcell explained at the 1943 House hearings that the one-hundred-word limitation was arbitrary. A number of staff members were asked to see how succinctly they could express their proposals, and one hundred words seemed to cover it. *1943 Hearings, supra* note 88, at 190. But when management chooses to spend pages (at shareholder expense) to reply to a one-hundred-word paragraph, then the limitation looks too severe. A month after the present rule was adopted, Commissioner O'Brien commented that while "this is an inadequate substitute for the right to give a full explanation of such proposals at a shareholders' meeting, it is a step in the direction of placing the shareholder where he would be if it were physically possible to gather all shareholders at the annual meeting" (emphasis added). Address of Robert H. O'Brien, Commissioner, SEC, Before The Conference Board, New York City, Jan. 21, 1943, at 5. See also *Hearings on Corporate Proxy Contests Before a Subcomm. of the Senate Comm. on Banking and Currency*, 84th Cong., 2d Sess., pt. 3, at 1601-02 (1955) (testimony of Wilfred May).

506. See Appendix C *infra*, proposal 2.

posal, the proponent would be required to disclose information about his personal interests and background insofar as it relates to the proposal, and perhaps he would thereby reveal his motive for the proposal. While the proponent's motive is not material to the question whether the shareholders should have an opportunity to consider the resolution, it may be considered significant by a shareholder in deciding how he should vote.

Furthermore, the proposal would not be available to a shareholder who is engaged in an *economic* struggle with management. If he is seeking votes for himself or an affiliated person for any other purpose, this means of supplying a proxy statement would not be open to him. In this regard, filing requirements and antifraud rules are clearly in order.

Admittedly this proposal involves a substantial expense, but it is one that can easily be justified. The shareholder is communicating with his fellow shareholders on a matter of interest to the group (or else it could be excluded). Thus a benefit to the group is involved. By analogy to the derivative suit, or even to a class suit,<sup>507</sup> such a benefit justifies assessing the groups for its costs. It should be remembered that the proxy statement is a company document and not one which belongs to management alone.<sup>508</sup>

### 3. *Ease the Existing Requirement That a Proxy Statement Precede or Accompany All Solicitations*

Participants in a public-interest proxy contest should be able to publicize their efforts without regard to whether they have furnished a proxy statement to everyone, under certain circumstances enumerated earlier.<sup>509</sup> Moreover, if the expanded supporting statement is used, all shareholders will see a close equivalent of a proxy statement; thus, a proposal to relax the definition of "solicitation"<sup>510</sup> is less significant because a shareholder will presumably be adequately informed at least by the supporting statement before he votes on a proposal.

What is needed is an interpretation or definition of "solicitation" to exclude from its reach certain kinds of communications that presently are covered by such cases as *Gittlin*<sup>511</sup> and *Okin*.<sup>512</sup> With-

507. See *Mills v. Electric Autolite Co.*, 396 U.S. 375 (1970).

508. See Eisenberg, *Access to the Corporate Proxy Machinery*, 83 HARV. L. REV. 1489 (1970).

509. See text preceding note 348 *supra*.

510. See note 335 *supra*.

511. *Studebaker Corp. v. Gittlin*, 360 F.2d 692 (2d Cir. 1966).

512. *SEC v. Okin*, 132 F.2d 784 (2d Cir. 1943). See text accompanying notes 336-37 *supra*.

out this modification, the proxy rules may keep a concerned public from being informed about public-interest proposals, unless the proponents can afford to send a proxy statement to each shareholder. And, as discussed earlier,<sup>513</sup> there are serious constitutional problems with the present interpretation.

The proposed amendment would allow both sides to air the issues in public, so long as they speak in a genuinely public manner and not just to shareholders. When shareholders are the exclusive audience, the existing rules would apply. Moreover, the present rules would continue to apply to a contest for control or to an acquisition transaction having the same effect as a change of control. In such contests, the shareholder interest is so overriding that the existing requirements that a proxy contest begin with a proxy statement must be enforced. Furthermore, in such a contest usually no economic hardship is imposed by insisting that all shareholders receive a proxy statement.<sup>514</sup>

The proposed rule does not try to identify a public-interest proxy contest as such. It does require that the communication be with respect to a proposal that has been *submitted* under rule 14a-8; it does not, however, require that the proposal actually be *included*, since the solicitation may commence before that inclusion or may apply to a proposal rejected under the rule, or to one for which a limited solicitation is undertaken. Furthermore, by insisting that the communication be made in a public manner, it is assumed that only proposals affecting the public interest will be worth the expense of such an effort. The proposed rule by implication extends to management the opportunity to respond to a communication before it issues a proxy statement, since otherwise management might be unfairly muzzled. Even if the proponents were engaged in an election contest with management, they could invoke the rule unless they were seeking to elect a majority of directors to be elected at that meeting—which might be less than a majority of the full board if the terms of the members are staggered.<sup>515</sup>

Accordingly, it is suggested that rule 14a-3<sup>516</sup> be amended as set forth in the Appendix to this Article.<sup>517</sup> The purpose in choosing that section for amendment, rather than the definition section, rule

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513. See text accompanying notes 352-57 *supra*.

514. The victors in a control contest can usually anticipate reimbursement for their expenses. See *Steinberg v. Adams*, 90 F. Supp. 604 (S.D.N.Y. 1950); *Rosenfeld v. Fairchild Engine & Airplane Corp.*, 309 N.Y. 168, 128 N.E.2d 291 (1955).

515. See rule 14a-11, 17 C.F.R. § 240.14a-11 (1969), for the special rules applicable to election contests. See also text accompanying notes 323-24 *supra*.

516. 17 C.F.R. § 240.14a-3 (1969).

517. See Appendix C *infra*, proposal 3.

14a-1,<sup>518</sup> is that the exemption would not extend to the filing requirements of rule 14a-6<sup>519</sup> or the antifraud requirements of rule 14a-9.<sup>520</sup> However, no specific suggestions for the filing requirements are contained here since that subject involves more a detail than a principle.

#### 4. *Expand the Use of Proxy Statements as Information-Disseminating Devices*

Rule 14a-8 was born out of the recognition that the proxy statement serves as a substitute for a meeting.<sup>521</sup> It is also true that the proxy statement has "become the pre-eminent medium for upgrading the quality and quantity of corporate disclosure."<sup>522</sup> The proxy statement's disclosure function should now be utilized to further the shareholder's knowledge about the public impact and concerns of his corporation.<sup>523</sup>

One practice common to shareholder meetings is the question-and-answer session at which management deals with a wide range of inquiries. It is most likely that matters of public interest arise at this time. Some questions are intended not just to satisfy a shareholder's curiosity, but to obtain or confirm information that might affect future action. What the questioner is seeking is an answer in a public forum. But questions asked at the open forum of a shareholders' meeting do not carry very far. It is suggested that the proxy rules be amended to permit the use of the proxy statement to serve as such a forum for asking and obtaining the answers to questions. In this manner, the proxy statement would be serving its function as a substitute meeting.<sup>524</sup>

The proposed rule takes account of the opportunity it could present to harass management. Therefore, the questions permitted

518. 17 C.F.R. § 240.14a-1 (1969).

519. 17 C.F.R. § 240.14a-6 (1969). See notes 320-21 *supra* and accompanying text.

520. 17 C.F.R. § 240.14a-9 (1969).

521. See note 88 *supra* and accompanying text.

522. Cohen, *Introduction to E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL* at xvi (2d ed. 1968).

523. An early comment on rule 14-8 noted that further expansion of Rule X-14A-8, moreover, seems justifiable as a means of increasing the shareholder's understanding of his enterprise. Since stockholder proposals are themselves informative, in that they function as cross-currents of new ideas and information among the security holders, they might be subject to SEC regulation as mere proposals, if not as mandates to the directors.

Note, *Permissible Scope of Stockholder Proposals Under SEC Proxy Rules*, 57 YALE L.J. 874, 880 (1948).

524. See Appendix C *infra*, proposal 4. An imaginative recent use of the proxy machinery was the inclusion in management's proxy statement (by court order) of a shareholder's objection to an acquisition also described therein. See Wall St. J., July 10, 1970, at 16, col. 5.

can only be directed to the range of company activities, or to activities that the company could carry on (not necessarily only those things management contemplates), but protects confidential information by the same formula used in the General Motors shareholder committee proposal.<sup>525</sup> The proposed rule also excludes personal questions. While it would be ideal in one sense to print the answers in the proxy statement or the annual report, this procedure could be excessively burdensome. But the shareholder should at least be able to obtain circulation of the information and have it made part of the public file. Therefore, the compromise is to require a post-meeting report to be sent to shareholders<sup>526</sup> containing the answers or a fair summary thereof. Answers should also be required to be filed by management in the same manner as a monthly report on form 8-K,<sup>527</sup> subject to antifraud rules.<sup>528</sup>

Another significant reason for providing this information, subjecting it to antifraud rules, and causing it to be made public, is that it will serve as a check on the rhetorical answer by management that it is being responsible. Campaign GM demonstrated a tendency on the part of institutions that professed to desire the same objectives as itself to rely on management's assertions that it was doing what was necessary to achieve those objectives.<sup>529</sup> The institutions indicated that they would continue to monitor the situation,<sup>530</sup> and a means must be found to assist them in this endeavor. Otherwise, it is likely that management could withstand any public-interest assertion by continued rhetoric. Thus, a new paragraph (e) is suggested for rule 14a-8 as set forth in Appendix C to this Article. An amendment to paragraph (d) might also be desirable to establish a procedure for objections to questions.

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525. See Appendix B *infra*, proposal 3, para. 4.

526. Lewis Gilbert has been trying to do this for years, with some success. See J. GILBERT & L. GILBERT, THIRTIETH ANNUAL REPORT OF STOCKHOLDER ACTIVITIES AT CORPORATION MEETINGS 38 (1969).

527. 17 C.F.R. § 249.308 (1969) requires that reports filed pursuant to 17 C.F.R. §§ 240.13a-11, 240.15d-11 (1969), use form 8-K, which requires disclosure of the following information: changes in control of registrant; acquisition or disposition of significant amount of assets; material legal proceedings; changes in the rights of holders of securities; material withdrawal or substitution of assets securing any class of securities; defaults upon senior securities; increase or decrease in the amount of securities outstanding; options to purchase securities; material revaluation of assets; matters submitted to security holders for a vote; any other matter that the registrant chooses to disclose.

528. Rule 14a-9, 17 C.F.R. § 240.14a-9 (1969).

529. See text accompanying note 435, and notes 445 & 462 *supra*.

530. See text accompanying notes 431-32, 440-42, and 446-47 *supra*.

### 5. *Amend Procedures for Review of Questions Arising Under Rule 14a-8*

Certain procedural reforms will be necessary in view of the Dow decision. Chairman Budge has said that "[i]t has generally been the policy of the Commission to make an informal review of the staff's position on a particular proposal when it is requested to do so by either the management, the proponent or the staff."<sup>531</sup> The fact of Commission review was given decisive significance in the Dow case,<sup>532</sup> and obviously some orderly way must be found for making Commission, and hence judicial, review not arbitrary. Efficient means of rapidly processing resolutions, making a record, examining briefs, hearing arguments, and writing an opinion are needed. The opinions and decisions would then be public documents. The best means of achieving these essential procedural reforms should probably come from within the agency. But there is clearly a need for procedural reform that should not be long neglected.

### 6. *Appoint a Group To Study Remedial Changes in the Proxy Rules*

A study group within the SEC should be formed, using outside consultants, to study other means of making proxy rules more responsive to the public-interest concerns of a corporation. It would probably be helpful to elicit information from corporations about their social activities, and the social cost of their other activities, on a regular basis. For this purpose, the regular reporting obligation should perhaps be utilized. However, this is doubtless a very complex subject, and the information furnished might vary considerably from company to company, or industry to industry. This is not an area in which the SEC has developed any particular competence over the years, and this vacuum of experience points to the advisability of consulting industry leaders, and others, who have been concerned with such problems. Methods of allowing the broadening of the decision-making base of the corporation should also be studied. For example, renewed consideration might be given to the SEC's 1943 proposal<sup>533</sup> to allow nominations of directors to be made by shareholders and included in the proxy statement.<sup>534</sup> When Justice Doug-

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531. Remarks of Hamer H. Budge, Chairman, SEC, Before the Am. Soc. of Corporate Secretaries, White Sulphur Springs, W. Va., June 12, 1970, at 14.

532. See note 74 *supra*.

533. 1943 Hearings, *supra* note 88, at 34-36.

534. This proposal was supported in Caplin, *Shareholder Nominations of Directors: A Program for Fair Corporate Suffrage*, 39 VA. L. REV. 141, 152 (1953). It was also supported at the 1970 General Motors meeting. See Transcript, *supra* note 44, at 59.

las was chairman of the SEC he believed it appropriate to suggest that there be public, paid directors on the boards of major corporations.<sup>535</sup> The idea might be revived and thought through by the study group. Directors without a functioning staff would be of little value, as can be seen from the experience of investment companies,<sup>536</sup> or worse, the Penn Central Railroad.<sup>537</sup> The group should also explore whether it is necessary for the SEC to adopt rules to require dissemination of soliciting material to beneficial owners, or whether existing stock exchange rules are adequate for this purpose.

#### IV. REFLECTIONS

Campaign GM was conceived as a test of our corporate system. It followed the law and it observed the accepted forms in asking the shareholders of a corporation to exercise the prerogatives and responsibility of ownership and to impose a curb on the abuses resulting from the use of their property. The press hailed the campaign as the right way to attempt change; it was "working within the system." Others saw it as a most menacing threat to the system, which only appeared to use the forms of the system.

More than one view is possible. One could see the campaign as a use of the established forms—knowing that they would fail—to permit the conclusion that the system has failed—ample justification for much sterner stuff the next time. This would not be working within the system; it is working against the system by mocking its means. But one could also see the campaign as a demonstration that things are not working well, and that improvements are necessary. If it is part of an educational campaign to show the need for change and inadequacy of present attitudes, then it is working within the system. Probably both views have validity in that some people may have been motivated by a desire to humiliate the system, and some by a desire to save it. But is it really important to explore for the motivations of the participants? The campaign revealed a uniform set of facts about the system in any case. And what the next step will be depends more on "the system" than on its challengers.

Working within the system is viable only if it offers the partici-

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535. W. DOUGLAS, *DEMOCRACY AND FINANCE* ch. 4 (1940).

536. Glick, *Mutual Fund Management Fees: In Search of a Standard*, 25 *BUS. LAW.* 1471, 1482 (1970).

537. The deterioration of the Penn Central Railroad, which culminated in bankruptcy proceedings, occurred without any serious probing by the directors into the company's state of affairs. It seems a reasonable inference that they were not sufficiently informed to ask the right questions, as it is inconceivable that a fully informed board would have permitted the continuation of the worsening conditions. See Loving, *The Penn Central Bankruptcy Express*, *FORTUNE*, Aug. 1970, at 104, 171.



pants an opportunity to succeed. If the system offers merely a safety valve for dissidents to let off steam harmlessly, they will reject the system. The question must be: can the challengers to the performance of our corporate system possibly achieve their goals within that system? In part, the answer turns on how "success" is defined. For various reasons—inertia, economic disparity, and the like—it is highly unlikely that the dissidents can outpoll management. But, if by the combination of the effect dissidents can have on shareholders and the effect they can have on public opinion management will evolve broader decision-making structures and accomplish the social goals believed necessary, that could be considered victory. In fact the mere engaging in open debate is at least a partial victory.

The resolution of many of the problems presented—what issues can be submitted to shareholders, the role of the modern corporation in society, what is required of our institutional investors—must be achieved in the context of the times that make these questions urgent. The conviction is widespread that the crisis of our times is largely a product of corporate conduct. Private goals have been pursued by corporations diligently and skillfully without regard to their social cost so that, to many, our large corporations have become not a national asset but an implacable foe. The thrust of Campaign GM was not war but an accommodation. Perhaps its theme was best summed up by the Reverend Channing E. Phillips, one of its candidates for director, at the rally held in Detroit on the eve of the meeting. Reverend Phillips said of Campaign GM:

It is not an attempt to abolish corporations, but to preserve them, by altering their myopic decisions. It is not an attempt to eradicate profit, but to influence priorities, that society might be served rather than controlled by economic pursuits. And General Motors, as the world's largest corporation is a symbol—an important symbol—of this problem. So the cry, "Tame GM"—not abolish GM, but tame it, until it becomes the servant of society, harnessed to the principles of decency and justice for which this country stands in creed, moving us ahead toward the humane society where men live in harmony with each other and with nature. That is our concern.<sup>538</sup>

The problem, as seen by Reverend Phillips, was that our economic state had come to be dominated by men who were informed "narrowly and deeply" and who had ignored the broader concerns necessary for the management of our economy.<sup>539</sup>

The social involvement of corporations, then, offers a path

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538. Address of Rev. Channing Phillips, Detroit, Mich., May 21, 1970, at 2.

539. See R. FULLER, *OPERATING MANUAL FOR SPACESHIP EARTH* (1968); J. GALBRAITH, *THE NEW INDUSTRIAL STATE* 73 (1967).

through the crisis of our times. If that path is not followed, and if "business as usual" remains the usual business, the crisis must deepen. If corporate shareholders stiffen the resistance of corporations to change, a greater crisis will ensue.

The public-interest proxy contest provides a useful means of furthering corporate involvement in resolving the crisis. It places the issues squarely before the corporate owner—the shareholder—who increasingly is broadly representative of the public. It maintains pressure on decision makers by alerting the public and the legislature to the problems created by the corporation and to the possible means of dealing with those problems. It is an excellent means of gathering information and developing insights into the problems. Its techniques are to emphasize discussion and orderly resolution.

The law, thus, should recognize the value of the public-interest proxy contest and rules and interpretations favorable to it should develop. Campaign GM demonstrated the strengths and weaknesses of such a contest. Campaign GM also posed challenges to the institutions, which are an integral part of the system. The law can do little of an affirmative nature here, but it should continue to allow the use of institutional power in the public interest. That power remains to be used, of course. The law should, however, provide more information about the institutional relationships to corporations and the conduct of institutions in this respect.

Few changes in laws are required. Mainly the job is up to the people.

## **APPENDIX A**

**RULE 14a-8, 17 C.F.R. § 240.14a-8 (1969).**

### **PROPOSALS OF SECURITY HOLDERS**

(a) If any security holder entitled to vote at a meeting of security holders of the issuer shall submit to the management of the issuer, within the time hereinafter specified, a proposal which is accompanied by notice of his intention to present the proposal for action at the meeting, the management shall set forth the proposal in its proxy statement and shall identify it in its form of proxy and provide means by which security holders can make the specification provided for by Rule 14a-4(b) (§ 240.14a-4(b)). The management of the issuer shall not be required by this rule to include the proposal in its proxy statement for an annual meeting unless the proposal is

submitted to the management not less than 60 days in advance of a day corresponding to the first date on which the management's proxy soliciting material was released to security holders in connection with the last annual meeting of security holders, except that if the date of the annual meeting has been changed as a result of a change in the fiscal year, a proposal shall be submitted a reasonable time before the solicitation is made. A proposal to be presented at any other meeting shall be submitted to the management of the issuer a reasonable time before the solicitation is made. This section does not apply, however, to elections to office or to counter proposals to matters to be submitted by the management.

(b) If the management opposes the proposal it shall also, at the request of the security holder, include in its proxy statement a statement of the security holder, in not more than 100 words, in support of the proposal, which statement shall not include the name and address of the security holder. The proxy statement shall also include either the name and address of the security holder or a statement that such information will be furnished by the issuer or by the Commission to any person, orally or in writing as requested, promptly upon the receipt of any oral or written request therefor. If the name and address of the security holder is omitted from the proxy statement, it shall be furnished to the Commission at the time of filing the management's preliminary proxy material pursuant to Rule 14a-6(a) (§ 240.14a-6(a)). The statement and request of the security holder shall be furnished to the management at the same time that the proposal is furnished. Neither the management nor the issuer shall be responsible for such statement.

(c) Notwithstanding the foregoing, the management may omit a proposal and any statement in support thereof from its proxy statement and form of proxy under any of the following circumstances:

(1) If the proposal as submitted is, under the laws of the issuer's domicile, not a proper subject for action by security holders; or

(2) If it clearly appears that the proposal is submitted by the security holder primarily for the purpose of enforcing a personal claim or redressing a personal grievance against the issuer or its management, or primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes; or

(3) If the management has at the security holder's request included a proposal in its proxy statement and form of proxy relating to either of the last two annual meetings of security holders or any special meeting held subsequent to the earlier of such two annual meetings and such security holder has failed, without good cause to

present the proposal, in person or by proxy, for action at the meeting; or

(4) If substantially the same proposal has previously been submitted to security holders, in the management's proxy statement and form of proxy, relating to any annual or special meeting of security holders held within the preceding five calendar years, it may be omitted from the management's proxy material relating to any meeting of security holders held within the three calendar years after the latest such previous submission: *Provided, That:*

(i) If the proposal was submitted at only one meeting during such preceding period, it received less than 3 percent of the total number of votes cast in regard thereto; or

(ii) If the proposal was submitted at only two meetings during such preceding period it received at the time of its second submission less than 6 percent of the total number of votes cast in regard thereto; or

(iii) If the proposal was submitted at three or more meetings during such preceding period, it received at the time of its latest submission less than 10 percent of the total number of votes cast in regard thereto.

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

(d) Whenever the management asserts that a proposal and any statement in support thereof may properly be omitted from its proxy statement and form of proxy, it shall file with the Commission, not later than 20 days prior to the date the preliminary copies of the proxy statement and form of proxy are filed pursuant to § 240.14a-6(a), or such shorter period prior to such date as the Commission may permit, a copy of the proposal and any statement in support thereof as received from the security holder, together with a statement of the reasons why the management deems such omission to be proper in the particular case, and, where such reasons are based on matters of law, a supporting opinion of counsel. The management shall at the same time, if it has not already done so, notify the security holder submitting the proposal of its intention to omit the proposal from its proxy statement and form of proxy and shall forward to him a copy of the statement of the reasons why the management deems the omission of the proposal to be proper and a copy of such supporting opinion of counsel.

**APPENDIX B****PROPOSAL NUMBER 1**

Resolved:

That the Board of Directors amend Article Third subsection (i) of the Certificate of Incorporation by adding the following language:

' , provided that none of the purposes enumerated in subsections (a) through (i) of Article Third shall be implemented in a manner which is detrimental to the public health, safety or welfare, or in a manner which violates any law of the U.S. or of any state in which the Corporation does business.

**PROPOSAL NUMBER 2**

Resolved:

That Number 15 of the By-Laws of the Corporation be amended to read as follows:

15. The business of the Corporation shall be managed by a board of twenty-six members.

**PROPOSAL NUMBER 3**

WHEREAS the shareholders of General Motors are concerned that the present policies and priorities pursued by the Management have failed to take into account the possible adverse social impact of the Corporation's activities, it is

RESOLVED that:

1. There be established the General Motors Shareholders Committee for Corporate Responsibility.
2. The Committee for Corporate Responsibility shall consist of no less than fifteen and no more than twenty-five persons, to be appointed by a representative of the Board of Directors, a representative of the Campaign to Make General Motors Responsible, and a representative of United Auto Workers, acting by majority vote. The members of the Committee for Corporate Responsibility shall be chosen to represent the following: General Motors Management, the United Auto Workers, environmental and conservation groups, consumers, and the academic community, civil rights organizations, labor, the scientific community, religious and social service organizations, and small shareholders.
3. The Committee for Corporate Responsibility shall prepare a report and make recommendations to the shareholders with respect to the role of the corporation in modern society and how to achieve

a proper balance between the rights and interest of shareholders, employees, consumers and the general public. The Committee shall specifically examine, among other things

A. The Corporation's past and present efforts to produce an automobile which:

- (1) is non-polluting
- (2) reduces the potentiality for accidents
- (3) reduces personal injury resulting from accidents
- (4) reduces property damage resulting from accidents
- (5) reduces the costs of repair and maintenance whether from accidents or extended use.

B. The extent to which the Corporation's policies toward suppliers, employees, consumers and dealers are contributing to the goals of providing safe and reliable products.

C. The extent to which the Corporation's past and present efforts have contributed to a sound national transportation policy and an effective low cost mass transportation system.

D. The manner in which the Corporation has used its vast economic power to contribute to the social welfare of the nation.

E. The manner by which the participation of diverse sectors of society in corporate decision-making can be increased including nomination and election of directors and selection of members of the committees of the Board of Directors.

4. The Committee's report shall be distributed to the shareholders and to the public no later than March 31, 1971. The Committee shall be authorized to employ staff members in the performance of its duties. The Board of Directors shall allocate to the Committee those funds the Board of Directors determines reasonably necessary for the Committee to accomplish its tasks. The Committee may obtain any information from the Corporation and its employees reasonably deemed relevant by the Committee, provided, however, that the Board of Directors may restrict the information to be made available to the Committee to information which the Board of Directors reasonably determined to be not privileged for business or competitive reasons.

#### PROPOSAL NUMBER 4

Resolved:

That General Motors announce and act upon a commitment to a greatly increased role for public mass transportation—by rail, by bus, and by methods yet to be developed.

## PROPOSAL NUMBER 5

Resolved:

That, by January 1, 1974, all General Motors vehicles be designed so as to be capable of being crash-tested—front, rear, and side—against a solid barrier at sixty miles per hour, without causing any harm to passengers wearing shoulder restraints.

## PROPOSAL NUMBER 6

Resolved:

First, that General Motors support and commit whatever funds and manpower are necessary to comply with the vehicle emission standards recently recommended by the National Air Pollution Control Administration for the 1975 model year; and to comply with these standards before 1975 if in the course of developing the emission controls this is shown to be technologically feasible.

Second, that General Motors commit itself to an extensive research program (with an annual budget as large as its present advertising budget of about a quarter billion dollars) on the long-range effects on health and the environment of all those contaminants released into the air by automobiles which are not now regulated by government. These would include, but not be limited to asbestos and particulate matter from tires. The results of this research would be periodically published.

## PROPOSAL NUMBER 7

Resolved:

That first, the warranty for all General Motors cars and trucks produced after January 1, 1971, be written to incorporate the following:

(1) General Motors warrants that the vehicle is fit for normal and anticipated uses for a period of five years or 50,000 miles, whichever occurs first.

(2) General Motors will bear the cost of remedying any defects in manufacture or workmanship whenever or wherever they appear, for the life of the vehicle. Neither time nor mileage limitations nor exclusions of successive purchasers nor other limitations shall apply with respect to such defects.

(3) General Motors accepts responsibility for loss of use of vehicle, loss of time, and all other incidental and consequential personal injuries shown to have resulted from such defects.

Second, General Motors raise its reimbursement rates to dealers on warranty work, making them competitive with other repair work.

## PROPOSAL NUMBER 8

## Resolved:

That General Motors undertake to monitor daily the in-plant air contaminants and other environmental hazards to which employees are exposed in each plant owned or operated by General Motors; that the Corporation report weekly the results of its monitoring to a safety committee of employees in each plant; that if such monitoring discloses a danger to the health or safety of the workers in any plant, or in any part of a plant, the Corporation shall take immediate steps to eliminate such hazard, and that no employee shall be required to work in the affected area so long as the hazard exists.

## PROPOSAL NUMBER 9

## Resolved:

That General Motors take immediate and effective action to allot a fair proportion of its franchised new car dealerships to minority owners; furthermore, that General Motors act to increase significantly the proportion of minority employees of General Motors in managerial and other skilled positions.

**APPENDIX C**

## SUMMARY OF PROPOSED PROXY RULE CHANGES

1. Repeal subparagraph (c)(2) of rule 14a-8, 17 C.F.R. § 240.14a-8 (c)(2) (1969).
2. Amend rule 14a-8(b), 17 C.F.R. § 240.14a-8(b) (1969), to read as follows:

If the management opposes the proposal, it shall also, at the request of the security holder, include either in its proxy statement or accompanying said proxy statement, a statement of the security holder in support of the proposal, which statement shall not exceed both sides of a single printed page of the same size as was used the previous year, or is now being used, whichever is larger. No security holder whose statement exceeds 100 words, nor any person affiliated with such security holder, shall also be entitled to solicit proxies with respect to the same meeting for any other purpose. The statement shall include the name, address, and principal occupation of the security holder, the amount of securities beneficially owned, and any transaction, material to the shareholder, which he, or persons affiliated with him, have had with the corporation during the preceding two years. A copy of the statement in preliminary form shall



be filed with the Commission and sent to management, at the same time the proposal is furnished. Neither the management nor the issuer shall be responsible for such statement.

3. Amend rule 14a-3, 17 C.F.R. § 240.14a-3 (1969), by adding a new paragraph (d) as follows:

(d) For purposes of the Rule only, the following shall not be deemed to be a "solicitation":

A communication made in a public manner, not addressed exclusively to shareholders, with respect to any shareholder proposal which has been submitted under Rule 14a-8, unless the proponents of the proposal, or the person making the communication, are at the same time:

(1) participants in an election contest, as such terms are defined in Rule 14a-11, involving a majority of the directors to be elected; or

(2) persons affiliated with any of the parties to or the opponents of a merger, consolidation, acquisition or similar matter; provided, however, that no proxy or request for proxy may be furnished with such communication.

4. Add new paragraph (e) to rule 14a-8, 17 C.F.R. § 240.14a-8 (1969):

(e) If a security holder submits a question to management within the time set forth in paragraph (a) of this rule relating to any activity or contemplated activity of the corporation; or with respect to the policy regarding any such activity, or contemplated or potential activity; or with respect to the functioning of the board of directors or management; the proxy statement used by management shall set forth the questions, and such questions shall be answered at the meeting. The answers shall also be set forth, or fairly summarized, in a post-meeting report which shall be sent to all shareholders within 30 days following the meeting and shall be filed with the Commission. The answers shall also be filed with the Commission in the same manner as a report on Form 8-K and shall be subject to Rule 14a-9. *Provided*, however, management may refuse to answer any question it reasonably determines is privileged for business or competitive reasons, or which relates to personal information about any payments or other compensation from the corporation, and provided further that management may omit any question and answer which substantially duplicates another question submitted at the same meeting.

5. Amend procedures for review of questions arising under rule 14a-8, 17 C.F.R. § 240.14a-8 (1969).

6. Appoint a study group.