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The Securities and Exchange Commission's 1992 Proxy Amendments: Questions of Accountability

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I. Introduction

"Publicity is justly commended as a remedy for social and industrial disease. Sunlight is said to be the best disinfectant; electric light the most efficient policeman."[1]

"The human and economic wreckage from the manipulative corporate raids of the '80s [makes it] hard to fathom why the Commission would allow big, powerful investors the right to line up votes for a proxy contest, including a contest for control of a company's

1. Louis Brandeis, Other People's Money and How the Bankers Use It 92 (1914).

board, without some kind of public disclosure to the other shareholders."[2]

The participation of institutional investors[3] in the corporate governance process has generated an enormous amount of debate among scholars, politicians, and regulators.[4] Proponents of institutional investor activism in the United States often cite the Japanese,[5] German,[6] and British[7] systems as hall-

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2. H. Brewster Atwater, Co-chairman, Business Roundtable Corporate Task Force, *quoted in Secret Communications Loophole Attacked by Business Roundtable*, PR NEWSWIRE ASSOCIATION, INC., Oct. 16, 1992, *available in* LEXIS, News Library, Arcnws File.

3. The New York Stock Exchange defines an institution as an organization that "manage[s] the combined assets of many investors, both large and small." NEW YORK STOCK EXCHANGE, FACT BOOK FOR THE YEAR 1991 3 (1992). This definition encompasses public pension funds, corporate pension funds, union pension funds, retail mutual funds, banks, insurance companies, annuity companies, private foundations, and educational and other philanthropic institutions. *Id.*

4. In 1992, The President's Competitiveness Policy Council announced plans to study how corporate governance issues in the financial markets affect U.S. companies' competitiveness. It set one objective to "create an environment of economic and policy stability within which managers can do what many of them already want to do—manage the corporation for long-term growth." COMPETITIVENESS POLICY COUNCIL, FIRST ANNUAL REPORT TO THE PRESIDENT & CONGRESS: BUILDING A COMPETITIVE AMERICA 24 (Mar. 1, 1992). A Corporate Governance subcouncil will be chaired by Ed Regan, former Comptroller of the State of New York, the author of extensive recommendations to both the 1991 and 1992 rule proposals by the Securities and Exchange Commission (the "SEC" or the "Commission"). One of Mr. Regan's proposals was submitted by the SEC for comment in the 1992 proxy reproposal. *See infra* note 117 and accompanying text. A main reason for the new interest in institutional investors and their relation to corporate governance is the rapid growth in holdings by institutional investors. From 1950 to 1980, the level of equities owned by institutional investors rose from 8% to 33% and then increased to 53% in 1991. John C. Coffee, Jr., *Comparative Corporate Governance*, N.Y. L.J., Mar. 26, 1992, at 5. Today, a Fortune 100 corporation can be 70-80% owned by a few institutional investors. *Id. See, e.g.*, Bevis Longstreth, *Reflections on the State of Corporate Governance*, 57 BROOK. L. REV. 113, 113 (1991) (relating that "[t]o judge from the wealth of recent writings and symposia on the subject, corporate governance, and in particular, the role of the institutional investor therein, has become the new 'hot' topic among academics (Richard M. Buxbaum, Ronald J. Gilson, Reinier Kraakman, Louis Lowenstein, George W. Dent, Jr.), lawyers (Martin Lipton, Steven A. Rosenblum and A.A. Sommer, Jr.), businessmen (Elmer Johnson) and institutional investors (CalPERS))." CalPERS is the abbreviation for California State Public Employee's Retirement System.

5. Coffee, *supra* note 4, at 7. The major Japanese institution that takes an active role in corporate governance is the Keiretsu. The Keiretsu is a network of companies organized around a "main bank" that finances the investments among member companies at rates and conditions well below what the market would normally dictate. *Id.* at 6. Accordingly, the Keiretsu bank "holds both equity and debt investments in each member" and each member owns a significant proportion of

the shares in the main bank. *Id.* Moreover, each of the companies within the Keiretsu owns a "permanent" investment in all the other Keiretsu companies, averaging approximately .5 to 3%. *Id.* The unique structure of the Keiretsu allows its members to simultaneously be "shareholder, creditor, supplier, customer, and debtor." *Id.* It is the combination of reciprocity and cross ownership that fuels the Keiretsu's success. *Id.*

In addition to the reduced costs of capital resulting from bank financing, each member has a steady demand for its goods since business among the group is conducted in a mutually reinforcing manner, and each utilizes other member companies as its principal supplier. Coffee, *supra* note 4, at 6. For example, the Keiretsu bank lends to individual Keiretsu corporations. Each corporation, in turn, supplies goods and services to all other Keiretsu members. *Id.* This results in what one commentator has described as an evolution of "complex relationships" whose terms are "based on norms of reciprocity and implicit contracting." *Id.*

6. Jayne W. Barnard, *Institutional Investors and the New Corporate Governance*, 69 N.C. L. REV. 1135, 1146-47 (1991). According to one commentator, only banks and insurance companies are important to the German market, as opposed to the variety of institutional investors present in the United States. Friedreich K. Kubler, *Institutional Owners and Corporate Managers: A German Dilemma*, 57 BROOK. L. REV. 97, 99 (1991). German public companies are governed by a two tier board of directors, the Vorstand and the Aufsichtsrat. Barnard, *supra* at 1147. The Vorstand, the management board, manages the company, creates company policy, and is held accountable for company success or failure. *Id.* The Aufsichtsrat, the supervisory board, supervises the Vorstand by selecting the Vorstand's members and "approv[ing] the yearly balance sheet and profit statement." *Id.* The Aufsichtsrat traditionally consists of "bankers, businessmen or representatives of the public." *Id.* (quoting JEREMY C. BACON & JAMES L. BROWN, THE BOARD OF DIRECTORS: PERSPECTIVES AND PRACTICES IN NINE COUNTRIES 28 (1977)); *see also* Coffee, *supra* note 4, at 6 (noting that banks hold 34% of the "voting power in the [largest] 100 German corporations and more than 50 percent of the 10 largest firms"). Banks wield a considerable amount of power in the Aufsichtsrat and, hence, in corporate governance for two reasons. First, banks control a large number of votes because "they often serve as trustees or assignees of publicly owned shares . . . ." Barnard, *supra* at 1147. Second, the German securities market lists less than 500 "publicly-traded German companies," and German banks own a large percentage of the available shares or lend capital directly to the corporations. *Id.* at 1147-48.

Due to the creditor-debtor relationship between the banks and German corporations, the banks are uniquely informed and have developed a great "expertise." *Id.* at 1148. German institutional influence has focused on long-term gain and has been characterized as "aggressive, comparative, and informed." *Id.* As a result, shareholder wealth has been "maximiz[ed] and German corporations are internationally very competitive." *Id.* Other commentators point out that equity capital is less expensive in Germany because "bank monitoring reduces risk." Coffee, *supra* note 4, at 7.

7. Coffee, *supra* note 4, at 7. In Great Britain, institutional investors are a significant force in the market. *Id.* at 7. The British exchange is "deep and liquid," and is "much more developed than any other European stock exchange" with a "much larger public float than the Tokyo stock exchange." *Id.*

As of 1985, institutional investors owned 60% of all equities in the British market. Paul L. Davies, *Institutional Investors: A U.K. View*, 57 BROOK. L. REV.

mark examples where large institutions have actively and successfully participated in corporate governance.[8] Institutions in

129, 131 (1991) (citing Cosh et al., *Institutional Investment, Mergers and the Market for Corporate Control*, 1 INT'L J. INDUS. ORG. 73, 77 (1989)). Of these institutional investors, pension funds and insurance companies hold a prominent portion of the equities, about 54.2% and about 32.9%, respectively. *Id.* This commentator noted that "[e]quity investment directly by individuals is a relatively shallow activity." *Id.*

The main distinction between the United States and British situations is that the British market does not have a body which oversees shareholder voting procedure and, thus, institutional investors are unregulated. The large English institutions, pension funds, insurance companies, unit trusts, and investment companies, have formed independent associations, "umbrella institutions," which spread the institutional monitoring costs. Coffee, *supra* note 4, at 7. However, even with this system and environment, British institutions have not been very active. *Id.*

8. Panelists at the Securities and Exchange Commission's Forum on Corporate Governance and American Competitiveness noted that "a fundamental restructuring" of the SEC's rules and regulations would allow American institutional investors to monitor American management in a manner similar to Japanese and German institutions. Coffee, *supra* note 4, at 5.

These three systems have all been criticized for various inadequacies. The Japanese system has been criticized because only about 25% or less of the equity of Keiretsu companies is available to the public and, hence, the minority shareholder is exposed for abuse. *Id.* at 6. Such shareholders are "clearly exposed to sub-normal returns, because the stockholding members of the Keiretsu can exact their principal return through their non-shareholder relationships to the corporation." *Id.* A "weak level of monitoring" and "shareholder expos[ure] to below market returns" are characteristic of the Keiretsu. *Id.* The Keiretsu is a system of industrial organization, not shareholder protection, and will only address shareholder problems after "insolvency or scandal." *Id.* Recently, as indicated by the decline in the NIKKEI Dow, the Japanese stock exchange index, minority shareholders have been hurt by the "conflicts of interest inherent in the Keiretsu system." *Id.* Even the insurance companies, normally considered "illiquid" investors, have threatened the Keiretsu with disinvestment due to low dividends. Coffee, *supra* note 4, at 6.

The German system has also been criticized as producing an extremely underdeveloped securities market where approximately 100 companies lack a "controlling shareholder or group." *Id.* at 6. Furthermore, one commentator has stated:

> In Germany, . . . financial markets are shaped by more permanent social relations between enterprises and workers, between corporations and management and between banks and manufacturing industry. This appears to indicate a different rhythm, perhaps more in line with other segments of society. Business is slower and steadier; there is less mobility, less growth and less color and excitement. Germany has no Michael Milken and no Donald Trump. But there is also more continuity and somewhat less risk.

Kubler, *supra* note 6, at 110-11. Criticism of the British system resembles the criticisms of the American regulatory environment under the new proxy regulations made by the authors in this paper. *See infra* notes 289-329 and accompanying text. Problematic areas specifically include the lack of accountability of large pension plans that invest their assets in the equity markets. Davies, *supra* note 7,

these foreign countries not only monitor and replace management in corporations that occupy the institutions' "portfolios," but they also engineer market conditions through their control of corporations' access to debt and equity capital.[9]

Institutional investors in the United States do not individually own large enough equity interests in corporations to wield the influence necessary to effectuate centralized economic planning.[10] Institutional investors acting in concert, however, often do wield sufficient voting power to effectuate corporate change and influence corporate decisions.[11] In the aggregate, institutional investors own $6.5 trillion in assets which represents more than one-fifth of all United States assets.[12]

One way for such investors to pool their resources is by entering into shareholder agreements with each other to vote their shares together by proxy.[13] Historically, federal securities regulation posed significant hurdles to such shareholder cooperation for both the institutional and individual investor. Under the old rules, proxy disclosure was required for most share-

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at 142-43. *But see generally* Coffee, *supra* note 4, at 7 (concluding that the success of the British model poses a positive model for institutional activism in the United States).

9. Coffee, *supra* note 4, at 6.

10. Institutions commonly hold about 2-3% of the stock of a single company. Some even hold over 5%, which requires them to file a Schedule 13D or Schedule 13G. Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 568 (1990). Even the largest of the institutional investors hold only small portions of individual companies. One commentator has stated that in order to "take effective legal action any institutional shareholder must rely upon support of other institutional and individual shareholder." A.A. Sommer, Jr., *Corporate Governance in the Nineties: Management vs. Institutions*, 59 U. CINN. L. REV. 357, 367 (1990).

11. *See* John Pound, *Beyond Takeovers: Politics Comes of Corporate Control*, HARV. BUS. REV., Mar.-Apr. 1992, at 83, 87 (noting that "a heavy concentration of institutional investors greatly lowers the costs of presenting an alternative agenda").

12. John M. Conley & William M. O'Barr, *The Culture of Capital: An Anthropological Investigation of Institutional Investment*, 70 N.C. L. REV. 823, 823 (1992). Other commentators have noted that institutional investors own 53% of all United States equities. Coffee, *supra* note 4, at 5. One scholar estimated in 1987 that pension funds owned 50% of the common stock of the Standard and Poor's 500 (the S & P 500) corporations. Sommer, *supra* note 10, at 361.

13. A proxy is a written authorization given by one person to another to represent that person and vote his shares at the shareholder meeting. *See infra* part III.

holder communications.[14] Compliance with these rules was costly and, hence, had a chilling effect on institutional investor activism.[15] In addition, the regulatory barriers presented by section 13(d) of the Securities and Exchange Act of 1934 ("Exchange Act") provide some deterrence to large scale cooperation among shareholders, who fearful of forming a group for 13(d) purposes and retroactively being determined to have triggered 13(d), do not communicate.[16] This barrier still remains, but some have called for leniency in its enforcement, or its rescission, and many new institutional strategies have completely avoided detection by the SEC or have evaded the legal boundaries of section 13(d).

The demise of junk bonds, the increase in state regulation,[17] and the resultant disappearance of the corporate raider[18]

14. *See* ROBERT A. G. MONKS & NELL MINOW, POWER AND ACCOUNTABILITY 260-61 (1991); *see also* Black, *supra* note 10, at 524-25, 535-42 (1990); Coffee, *supra* note 4, at 5; Ronald J. Gibson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 894-96 (1992).

15. Black, *supra* note 10, at 536-37, 564-65. A senior official in CalPERS stated in regard to the proxy situation: "[O]ver the last six years, CalPERS, has introduced over 40 shareholder proposals on a variety of corporate governance matters . . . the process has been arduous, confusing, expensive and generally disappointing to us." Letter from James Mosman, Chief Executive Officer of the California State Teachers' Retirement System, to the Securities and Exchange Commission (July 31, 1992) (on file with author).

16. *See infra* notes 337-54 and accompanying text.

17. States have raised significant opposition to corporate acquisition in the last several years. The most significant regulatory hurdles are the takeover statutes. By 1990, 42 states had enacted some form of takeover statute. 5 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2264 (3d ed. 1990 & Supp. 1993). The most significant is the Delaware Business Combination Statute, DEL. CODE ANN. tit. 8, § 203 (1992), since "over 40% of the companies listed on the New York Stock Exchange [NYSE] are incorporated in Delaware." Leo Harzel & Laura Richman, *Delaware's Preeminence by Design*, *in* 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, F-1 (2d ed. 1990 & Supp. 1991) (citing N.Y.S.E. GUIDE (CCH) N725-802). The Delaware statute bars a business combination between Delaware corporations and interested shareholders for three years after the shareholder becomes interested unless 1) the board of directors approves the merger; 2) two-thirds of the uninterested shareholders approve the merger; 3) the interested shareholder owns at least 85% of the stock; or 4) the corporation had opted out of the statute. DEL. CODE ANN. tit. 8, § 203 (1992).

Another recent legislative measure which has increased the difficulty of consummating hostile takeovers is the passage of statutes by state governments which permit boards of directors to act in the interests of diverse constituencies. By 1990, 29 states had enacted such statutes. Martin Lipton & Steven A. Rosen-

have substantially changed the means for effecting corporate control.[19] These changes, coupled with the emergence of the institutional investor and recent economic malaise, have subjected the federal proxy regulations, one of the few remaining venues for effecting corporate management, to intense scrutiny.

In response to voiced investor dissatisfaction,[20] on October 15, 1992, the SEC approved a package of "reforms" that, *inter alia*, significantly relaxed proxy filing requirements for share-

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blum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 214-15 (1991). These statutes grant directors wide discretion by explicitly requiring them to consider the effects of tender offers on nonshareholder constituencies. Delaware has followed this trend. However, it has been the Delaware Supreme Court that has implemented these changes rather than the state's legislature. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985) (permitting directors to consider "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)" when making the determination of whether to accept a tender offer). *Id.* The Delaware Supreme Court subsequently clarified this view, stating that when addressing a tender offer, the board may consider, "the impact of both the bid and the potential acquisition on other constituencies, *provided that it bears some reasonable relationship to general shareholder interests. . . .*" Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1282 n.29 (Del. 1988) (emphasis added). *But see* Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 182 (Del. 1986) (holding that consideration of non-shareholder constituencies is improper when an auction for the corporation is in progress).

18. Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, 57 BROOK. L. REV. 1, 23 (1991). One of the first issues to spur institutional investors to take a more active role in corporate matters was the issue of management attempts and successes at hindering and preventing hostile takeovers. *Id.* at 22. Takeovers were previously the most popular means to check management's actions. Pound, *supra* note 11, at 83. However, the economic efficiency of the takeover has been questioned as a method of "disciplin[ing] wayward managers." Black, *supra* note 10, at 522. One commentator stated the following: "Only a badly mismanaged target can justify the typical 50% takeover premium." *Id.* *See also* THE BATTLE FOR CORPORATE CONTROL (Arnold W. Sametz & James L. Bicksler eds., 1991) (discussing the financial efficiencies of the separation of ownership and control including the effect of takeovers on the economic well being of the corporate community).

19. *See infra* notes 66-73 and accompanying text.

20. In November, 1989, CalPERS delivered a petition to the SEC requesting numerous changes in the proxy system. Letter from CalPERS to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission (Nov. 3, 1989) *in* 1 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 295, 306 (Corporate Law and Practice Course Handbook Series No. 712, 1990). The CalPERS petition prompted other groups to petition Congress and/or the SEC to promulgate rules to address the problems with the proxy regulations. Robert Rosenbaum, *Big Investors Push For Power*, CONN. L. TRIB., Dec. 16, 1991, at 16.

holders.[21] As a result of these changes in the economic landscape and current legislative reform, future corporate change will be effectuated largely through the proxy system: a battle of words among shareholders, management, and dissidents.[22] The hotly debated reforms, after over three years of drafting and discussion,[23] two SEC proposals[24] and subsequent comment so-

21. *Special Supplement, Securities and Exchange Commission Final Rules on Shareholder Communications and Disclosure on Executive Compensation*, 24 Sec. Reg. & L. Rep. (BNA) No. 41, at S1 (Oct. 16, 1992) [hereinafter *1992 Final Proxy Amendments*]. The revisions became effective on October 22, 1992, the date of publication in the Federal Register. 57 Fed. Reg. 48,276 (1992). Aside from a 30-day transition period for any new proxy or information statement, form of proxy, periodic report under the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78ll (1988 & Supp. V 1993) [hereinafter the Exchange Act], or request for a mailing or shareholder list received after date of publication, all soliciting parties or registrants must abide by the new rules. *Id.*

22. Pound, *supra* note 11, at 83-84. Martin Lipton, inventor of the poison pill takeover prevention strategy and critic of the takeover era, argues that shareholder democracy is far preferable to the hostile takeover as a device for disciplining corporate management. Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 66-67 (1987).

23. The SEC first proposed to revise the proxy rules on June 21, 1991, after it learned of shareholder concern over the liability and costs associated with the rules during its examination of limited partnership "roll up" transactions. *SEC Proposed Proxy Rule Amendments*, 23 Sec. Reg. & L. Rep. (BNA) No. 25, at 970 (June 21, 1991) [hereinafter *1991 Proposal*].

After two years of debate within the SEC, House Energy and Commerce Committee Chairman John Dingell (D-Mich.) wrote a letter to the SEC on March 31, 1992 requesting an explanation for the delay in proxy reform. *SEC Will Consider Proxy Reform in The Near Future, Breeden Says*, 24 Sec. Reg. & L. Rep. (BNA) No. 19, at 677 (May 8, 1992). Representative Dingell wanted a time schedule and characterized the lack of action as "quite troubling." *Breeden Asked to Explain Delay in Reform of Proxy Rules*, 24 Sec. Reg. & L. Rep. (BNA) No. 15, at 489 (Apr. 10, 1992) (discussing the discourse between the Chairman of the SEC, Richard Breeden, and the House Energy and Commerce Telecommunications Act Finance Sub-committee). Several months later, on October 15, 1992, the SEC published its final proxy rules, which complied with its goal of having the new rules in place for the 1993 proxy season. *See SEC will Move Quickly, Adopt Proxy Rule Proposals without Great Change, According to Chairman Breeden*, Corporate Counsel Weekly (BNA), July 8, 1992, at 8 (reporting the SEC's goal of having new rules in place for the 1993 proxy season, Breeden stated, "[t]he time for talk on the issue has run out; the time for action has arrived").

24. The SEC proposed revisions to the proxy rules on June 21, 1991, and then re-proposed amendments subsequent to commentary by academics, the legal community, corporate concerns, and shareholders on July 15, 1992. *See 1991 Proposal*, *supra* note 23, at 970; *Securities and Exchange Commission's Proposed Rules on Shareholder Communication*, 24 Sec. Reg. L. Rep. (BNA) No. 26, at 23 (June 26, 1992) [hereinafter *1992 Reproposal*].

licitations,[25] will purportedly allow "market forces" to restore a "better sense of balance to America's [b]oard rooms."[26] The new rules claim to facilitate communications among shareholders and reduce the costs of complying with SEC regulations for persons engaged in proxy solicitation.[27]

In its efforts to increase the amount of information available to shareholders, the SEC also increased the power available to institutional investors. Many have argued that the American institutional investor could serve a role as a monitor to check the excess or inefficiency of management.[28] While institutional investor activism may effectuate increased managerial efficiency,[29] it also presents new problems of accountability, responsibility, and liability.[30]

Who will "watch" these new corporate "watchers?"[31] Traditionally, the SEC has sought market and investor protection by requiring full and complete disclosure of certain material information effecting the value of the corporation,[32] as well as pro-

25. *1991 Proposal*, *supra* note 23, at 970. This high political drama pitted management against shareholders and generated over 900 comment letters, in response to the SEC's proposed revisions to the proxy regulations. *Id.* The re-proposal elicited an additional 800 letters. *1992 Final Proxy Amendments*, *supra* note 21, at S-2.

26. David R. Sands, *Investors Victors in Wide SEC Reforms*, WASH. TIMES, Oct. 16, 1992, at C1 (quoting the then SEC Chairman, Richard Breeden).

27. *1992 Final Proxy Amendments*, *supra* note 21, at S-1.

28. *See generally* Black, *supra* note 10, at 522 (discussing the debate concerning impediments to shareholder actions in corporate governance, including the proxy rules); John H. Matheson & Brent A. Olsen, *Corporate Law and the Long-term Shareholder Model of Corporate Governance*, 76 MINN. L. REV. 1313, 1327, 1361-63 (1992) (discussing how reform of the proxy system would effectuate change in corporate governance).

29. *See, e.g.*, Leslie Scism, *Bottom-Line Activism of CalPERS Pays Off, New Study Indicates*, WALL ST. J., Jan. 6, 1994, at C1 (reporting that the securities in CalPERS's stock portfolio "handily" outperformed the S & P 500 Index as a result of their active campaign in corporate governance).

30. MONKS & MINOW, *supra* note 14, at 10.

31. *Debate, Can Pension Funds Lead the Ownership Revolution?*, HARV. BUS. REV., May-June 1991, at 166, 166 (statement by Ira M. Millstein, chairman, Board of Advisors, Institutional Investor Project, Columbia University, and Senior Partner, Weil, Gotshal and Manges).

32. Disclosure lies at the core of both the Securities Act of 1933 and the Exchange Act of 1934. As the Supreme Court stated in 1963: "A fundamental purpose [of the federal securities regulatory scheme is] . . . to substitute a philosophy of full disclosure for a philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963).

viding stringent anti-fraud laws.[33] Large investors, as well as corporate management, are required under both the Securities Act of 1933 (Securities Act) and the Exchange Act to disclose information disseminated and evaluated by the market. The SEC's 1992 amendments tip the reporting balance by allowing certain shareholder communications, which may have a profound impact on the corporation and all other shareholders, to go unregulated.

To analyze the effect of the 1992 Amendments, Part II of this Article traces the evolution and significant rise of the institutional investor and its involvement in corporate America. Part III examines the proxy structure, and Part IV analyzes the old proxy rules, the perceived shortcomings of these rules, and the SEC's 1992 amendments. Part V then analyzes the effect of the amended proxy rules on institutions and individual shareholders in the market. The SEC amendments that are beneficial and increase efficiency are also discussed. Additionally, particular attention is paid to the inherent dangers of deregulating shareholder communications among large institutional investors, and the use of the resultant leverage this gives the institutional investor, a leverage which has been used to circumvent the entire proxy system. Finally, the insufficiency of regulatory protection outside of the proxy regulations and the effect of the 1992 Amendments on the proxy contest are analyzed and discussed.

This safeguard rests on the efficient market theory, which states that stock markets are efficient at pricing securities. The premise underlying this theory is that complete and full disclosure of all material information regarding a given stock is disseminated, analyzed and evaluated by the market, and that since this information is known by the market, the stock's selling price accurately reflects its true market value. Christopher P. Saari, Note, *The Efficient Capital Market Hypothesis, Economic Theory and Regulation of the Securities Industry*, 29 STAN. L. REV. 1031, 1056 (1977). In recent years, the efficient market theory has become the object of some criticism. *See generally* Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985) (contending that the markets are not as efficient as once thought).

33. *See generally* LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 699-723 (2d ed. 1988) (discussing the anti-fraud rules provided under the federal securities laws).

II. The Institutional Investor

Although often discussed as a single group, modern institutional investors are not necessarily homogeneous.[34] They may, however, be classified into several different groups possessing similar goals, alliances, risk preferences, and economic behavior. These general classifications include: private, public, and union pension funds; mutual fund investment companies; bank non-pension trusts; insurance companies; and foundations and endowments.[35] Of these categories, the largest investors are pension funds.[36] To date, pension fund managers have also been the most active institutions, led by the California State Public Employee's Retirement System (CalPERS), which first brought the modern institutional investor to the public's attention in 1989.[37]

Institutional investors are represented in the earliest records of American corporations.[38] From 1860 to 1912 the level

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34. MONKS & MINOW, *supra* note 14, at 182. Institutional investors are characterized as a diverse crowd in which money is "invested for different purposes and with different obligations." *Id.* Their only common bond is that they are fiduciaries: entities, be they individuals or organizations, that manage "assets on behalf of someone else." *Id.* They hold no duty or obligation to anyone but the people whose money they manage. *Id.*

35. Carolyn Kay Brancato & Paul Gaughan, *The Growth of Institutional Investors in the United States Capital Markets*, COLUM. U. CTR. FOR L. AND ECON. STUD., INSTITUTIONAL INVESTORS PROJECT (Nov. 1988). *See also* Buxbaum, *supra* note 18, at 7 (providing another similar list of institutional investor types). Approximately 85% of all institutional investors may be classified under these general groupings. *Id.*

The United States government makes a much broader categorization of institutional investors in its sectoral balance sheets and flow statements. These recording lists delineate the following groups of financial institutions: mortgage companies, finance companies, life insurance companies, fraternal insurance organizations, non-life insurance companies, private (non-insured) pension funds, state and local pension funds, open-end investment companies, closed-end investment companies, personal trust departments of commercial banks, common trust funds of commercial banks, and securities brokers and dealers. RAYMOND GOLDSMITH, INSTITUTIONAL INVESTORS AND CORPORATE STOCK 27 (1973).

36. In 1991, pension fund holdings were believed to be up to 45% of U.S. equity, and they are predicted to be over 50% by the year 2000. Roberta S. Karmel, *Is it Time for a Federal Corporate Law?*, 57 BROOK. L. REV. 55, 68 (1991).

37. *See infra* notes 78-86 and accompanying text (discussing shareholder social activism and the new trend of activism in corporate governance).

38. *See* GOLDSMITH, *supra* note 35, at 34-39; *see also* ALICIA H. MUNNELL, THE ECONOMICS OF PRIVATE PENSIONS 3 (1982) (reporting that the American Express Company established the first private pensions in 1875). Though materials and information are scarce for the period before 1900, corporate historians have de-

of institutional investment in the market was low, representing only from one and one-half to three and one-half percent of the market.[39] The advent of the industrial revolution with rapidly expanding manufacturing, transportation, and mining companies increased the need for corporate equity and popularized the securities markets.[40] However, institutional investment in corporate equity still remained negligible, so that by 1929, institutional investment had only increased to three percent.[41]

Then in the 1930s, institutional investment significantly increased to seventeen percent.[42] Subsequent to World War II, the size of the institutional investor and its equity investment grew tremendously.[43] This increase marked the beginning of the emergence of the institutional investor as a significant factor in the securities markets.[44] Accompanying the increase in

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rived estimates of institutional involvement from available historical statements and financial sources of the main groups of financial institutions. GOLDSMITH, *supra* note 35, at 34-35. The main source of documentation indicating the size of institutional investors' assets in contemporary history is the national or sectorial balance sheets. These sources were not prepared during the 19th century and only benchmark years were recorded in the first half of the 20th century. Hence, recreation of the percentage of institutional ownership is difficult for this era. *Id.* *See also* MONKS & MINOW, *supra* note 14, at 182-83 (tracing the origins of institutional investment to the use of trusts in the 1780s).

39. GOLDSMITH, *supra* note 35, at 73. The share of institutional ownership of corporate outstanding equity rose to a high of 3 1/2% in 1860 and then fell to a low of 1 1/2% in 1912. *Id.*

40. The railroad especially played a part in bringing the corporation into prominence in the United States economy. *Id.* at 35.

The supply of stock in non-financial corporations from 1860 to 1952 is as follows:

YEAR	NET ISSUE (MV)*	OUTSTANDING ISSUES (MV)*
1860	$ 1,100,000,000	$ 18,000,000,000
1880	7,200,000,000	38,000,000,000
1900	15,000,000,000	56,000,000,000
1912	23,000,000,000	89,000,000,000
1922	37,600,000,000	88,000,000,000
1929	42,500,000,000	160,000,000,000
1939	-26,400,000,000	100,000,000,000
1945	24,000,000,000	61,000,000,000
1952	90,700,000,000	56,000,000,000

*indicates market value at end of year listed

Id. at 38 tbl. 2-2.

41. *Id.* at 73.

42. *Id.* at 80.

43. *Id.*

44. GOLDSMITH, *supra* note 35, at 72-73.

institutional investment was a diversification of the institutional investment portfolio.[45] Investments were spread over a variety of stocks rather than concentrated in the bank and railroad industries as previously had been the case.[46]

The increase in funds available to institutional investment was connected with changed investor preferences.[47] There was a gradual shift of investor preference away from direct holding of stock in favor of indirect holding through mutual funds and pensions.[48] Furthermore, during this time period, individual households shifted their preferred investment option from real estate assets to financial assets.[49] These changes resulted in tremendous growth in pension and mutual funds. Prior to the "post-war period," investment was primarily the province of the wealthy who were shareholders as the beneficiaries of trusts.[50] At the close of the war, pension plans, insurance companies and investment funds began to amass the resources of the lower and middle income segments of the population and to invest them in the securities markets.[51] Indirect investment, through institutional investors, grew in significance because of what many viewed as the shortcomings of other United States retirement plans and methods.[52]

Today, three primary means exist to provide for retirement in the United States: government organized retirement plans (such as social security); employer and employee agreements (private pension plans); and "individually purchased" retirement plans (such as annuities).[53] Social security was never meant to be the sole source of retirement income, and many

45. *Id.* at 80-81.

46. *Id.*

47. *Id.* at 204.

48. *Id.*

49. GOLDSMITH, *supra* note 35, at 204.

50. *Id.* at 81.

51. *Id.*

52. Buxbaum, *supra* note 18, at 10. As one commentator noted, "no motive in man's history has been more constant or more obvious than his quest for security." PAUL P. HARBRECHT, PENSION FUNDS AND ECONOMIC POWER 3 (1959). It is suggested that this "national psychology" stems from the financial situation most Americans faced as a result of the Great Depression. MUNNELL, *supra* note 38, at 8. Historical factors, such as World War II wage controls, inflation and tax changes also contributed to the American interest in retirement security. *Id.* at 8.

53. Buxbaum, *supra* note 18, at 7. In 1986, these state, private and local pensions covered 45.28% of the United States labor force and in 1980 over one quarter

doubt its future viability as a source of retirement income.[54] The other two non-public sources contribute an aggregate of forty percent of all retirement income.[55] The demise of social security, whether perceived or actual, has made other sources of retirement income a necessity[56] and has forced the middle class to increase savings, revise company pension plans, and encourage increased employer funding of pension plans.[57]

Along with the rise of institutional investment came a shift in the investment strategies of institutional investors, away from government securities and into corporate equity.[58] In the decade following World War II, the interest rate on private debentures shadowed the government interest rate.[59] Consistently higher returns offered in the equity markets induced institutional investors to invest an increased share of fund assets in the stock market.[60] Both state and federal deregulation also permitted new categories of institutional investors to enter or increase their equity positions in the equity markets.[61] While

of the individuals over 60 received benefits from such pensions. LAWRENCE J. KOTLIKOFF & DANIEL E. SMITH, PENSIONS IN THE AMERICAN ECONOMY 3, 4 (1983).

54. Buxbaum, *supra* note 18, at 7. One commentator refers to social security as a "current account system" in which the "last generation" may or may not benefit from the "bargain." *Id.* This fear is vividly brought to life by the fact that social security revenues almost equalled expenditures for the period from the mid 1950s to 1983. HENRY J. AARON ET AL., CAN AMERICA AFFORD TO GROW OLD? PAYING FOR SOCIAL SECURITY 1 (1989). The viability of social security is questioned because in the near future the baby-boomer generation will retire, and the average lifespan has increased while the birth rate has decreased. *Id.* at 2. During this period, the government increased benefits without any commensurate increase in taxes. *Id.* This resulted in an underfunded public retirement system where a great number of retirees would be supported by a fewer number of employees. *Id.* at 3.

55. Buxbaum, *supra* note 18, at 8. Pensions have remained a steady fixture in retirement income at 15% but have not grown in prominence. *Id.* Private arrangements, however, have risen to over 25%. *Id.*

56. *Id.* at 9-10. Social security may only offer $975.00 per person per month, at minimum, and 150% of this per couple for the "practically unobtainable maximum." *Id.* at 10.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. For example, in the late 1950s state law restrictions were liberalized to permit life insurance companies to invest a higher percentage of their assets in the stock market. GOLDSMITH, *supra* note 35, at 230. Additionally, in 1962 federal legislation governing personal trusts was significantly liberalized increasing the equity owned by personal trusts from $3.6 billion in 1962 to $9.5 billion in 1968. *Id.* at 241.

the returns were high, the conservative nature of this period's institutional investors provided for only a slow and steady migration of capital into the equity markets.[62]

Congressional enactment of the Employee Retirement Income Security Act of 1974 (ERISA)[63] in 1974 also fueled the growth and spurred the activism of state and local pension funds.[64] Through ERISA, Congress wished to provide private companies with incentives to create pension plans and to protect plan beneficiaries against inadequate funding and misdealing.[65] Growth in pension funds was achieved by providing employers significant tax benefits for creating private pensions.[66] Protection of the investment was accomplished through

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62. *Id.* at 265. Professor Goldsmith notes the "striking" difference in the speed at which different types of institutional investors shifted from a debt to an equity portfolio. *Id.* at 264. The pension, insurance and bank funds made a more conservative transition while capital-appreciation oriented funds made the transition at an accelerated pace. *Id.*

63. Pub. L. No. 93-406, 88 Stat. 829 (codified as amended at 29 U.S.C. §§ 1101-14 (1988)).

64. Clifford L. Whitehill, *Institutional Ownership, in* INSTITUTIONAL INVESTORS: PASSIVE FIDUCIARIES TO ACTIVIST OWNERS 75, 79 (PLI Corp. Law and Practice Handbook Series No. 704, 1990). One commentator related that the Labor Department estimated that ERISA funds were valued at $2 trillion in 1990. MONKS & MINOW, *supra* note 14, at 187; *see also* Patrick J. Ryan, *Rule 14a-8, Institutional Shareholders Proposals, and Corporate Democracy*, 23 GA. L. REV. 97, 148 (1988) (concluding that "in response to the requirements imposed by . . . ERISA, pension fund assets have risen to more than $1.5 trillion, up from $548 billion in 1970").

Before ERISA, pension funds had amassed significant assets, however, many pensions were not fully funded. *See generally* HARBRECHT, *supra* note 52, at 5-11 (discussing the influences which shaped pension funds and explaining their tremendous growth prior to 1956). Ultimately the move into the corporate securities area greatly benefitted the pension trusts, which by 1959 had become the largest purchasers of stock and had purchased almost as much stock as individual investors as a whole. *Id.* at 3.

Employees also pressured employers to "fully fund" private pension systems and a majority of employers complied. *Id.* Government pensions followed suit both fully funding their pensions and increasing benefits. *Id.* Employees had been applying pressure to establish pension funds prior to ERISA. *Id.* at 7. As the subcommittee of Labor & Public Welfare noted in 1956: "[s]ince 1948 the labor unions have put on a drive to obtain welfare and pension programs." *Id.* (citing S. REP. No. 1734, 84th Cong., 2d Sess. 12 (1956)). However, prior to ERISA, companies had been resisting complying with these demands. *Id.*

65. MONKS & MINOW, *supra* note 14, at 187.

66. Edward W. Brankey & Frank P. Darr, *Debtor Interests in Pension Plans as Property of the Debtor's Estate*, 28 AM. BUS. L.J. 275, 279 (1990).

imposing fiduciary duties on ERISA pension fund managers.[67] Under ERISA, the fiduciary must act for the benefit of and "solely in the interests of . . . the plan's participants and beneficiaries."[68] Increasingly, institutional investors have cited the proper discharge of these fiduciary duties as the driving force behind their renewed interest in corporate governance.[69] Moreover, in 1988, the Department of Labor determined that a proxy vote was an economic asset of the fund that cannot be wasted, because to do so would result in an actionable breach of fiduci-

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These benefits included the following:

> 1. The employer can deduct its contributions to the plan . . . currently even though the employee may receive no benefit that year. 2. Generally, earnings and gains on plan funds are exempt from taxation during accumulation. 3. Participants are taxed on benefits only when funds are actually received. 4. The first $5,000 of the death benefit from [the employee's] account . . . can go to the beneficiary free of income tax. Also, an employee's voluntary nondeductible contributions are recovered income-tax-free.

Id. at 279 n.35 (citing Pens. & Profit Sharing (P-H), ¶ 5010 (1984) (first alteration in original)).

67. Sommer, *supra* note 10, at 363. Other sources of law provide a fiduciary standard for institutional investment. In addition to ERISA, federal law governs any "breach of fiduciary duty involving personal misconduct" in an investment company through the Investment Company Act. Robert D. Rosenbaum & Eileen M. Lavigne, *Fiduciary Duty Limitations on Voting and Investment Policies of Institutional Investors*, *in* INSTITUTIONAL INVESTORS: PASSIVE FIDUCIARIES TO ACTIVIST OWNERS 133, 135 (PLI Corp. Law and Practice Course Handbook Series No. 704, 1990) (quoting § 36(a) of the Investment Company Act of 1940, 15 U.S.C. § 80a-35 (1988)). The Internal Revenue Code provides a similar fiduciary duty to public funds if they wish to retain tax-exempt status. *Id.* at 136. Banking law regulations also impose a self-dealing restriction on bank managed trust funds. *Id.* at 135. State law regulates institutional investment through trust law, both statutory law and common law; state insurance laws; state pension statutes such as those in California and New York; and uniform statutes, such as the Uniform Management of Institutional Funds Act, a uniform act regulating charitable organizations that was adopted by 32 states as of 1990. *Id.* at 136. All these duties, as well as those imposed by ERISA, have been cited by institutional investors as requiring and justifying their activism. *See Id.* at 135.

68. Sommer, *supra* note 10, at 363 (citing 29 U.S.C. § 1001(b) (1988)).

69. "The Reagan and Bush administrations have encouraged more activist" institutional investment through statements from the Labor Department expressing "the view that ERISA-governed pension plan fiduciaries have a duty to be activist shareholders, seeking to influence or replace underperforming management." Robert D. Rosenbaum & Michael E. Korens, *Trends in Institutional Shareholder Activism: What the Institutions are Doing Today*, *in* INSTITUTIONAL INVESTORS: PASSIVIST FIDUCIARIES TO ACTIVE OWNERS, 45, 48 (PLI Corp. Law and Practice Course Handbook Series No. 704, 1990) (citing David George Ball, Assistant Secretary of Labor, Address before the Financial Executives Institute (Jan. 13, 1990)).

ary duty owed to the plan beneficiaries.[70] As a result, pension funds regulated by ERISA have become the most active institutional investors in corporate governance.

Contemporaneous with the growth of pension funds and other institutional investors was the emergence of a shareholder voice for management accountability. Early participants in this movement were corporate gadflies who did not have a lot of capital or the ability to garner support into coalitions, but who did present their message to management at annual meetings.[71] Other individuals used similar populist themes to create profit.[72] However, the messages delivered by these shareholders were never unified, and it was not until the 1970s when institutional investors adopted these themes that this message caught the attention of management.

Due to these influences, individual institutions have grown to substantial size and wield awesome power. As a group, institutional investors control fifty-three percent of the United States equity markets, and over sixty percent of the equity of the fifty largest companies.[73] In the aggregate, the figures are

70. Letter from The Department of Labor, Pension & Welfare Program to Mr. Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. (Feb. 23, 1988) (in 1988 ERISA LEXIS 19, *5).

71. Individuals such as Wilma Saus, Norm Gilbert and Evalyn Davis lead this movement. These participants were often viewed as "unmitigated nuisance[s]" by corporate boards. *Annual Meeting Time*, FORBES, Apr. 15, 1976, at 40, 40. Over time, however, their themes and ideas have become more palatable to corporate management. *Id.*

72. One of the most successful entrepreneurs with this strategy was T. Boone Pickens. *See, e.g.*, James Buchan, *Pickens Backs in Takeover Trail; T. Boone Pickens*, OIL DAILY, Sept. 10, 1987, *available in* LEXIS, News Library, Arcnws File (noting that Picken's "populist attacks on the Good 'Ol Boys — the corporate bureaucrats with their hunting camps and fancy aircraft are his stock in trade").

73. For example, institutional investors own 69% of the outstanding shares of Eli Lilly, 63% of the outstanding shares of American Express, and 60% of the outstanding shares of American Home Products. Edward B. Rock, *The Logical and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445, 447-48 n.5 (1991) (citing Carolyn Kay Brancato, *The Pivotal Role of Institutional Investors in Capital Markets*, tbl. 8, (Salomon Brothers Center and Rutgers Center Conference on the Fiduciary Responsibilities of Institutional Investors) (June 14-15, 1990) (copy on file at the Georgetown Law Journal)). In 1989, the largest 20 funds owned 10.6% of the outstanding shares of General Motors, 9.1% of the outstanding shares of IBM, and 8.5% of the outstanding shares of General Electric. Conley & O'Barr, *supra* note 12, at 823 (citing WILLIAM O'BARR & JOHN M. CONLEY, FORTUNE AND FOLLY: THE WEALTH AND POWER OF INSTITUTIONAL INVESTING, tbl. 2.8 (1992)).

even more astounding. Institutional investors in the United States own more than $6.5 trillion in assets, an amount equal to more than a fifth of all United States' assets.[74] The immensity of their holdings has mooted the traditional "Wall Street Rule" which states that if the shareholder does not like how the company operates, he sells the stock.[75] When ownership interests are substantial, it is difficult for a shareholder to quickly or effectively divest his interests; any wholesale dumping of the stock will saturate the market and significantly reduce the share price.[76]

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74. *See* Conley & O'Barr, *supra* note 12, at 823. In 1989, the top 50 institutional investors owned approximately $923 billion in equity or 53% of total domestic equity. *The Institutional Investor 300; Ranking America's Top Money Managers*, INSTITUTIONAL INVESTOR, July 1990, at 137, 173.

75. Jayne W. Barnard, *Institutional Investors and the New Corporate Governance*, 69 N.C. L. REV. 1135, 1151 (1991). The "Wall Street Rule" is representative of conventional investor wisdom initially presented by Berle and Means in 1932. *See* ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 81 (1933). *But see* Mike Myers, *3M Shares Fall $10 on News of Disappointing Earnings, Institutional Investors Unload Shares After Second-Quarter Sales Said to be Up 3%*, STAR TRIB., June 11, 1993, at D1 (reporting that institutional investors "stampeded" to sell their 3M holdings after an announcement of disappointing U.S. sales).

76. *See, e.g.*, Myers, *supra* note 75, at D1 (reporting a $10 per share decline, approximately 8%, after institutional investors dumped their shares of 3M corporation). These costs can be prohibitive. For example, consider the situation of a large institutional investor which owns one percent of the outstanding shares or 300,000 shares in a blue chip corporation. If the institution, disappointed by corporate management, seeks to employ the "Wall Street Rule" and sell its position it will incur significant losses as a result of both the transaction costs and the decline in market value associated with the sale. Assuming transaction costs of two cents per share, in a negotiated transaction, the total transaction costs of selling the stock could exceed $60,000. *See, e.g.*, Henry T. C. Hu, *New Financial Products, the Modern Process of Financial Innovation, and the Puzzle of Shareholder Welfare*, 69 TEX. L. REV. 1273, 1304 (1991) (reporting that, in 1988, the transaction costs for institutional investors selling substantial blocks of stock averaged less than $.05 per share). The movement of such a large block of stock will also have a negative effect on the security's stock market price. Assume that selling such a block reduces the stock price four dollars per share due to the supply and demand conditions in the market and the perceived negative signal received in the market when a large owner undertakes wholesale withdrawal from the corporation. Thus, the investor would have compounded his loss by $600,000 (assuming an average withdraw price at a two dollar discount). In addition to the transaction costs associated with buying new shares, the dissatisfied investor would incur costs of over one half a million dollars for choosing the solution offered by the Wall Street Rule, selling his stock. As one commentator noted, "[t]he sheer size of this stake and the trading costs associated with selling makes the institution 'captive.'" Pound, *supra* note 11, at 87.

Prior to the 1980s, institutional investors often sided with corporate management, supporting their slate and voting for their propositions.[77] During this period, the only instances where institutional investors diverged from this alliance was in regard to social issues during the era of corporate responsibility.[78] These proposals, however, were often unsuccessful due to the difficulty in generating support among other investors, whether institutional or individual.

In the 1980s, proxy solicitors, insurgent shareholders, and corporate management realized that institutional investors held the key or swing votes for important proxy initiatives.[79] Moreover, institutional investors often were the deciding votes in takeover transactions.[80] During this era, the institutional investors increasingly voted against management-proposed takeover defenses,[81] preferring the premiums which tender offers provided to the market price. Tender offers represented the perfect solution to the institutional investors disinvestment dilemma:[82] in one transaction the institution could sell its entire

77. Barnard, *supra* note 6, at 1150.

78. Rosenbaum & Korens, *supra* note 69, at 45-47. Social activists began using the proxy system and shareholder influence in the late 1960s. BEVIS LONGSTRETH & H. DAVID ROSENBLOOM, CORPORATE SOCIAL RESPONSIBILITY AND THE INSTITUTIONAL INVESTOR, A REPORT TO THE FORD FOUNDATION 3 (1973). The proxy system was first used to promote social concerns in the Kodak-FIGHT campaign of 1967. *Id.* FIGHT, a civil rights group, formed a coalition with religious institutional investors to change minority hiring practices at Kodak Corporation. *Id.* at 4. A wave of shareholder activism followed. *Id.* at 12. Mutual funds even capitalized on this social activism by establishing funds which solely invested in corporations catering to certain social concerns, such as "green funds." *Id.* at 20-23.

79. Barnard, *supra* note 6, at 1159.

80. *See, e.g.*, Marlene Star, *Investors Set Own Course; Both Management, Dissident Get Shareholder Support*, PENSIONS & INVESTMENTS, June 10, 1991, at 62, *available in* LEXIS, News Library, Arcnws File (noting that several large institutional investors cast the deciding votes in the battle for control over Baltimore Bancorp).

81. *See, e.g.*, Barnard, *supra* note 6, at 1166 (reporting that in 1987 there were more than 50 anti-poison pill proposals); Corporate Counsel Weekly (BNA), Aug. 28, 1991, at 5 (reporting the 1991 proxy results: 30 proposals to rescind poison pill proposals were considered receiving an average favorable vote of 31.4% of the outstanding shares, and 18 golden parachute proposals averaging a favorable vote of 22.54% of the outstanding shares).

82. Institutional investors in this era were criticized for being short-term investors. In seeking proxy reform, certain institutional investors have responded by stating that they abide by long term investment philosophies. *See, e.g.*, Letter from CalPERS to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission 2 (Nov. 3, 1989) *in* 1 22ND ANNUAL INSTITUTE

interest at one price, often at a significant premium to market price.

As the merger era ended, institutional investors sought a more active role in merger transactions by assisting insurgents during proxy contests and seeking to either prevent management from implementing anti-takeover provisions or to force the removal of such provisions.[83] Corporate raiders with the support of large organized institutional investors often pressured management into a tender.[84] However, the demise of

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ON SECURITIES REGULATION 295, 299 (PLI Corp. Law and Practice Course Handbook Series No. 712, 1990) (contending that during the past 10 years their average holding period for a stock has been between 6 to 10 years).

However, even where there are long holding periods, institutional investors do not possess any long-term interest in the corporations in which they invest. Long holding periods merely represent the practical nature of their situation: institutional investors often hold shares for long periods because of the immensity of their holdings. It is difficult to remove a large equity interest from the market without significantly depressing the price received by the institutional investor. *See* Myers, *supra* note 75, at D1 (giving an example of this dilemma).

Furthermore, many funds are indexed, which means that they seek a representation of the entire market rather than only certain corporations. Therefore, institutional investors will retain their interests in a corporation to maintain proper diversification. Many large institutional investors have realized they "were too large and slow afoot to capture the bargains or to escape the bad news" and, hence, indexed their funds. Louis Lowenstein, *The Effects of Index Investment Policies on Corporate Governance*, *in* 2 23RD ANNUAL INSTITUTE ON SECURITIES REGULATION 597, 603 (PLI Corp. Law and Practice Course Handbook Series No. 755, 1991). Indexing is a way for large investors to "buy a slice of American industry as a whole," *id.*, and reduce transaction costs incurred by more active traders. *See* Myers, *supra* note 75, at D1.

These are the reasons institutional investors may be considered "long term investors," and not because of any long term beneficial interests to the corporation. Tender offers represent the perfect opportunity to divest a heavy equity position at a premium and institutions often would court them regardless of any long-term interests of the corporation.

83. *See, e.g.*, Marcia Parker, *Proxy System is '88 Targets*, PENSIONS & INVESTMENT AGE, Mar. 7, 1988, at 1 (noting that institutional investors are opposing the adoption of poison pills and other takeover defenses or urging their removal).

In early 1993, 29 companies faced shareholder proposals to remove poison pills. *Poison Pill*, CORP. GOVERNANCE SERVICE BACKGROUND REPS. (IRRC) DD-1 (Feb. 10, 1993). This number is down from prior years due to the present reductions in hostile takeovers. Other defensive measures targeted in 1993 were proposals to reincorporate in states with less merger regulation or to opt out of state takeover statutes. *See Poison Pill*, CORP. GOVERNANCE SERVICE BACKGROUND REPS. (IRRC) at OO-1 (Mar. 2, 1993).

84. Management realized institutional investors were the key to a successful tender offer defense and developed Shareholder Advisory Committees and held meetings with institutional investors to gain their allegiance. Leslie Wayne, *Seek-*

high risk debt instruments and the subsequent decline in tender offers has temporally stymied the takeover game. Institutional investors, no longer satisfied with being silent parties, and desirous of the profits of the merger and acquisitions era,[85] seek active participation in corporate management.[86] In contrast to the social responsibility proposals of the 1970s, today's institutional investors seek participation on an advisory basis on matters such as executive compensation, corporate adoption of takeover defenses, and corporate governance matters.[87]

One of the methods utilized by institutional investors to participate in corporate governance, Rule 14a-8[88] shareholder proposals,[89] is unchanged by the 1992 proxy amendments.

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ing to Stay Out of Proxy Battles, N.Y. TIMES, Apr. 8, 1991, at D1. Management of some corporations used these methods to successfully avoid a hostile takeover. *See, e.g.*, Marlene G. Star, *Avon Shareholders Agree; Pre-proxy Deal Calls for Investor Meetings, Secret Vote*, PENSIONS AND INVESTMENTS, Apr. 1, 1991, at 3 (reporting how Avon's management courted CalPERS and other large shareholders to avoid a hostile offer by Chartwell Associates). *Poison Pill*, CORP. GOVERNANCE SERVICE BACKGROUND REPS. (IRRC) DD-1 (Feb. 10, 1993).

85. *See, e.g.*, Stephen E. Clark, *Push Comes to Shove on Proxy Reform*, INSTITUTIONAL INVESTOR, Apr. 1991, at 83, 84 ("[w]atching takeover artists use the proxy system profitably, public funds, were inspired to use the system as leverage to influence management").

86. *See, e.g.*, Kevin G. Salwen & Joann S. Lublin, *Giant Investors Flex Their Muscles More at U.S. Corporations*, WALL ST. J., Apr. 27, 1992, at A1 ("[s]purred by anger over skyrocketing executive pay," institutional investors are pressing boards of directors for reforms instead of just selling shares when dissatisfied with management); Myron Magnet, *Directors, Wake Up!*, FORTUNE, June 15, 1992, at 85, 91-92 (observing that institutional investors are becoming more active, and having success, in underperforming companies).

One fund manager stated, "[W]hen it gets right down to it, I can say to the managers, 'Wait a minute, fellas—we *own* the company. You get it?'" *Id.* at 91 (quoting Chuck Ames, Partner, Clayton Dubiier & Rice) (emphasis in original).

Another commentator has suggested that public pension funds may become the new corporate raiders of the 1990s, using their power as investors to make money at the expense of the corporate employees. Donald L. Bartlett & James B. Steele, *Raiders with Innocent Airs*, ACROSS THE BOARD, July-Aug. 1992, at 13. Filling the void left by the demise of the corporate raiders, institutional investors will encourage restructuring, curtailing benefits and reducing salaries. *Id.*

87. *See supra* notes 77-86 and accompanying text.

88. 17 C.F.R. § 240.14a-8 (1993). While this provision of the rules was not amended, its significance has been magnified because shareholders have more freedom to communicate which allows them to garner support for various shareholder proposals.

89. *Id.* There are various limitations on the use of shareholder proposals. Only a record or beneficial owner of at least one percent or $1,000 who holds such equity for at least one year through the record date may submit a statement. *Id.*

Although shareholder proposals are merely precatory and excludable under certain circumstances,[90] they have had a significant influence on corporate governance.[91]

III. The Proxy System: An Overview

The right to vote by use of a proxy did not exist at common law.[92] Voting rights were seen as a personal trust, a remnant from the time when corporations were created not for profit, but instead, for civic ventures.[93] As a personal trust, shares were unassignable.[94] In later times, corporate charters could provide for a proxy, yet it remained common practice to vote shares in person or abstain from the vote.[95] This rule existed until the end of the nineteenth century when commerce in the United States exploded with the advent of the industrial revolution.[96] The new economic environment of this epoch proved amenable

§ 240.14a-8(a)(1). The statement itself is regulated; it is limited to 500 words, its contents must be verified and documented, the proponent must be identified, and it must be filed 120 calendar days before the annual meeting. *Id.* § 240.14a-8(a)(4), (a)(3), (b)(1), (b)(2).

90. Under Rule 14a-8, a corporation may only exclude a shareholder proposal under limited circumstances. A proposal may be excluded if it (1) is not a proper proposal under state law; (2) is false or misleading; (3) violates state, federal or foreign law; (4) violates the proxy rules; (5) merely seeks redress for a personal offense; (6) is not related to the company's business; or (7) pertains to the ordinary business of the corporation. 17 C.F.R. § 240.14a-8(c)(1)-(7). In order to take advantage of these excludable grounds, the corporation must utilize the SEC's review process. *Id.* § 240.14a-8(d). The "burden of proof [is] upon management to show that a particular security holder's proposal is not a proper one for inclusion in management's proxy material." *Adoption of Amendments to Proxy Rules*, Securities Exchange Act Release No. 4979, 1954 SEC LEXIS 38, at *3 (Jan. 6, 1954).

91. *See supra* notes 83-86 and accompanying text.

92. Charles S. Telly, *Proxies and the Modern Corporation: Scienter Under Sections 14a and 10b of the Securities Exchange Act*, 19 TULSA L.J. 491, 500 (1984). The first corporations were municipal and charitable corporations whose purposes did not involve monetary considerations. Voting rights were considered a personal obligation and could not be "delegated." *Id.*

93. Leonard H. Axe, *Corporate Proxies: II*, 41 MICH. L. REV. 225, (1942) (quoting 17 D.C. App. 144 (1900)).

94. *Id.*

95. Telly, *supra* note 92, at 500-01. Under English law, the power to establish a corporation was granted from the Crown. *Id.* As corporations developed under English law, they became recognized as creatures of statute and, accordingly, when the proxy became accepted it was only accepted if expressly granted by the corporate charter. *Id.* at 501-02.

96. *Id.* at 503.

to the corporate form,[97] and as the corporation became the favored type of business organization, ownership became widely diffused among investors nationwide. A voting rule that required each and every shareholder to attend the shareholder meeting, often in different states, or even different countries, became inadequate.[98] The common law requirements proved a formidable barrier to corporate growth.[99]

Corporations responded by allowing shareholders to vote by proxy solicitations as well as at shareholder meetings. Concerned about the fraud and market manipulation that occurred in the 1920s under an unregulated proxy system, Congress enacted legislation as part of the Exchange Act to regulate a proxy's contents, usage, and disclosure.[100] Through the Ex-

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97. Limited liability encouraged investment by limiting the investor's financial risk to the amount of the investment. By limiting a shareholder's liability to the value of his investment, the present value of future expected returns became the sole determinant of a share's value rather than the potential liabilities of the investor. The shares were valued the same by all investors, thereby making shares fungible and allowing for the creation of the financial markets.

There are, however, certain circumstances where the courts have disregarded the corporate fiction of limited liability and held the owners personally liable for the acts of the corporation. *See generally* I. MAURICE WORMSER, DISREGARD OF THE CORPORATE FICTION AND ALLIED CORPORATION PROBLEMS 1-41 (1927) (examining the various instances where the courts will disregarded the corporate fiction and explaining the courts' rationales).

98. The large number of stockholders in the present day corporation makes attendance by a stockholder at a meeting for the purpose of voting completely "impracticable." *See generally* Telly, *supra* note 92, at 503-07 (discussing the industrial revolution in the United States and its effect on the development of the modern corporation). Requiring owners to be present eviscerated any ownership rights shareholders possessed. *See generally* Loss, *supra* note 32, at 449-54 (contending that due to widespread ownership, proxy regulations make the proxy system either a "tremendous force of good or evil in our economic system").

99. Loss, *supra* note 33, at 449-54.

100. 15 U.S.C. § 78n (1988 & Supp. V 1993). Section 14(a) of the Exchange Act provides:

> It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interests or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78l of this title.

Id. § 78n(a).

The proxy regulations have been revised and amended numerous times since their promulgation in 1935. 4 Loss & SELIGMAN, *supra* note 17, at 1936-44. The

change Act, Congress granted broad rule making discretion to the SEC,[101] under which the SEC has enacted and tailored a series of elaborate rules which regulate proxy material and shareholder communications.[102] Today, proxies are the primary

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period from 1935 to 1965 was an evolutionary stage in the rule's development that, for the most part, created the rules prior to the 1992 revisions. *Id.* Revisions in the late 1960s either harmonized the proxy rules with other Securities legislation, codified long standing Commission practices, or were technical in nature. *Id.* Amendments in 1972, 1976, and 1983, enacted in response to periods of shareholder activism, liberalized shareholder proposal rules and established shareholder voting disclosure rules. *Id.* *See also id.* at 1936-44 (discussing the history of the evolution of the proxy rules at length).

101. 15 U.S.C. § 78n(a) (1988 & Supp. V 1993). The ability of the Commission to adopt rules under § 14(a) is granted in the text of § 14. The scope of this power has been limited to disclosure, and the SEC is not permitted to grant substantive rights relegated to state corporate law. Business Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990). The court in *Business Roundtable* stated:

> [W]e find that the Exchange Act cannot be understood to include regulation of an issue that is so far beyond matters of disclosure (such as are regulated under § 14 of the [Exchange] Act), and of the management and practices of self-regulatory organizations, and that is concededly a part of corporate governance traditionally left to the states.

Id. at 408.

The United States Supreme Court has also indicated that the SEC's rule will be deemed unconstitutional if it invades the province of state corporate law. *See* CTS Corp. v. Dynamics Corp., 481 U.S. 69 (1987). Furthermore, when regulating proxies the court must determine whether holding a person's communication subject to the proxy rules may infringe on his First Amendment right to free speech. *See, e.g.*, Long Island Lighting Co. v. Barbash, 779 F.2d 793, 796 (2d Cir. 1985) (recognizing, yet not addressing, the merits of a First Amendment defense of proxy regulation). The Commission recognized that the old proxy rules had raised "serious questions under the Free Speech Clause of the First Amendment." *1992 Final Proxy Amendments*, *supra* note 21, at S-16.

102. *See* 17 C.F.R. § 240.14a-1 to 240.14d-103 (1993). An overview of the functions and the mechanics of the original rules are necessary in order to understand the 1992 proxy amendments. Briefly, Rule 14a-1 contains definitions of several key terms utilized throughout the rules. Rule 14a-2 identifies the types of solicitations which trigger the proxy rules. The information required in proxy statements and supporting documents, such as an annual shareholder report and 10K form, is specified in Rule 14a-3. The next two rules, 14a-4 and 14a-5, specify the informational requirements of the proxy and the format of information contained in the proxy statement. These rules emphasize clarity in the format of both the proxy and proxy statement in order to avoid manipulation or deception. Rule 14a-6 describes the necessary requirements for filing with the SEC. Rule 14a-7 governs the mailing of security holder communications, pursuant to a request by a security holder, particularly the type of communication and assignment of costs. Another type of shareholder communication contained in the proxy, the shareholder proposal, is governed by Rule 14a-8. Shareholder proposals differ from 14a-7 inclusions in that they impose no cost on the shareholder; however, their content

means of corporate shareholder voting and serve an important function in corporate governance.[103]

Under the Exchange Act,[104] the generic term "'proxy' includes every proxy, consent or authorization within the meaning of section 14(a) of the [Exchange] Act."[105] The first of these three items, "proxy,"[106] generally refers to a contract: a contract between the record holder of a corporate security and a third party that grants the third party the authority to vote the rec-

is limited and not every shareholder may make one. Rule 14a-10 prohibits any person from soliciting any undated proxies, post-dated proxies, and proxies "deemed" to be dated after signed by the security holder. Rule 14a-11 regulates solicitations of proxies for corporate elections, specifically the election of the board of directors. Rule 14a-12 governs solicitations that precede a proxy statement, allowable under certain circumstances. The next rule, Rule 14a-13, regulates the registrant's duties when communicating with beneficial owners. The ability of the registrant to communicate with beneficial owners is important because identification of beneficial owners may be the key to a successful proxy contest. Finally, 14a-14 dictates when proxy documents are modified or superseded. 17 C.F.R. §§ 240.14a-1 to .14a-14, .14d-103 (1992).

103. R. Franklin Balotti et al., Meetings of Stockholders § 5.1, at 51 (1987 & Supp. 1990). The proxy system has been a means for corporate control since the promulgation of the first proxy rules in 1935. Klaus Eppler & Edward W. Scheuermann, *Overview of The History and Current Uses of Proxy and Consent Solicitation Contests: Shareholder Challenges and Management Responses, in* Proxy Contests, Institutional Investor Initiatives, Management Responses 9, 11 (PLI Corp. Law and Practice Course Handbook Series No. 696, 1990). In 1968, these commentators noted that the proxy contest was a growing tool to attain corporate control while also recognizing the rapid growth of "'a new corporate device—the so-called tender offer or takeover bid'." *Id.* (quoting Edward R. Aranow & Herbert A. Einhorn, Proxy Contests for Corporate Control V (2d ed. 1968)).

104. 15 U.S.C. §§ 78a-78ll (1988 & Supp. V 1993).

105. 17 C.F.R. § 240.14a-1(f) (1992).

106. Proxy refers generally to the "statutory fundamentals of Securities Regulation." Loss, *supra* note 33, at 454 (quoting 17 C.F.R. § 240.14a-1 (1992)). The proxy part of the trilogy refers to the actual voting card which is sent to shareholders and is returned as an authorization to vote as the card designates. *Id.* at 454 n.17; *see also infra* note 251 (providing a sample proxy card under the revised proxy rules). Consent and authorization have been used by the courts to broaden the scope of the proxy rules far beyond the proxy card. A broad reading of these terms has led one court to hold an invitation to enter into a voting trust as regulated by the rules. Loss, *supra* note 33, at 454 (citing Greater Iowa Corp. v. McLendon, 378 F.2d 783, 796-98 (8th Cir. 1967)). However, other courts have limited expansive interpretations such as this, substituting broad interpretations of other statutory terms. For example, another court interpreted the definition of "securities" to include voting trust certificates and solicitations in connection with the sale of securities. *Id.* (citing Reserve Life Ins. Co. v. Provident Life Ins. Co., 499 F.2d 715, 725 (8th Cir. 1974)).

ord holder's shares at the shareholders' meeting.[107] The next two items, "consent" and "authorization," have been interpreted by courts not to be limited by the previous term "proxy."[108] This allows the words "consent" and "authorization" to be given a distinct and broader reading beyond what is thought of as a traditional proxy.[109] Courts have held that this is in accord with the characterization of the Exchange Act as a remedial statute that should be construed broadly.[110]

The definition of proxy is so broad because whether voting by consent, abstaining from a vote, or assigning a voting right, a shareholder requires information regarding the corporate action and, thus, the potential for manipulation exists. Hence,

107. The right to vote extends to a proxy or any "consent or authorization within the meaning of Section 14(a)." BALOTTI ET AL., *supra* note 103, § 5.4, at 55 (citing Rule 14a-1(f); 17 C.F.R. § 240.14a-1(f) (1992)).

108. *See, e.g.,* Greater Iowa Corp. v. McLendon, 378 F.2d 783, 796 (8th Cir. 1967) (holding that "consent" and "authorization" are "extremely broad words" and are "not limited by the word proxy").

109. *See* Sargent v. Genesco, Inc., 492 F.2d 750, 766 (5th Cir. 1974). The word consent also represents another form of voting outside of a shareholder meeting. A consent allows the shareholder to act or vote through a writing under limited circumstances. The substantive law of consents is governed by state law, which limits their use to either "unanimous written consents for an action" or by a majority "assuming 100% attendance," *id.*, which obviates the need for meetings. BALOTTI ET AL., *supra* note 103, § 5.4, at 56. Consents are actual votes while proxies are authorizations to vote. *Id.* Despite the slight difference, consents are also included within the generic definition of proxies. *Id.*

Omissions, such as inaction and "the failure to object or to dissent," 17 C.F.R. § 240.14a-1(f) (1992), are also included within the definition of a proxy, consent, or authorization. The inclusion of omissions in the definition of proxy broadens it further, indicating that a formal vote, binding or otherwise legally effective, is not a prerequisite for an action to be subject to SEC proxy regulation. *Id.* (citing Sargent v. Genesco, Inc., 492 F.2d 750, 768 (5th Cir. 1974)). One commentator has stated, "[t]he critical element of a proxy is collective or representative action by shareholders." BALOTTI ET AL., *supra* note 103, § 5.4, at 55.

110. Zuckerman v. Franz, 573 F. Supp. 351, 357 (S.D. Fla. 1983) (holding that the tender offer provision is intentionally vague to allow each situation to be resolved on its facts); Browning Debenture Holder's Committee v. DASA Corp., 524 F.2d 811, 816 (2d Cir. 1975) (holding that the proxy rules must be construed broadly to allow for the success of establishing private regulation of the securities market); Kaufmann v. Lawrence, 386 F. Supp. 12, 17 (S.D.N.Y. 1974), *aff'd*, 514 F.2d 283 (2d Cir 1975) (holding that this section may not be read technically or restrictively); Gould v. American Hawaiian S.S. Co., 351 F. Supp. 853, 864 (D. Del. 1970) (holding the statute is remedial and must be construed broadly); Cattlemen's Inv. Co. v. Fears, 343 F. Supp. 1248, 1251 (D. Okla. 1972) (holding that proxy regulations in respect to tender offer filings must be read broadly to carry out the legislative intent of the Securities Act which is a remedial statute).

the definition of proxy is construed broadly to subject a wide spectrum of possible situations to proxy regulation.[111]

IV. The SEC's 1992 Proxy Amendments

A. *Overview*

On October 16, 1992, after three years of debate,[112] four congressional hearings,[113] consideration of comments made in public forums,[114] two solicitation periods,[115] and review of a record number of comment letters,[116] the Commission significantly

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111. *Id.*

112. Debate within the Commission regarding the proxy rules commenced with CalPERS letter in 1989 requesting 48 amendments to the proxy rules. Letter from CalPERS to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission (Nov. 3, 1989), *in* 1 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 295 (PLI Corp. Law and Practice Course Handbook Series No. 712, 1990).

113. *1992 Reproposal, supra* note 24, at 950. However, the amount of congressional analysis and research has been questioned. *See House Interest in Proxy Matters Provokes Corporate Response*, INSTITUTIONAL INVESTOR, Apr. 20, 1992, at 5 (reporting that the Energy and Commerce's Telecommunication and Finance Committee which oversees the SEC has mainly been focusing on other matters, leaving little time to grapple with the shareholder issues).

114. *1992 Reproposal, supra* note 24, at 950. The Commission sponsored a two-day public forum on March 18-19, 1992. A transcript of the public forum is on file with the Washington, D.C. office of the Securities and Exchange Commission in the Commission's public records room. *Id.* at 950 n.2.

115. *1991 Proposal, supra* note 23, at 970 (soliciting public comment on the 1991 proposals); *1992 Reproposal, supra* note 24, at 24 (soliciting comments on the 1992 proposals).

116. The 1991 proxy reform proposals drew more than 900 comment letters from directors, academics, legislators, shareholders, lawyers, and other interested groups. *1992 Reproposal, supra* note 24, at 949-50. The second proposals drew an additional 800 comment letters, for a record total of over 1,700 comment letters from the public. *1992 Final Proxy Amendments, supra* note 21, at S-2. The parties responding to both of the Commission's comment solicitations represent some of the largest financial interests in the United States. For example, comments were filed on behalf of the Business Roundtable, representing more than 200 of the nation's largest companies; The Investment Company Institute, representing over 3,800 investment companies with $1.42 trillion in assets; The Institutional Shareholder Services Inc., the nation's leading proxy advisory firm; The American Society of Corporate Secretaries, composed of more than 3,000 business executives; United Shareholders Association, an organization of 60,000 members; Goodyear Tire & Rubber Co., over 70 million shareholders; Phillips Petroleum; Merrill Lynch; several state pension funds including CalPERS, the largest public retirement fund; several insurance companies, including the Travelers; and The American Bar Association. The entire collection of letters is on file with the Commission in its Washington, D.C., office's records room.

revised its proxy regulations.[117] The Commission's amendments specifically addressed the regulation of communications with and among shareholders regarding management's performance; elections and non-election issues; prefiling requirements for both registrants and shareholders; the presentation of management's proposals; insurgent slate nominations; and election contest reporting and filing — all important issues relating to the shareholder's equity investment.[118] This section

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117. *1992 Final Proxy Amendments*, *supra* note 21, at S-1. Several of the proposals included in both the Commission's 1991 proposal and the 1992 reproposal were not included in the final amendments. *Compare 1991 Proposal* and *1992 Reproposal* with *1992 Final Proxy Amendments*, *supra* note 21, at Part II(J). The most significant of these was the shareholder analysis of the management performance proposed by Edward Regan. Letter from Edward V. Regan, Comptroller of the State of New York, to Richard Breeden, Chairman Securities and Exchange Commission (March 18, 1992) (on file with the SEC). Under this proposal, a registrant would have been required to include a 700-word statement "expressing views on the performance of the company, its management and the board of directors" by certain long-term investors in the corporation's annual proxy statement relating to the election of directors. *Id.* To be eligible to submit such statements, a person must have held at least one-half of one percent of the registrant's stock for at least three years. *Id.* Management would have been permitted to respond. *Id.*

Critics stated that the proposal was "extreme and riddled with ambiguities" and that proxy forms "should not be transformed into a forum for general comments." Letter from Cravath, Swaine & Moore to the Securities and Exchange Commission, 7 (Aug. 27, 1992) (on file with the SEC); Robert A. Kindler & Rachel R. Gerstenhaber, *Shareholder Initiatives, Institutional Investors and the SEC: 14A-8 Proposals and the New Proxy Rules*, *in* 2 24TH ANNUAL INSTITUTE ON SECURITIES REGULATION 15, 79 (PLI Corp. Law and Practice Handbook Series No. 755, 1992). Criticism was also centered on the additional expense, length and complexity this amendment would add to the proxy statement. Letter from the Business Roundtable to the Securities and Exchange Commission, 17 (Aug. 28, 1992) (on file with the SEC). Furthermore, the SEC's authority to require the inclusion of shareholder opinions in corporate proxy statements was questioned. *Id.* The Business Roundtable analogized that "[s]ection 14(a) . . . clearly does not authorize the Commission to adopt a rule requiring corporations to reimburse dissident shareholders for their solicitation expenses, and the Commission cannot achieve the same ends by requiring the inclusion of such solicitation materials in the corporate proxy statement at corporate expense." *Id.* at 18.

The Commission rationalized that the other amended rules now afford shareholders ample opportunity to communicate their view to other shareholders and, therefore, found this proposal to be unnecessary and excluded it from the 1992 final proxy amendments. *1992 Final Proxy Amendments*, *supra* note 21, at S-18.

118. *1992 Final Proxy Amendments*, *supra* note 21, at S-1. Concurrent with its promulgation of the proxy rule amendments, the SEC has amended reporting requirements to enhance the disclosure of executive's compensation. *Id.* at S-27.

The new compensation rules substitute a series of executive compensation tables in the annual corporate statement for the narrative both required previously. *Id.* The amendments seek to improve disclosure clarity of executive compensation.

will discuss the proxy rules prior to amendment with respect to each of these topics, the perceived inadequacies under these rules, and the SEC's 1992 Amendments.

B. *SEC's 1992 Proxy Amendments: Shareholder Communication Provisions*

1. *Regulation of Shareholder Communications Under The Old Rules*

The basic framework for proxy regulation under the new rules remains the same; only the exceptions have changed. Proxy rules are triggered when a party solicits or permits the use of his name to solicit proxies addressed to shareholders of eligible securities.[119] No solicitations can be made "unless each party solicited [was] concurrently furnished . . . with a . . . written proxy statement containing the information specified in Schedule 14A."[120] The purpose of the proxy statement is to suf-

See generally SEC Adopts Proxy Reform After Long Study, 61 U.S.L.W. (BNA) 2234 (Oct. 27, 1992) (discussing the new executive compensation rules).

The executive compensation amendments are applicable to proxy and information statements, registration statements, and periodic reports under the Exchange Act and to registration amendments and statements under the Securities Act. *1992 Final Proxy Amendments*, *supra* note 21, at S-27.

119. Eligible securities are securities which are traded on national exchanges. Additionally, this limitation of the proxy rules' application removes smaller companies, even if publicly traded, from compliance with the panoply of the federal securities laws. Before the 1992 amendments, this limitation exempted securities held by less than 500 record owners or corporations with assets less than five million dollars. 17 C.F.R. § 240.12(g)(1)(A)-(B) (1992). While federal rules may exempt these securities, some exchanges require, as a precondition to listing, similar compliance with proxy rules. *See, e.g.*, NASDAQ (requiring all issuers traded on NASDAQ exchange to list under § 12). Furthermore, these rules do not apply to "certain foreign, insurance, exempt securities or debt securities not traded on an exchange." BALOTTI ET AL., *supra* note 103, § 5.3, at 54-55.

120. 17 C.F.R. § 240.14a-3(a) (1992). Schedule 14A requires the soliciting party to disclose and describe: (1) the revocability of the proxy; (2) dissenter's appraisal rights; (3) the identity of both the soliciting party and party bearing the solicitation costs; and (4) the soliciting party's interests in the voting matter. *Id.* § 240.14a-101. The Schedule requires additional disclosure for election contests and shareholder proposals. *Id.* For example, if the solicitation relates to the election of directors and is issued by the registrant, the registrant must issue an annual report with the proxy statement. *Id.* § 240.14a-3.

Annual reports contain a balance sheet, an income statement, a statement of changes in financial position, other explanatory notes, the auditor's report and other comments from management including future prospects. J. FRED WESTON & EUGENE F. BRIGHAM, ESSENTIALS OF MANAGERIAL FINANCE 226 (8th ed. 1987). The requirements for the annual statement were designed to inform the shareholder in

ficiently inform shareholders to enable them to make informed decisions on the voting of their shares.[121] Furthermore, all soliciting materials, including the proxy statement, must be filed with the SEC ten days before they are used.[122] Therefore, whether a party is embroiled in the morass of securities regulation depends upon the definition of a "solicitation."[123]

The Commission defines "solicitations" as communications "reasonably calculated to result in the procurement, withholding or revocation of a proxy."[124] One case has extended the definition of solicitation to any event which is part of "a continuous plan ending in solicitation and which prepares the way for its success."[125] This means that communications made when a per-

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an "easily understood manner." Securities Act Release No. 6176 [1979-1980], Fed. Sec. L. Rep. (CCH) ¶ 82,422 (Jan. 15, 1980).

121. *See, e.g.,* 4 LOSS & SELIGMAN, *supra* note 17, at 1936 n.36.

122. 17 C.F.R. § 240.14a-6(a) (1992). Copies of such materials, in the form of "speeches, press releases and radio and television scripts," may optionally be filed with the SEC. *Id.* § 240.14a-6(h). However, there is a risk that the Commission will require a corrective disclosure for a party who takes advantage of this privilege; it is, therefore, an expensive risk. LOSS, *supra* note 33, at 460.

123. Often, determinations of whether a "solicitation" has been made are required before any formal proxy statements have been filed with the SEC. Thomas A. Cole, *Proxy Rules and Proxy Reform Issues, in* 2 23RD ANNUAL INSTITUTE ON SECURITIES REGULATION 637, 673 (PLI Corp. Law and Practice Course Handbook Series No. 755, 1992). During this pre-filing period, "both management and insurgents may seek to canvass shareholder attitudes via informal communications." *Id.*

124. 17 C.F.R. § 240.14a-1(l)(1)(iii) (1992). The definition states:

> (1) *Solicitation.* The terms "solicit" and "solicitation" include:
> (i) Any request for a proxy whether or not accompanied by or included in a form of proxy; (ii) Any request to execute or not to execute, or to revoke, a proxy; or (iii) The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.

Id. § 240.14a-1(*l*)(1)(i)-(iii). The defined terms do not apply to "the furnishing of a form of proxy to a security holder upon the unsolicited request of such security holder, the performance by the registrant of acts required by Rule 14a-7, or the performance by any person of ministerial acts on behalf of a person soliciting a proxy." *Id.* § 240.14a-1(*l*)(2)(i)-(iii).

125. SEC v. Okin, 132 F.2d 784, 786 (2d Cir. 1943). In *Okin*, the defendant mailed letters to the shareholders urging them not to sign proxies for the company. *Id.* The court held the letter was a solicitation and that to hold otherwise would "circumvent the statute" and Congressional intent. *Id.* Therefore, "[t]he earlier stages in the execution of . . . a continuous purpose must be subject to regulation." *Id.* *See also* Transworld Corp. v. Odyssey Partners, 561 F. Supp. 1315 (E.D.N.Y. 1983) (holding that a communication does not need to expressly request a proxy if it is "part of a continuous plan to end in solicitation").

son was not even considering a formal proxy solicitation might ultimately be found to be a part of a continuous plan undertaken in violation of the proxy rules since proxy materials were not filed with the SEC.

The question is, therefore, whether a communication based upon the totality of the circumstances is "reasonably calculated" to influence the shareholders' votes.[126] In examining the totality of the circumstances, the purpose of the solicitation must be assessed.[127] Purpose depends on the "nature of the communication and the circumstances under which it was distributed."[128]

For example, not every communication to shareholders qualifies as a solicitation.[129] In one case, a newspaper communication not reasonably calculated to result in the procurement of proxies was not a solicitation under section 14 of the Exchange Act.[130] On the other hand, a solicitation does not need to be directly "targeted" at a shareholder.[131] Speeches, press re-

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Judge Learned Hand's decision in *Okin* is widely cited by commentators because it concisely expresses the breadth of the term solicitation. 4 LOSS & SELIGMAN, *supra* note 17, at 1936-45; BALLOTTI ET AL, *supra* note 103, § 5.5, at 57; MICHAEL D. WATERS, PROXY REGULATION 12-13 (1992). The opinion related the following passage:

> [T]he complaint presents the question whether the power of the Commission . . . is limited to the regulation of a proxy, power of attorney, consent, or authorization, strictly as such; or whether it extends to any writings which are part of a continuous plan ending in solicitation and which prepare the way for its success. We have no doubt that the power extends to such writings; were it not so, an easy way would be open to circumvent the statute; one need only spread the misinformation adequately before beginning to solicit, and the Commission would be powerless to protect shareholders.

Okin, 132 F.2d at 786.

126. Long Island Lighting Co. v. Barbash, 779 F.2d 793, 796 (2d Cir. 1985) (stating "[t]he question in every case is whether the challenged communication, seen in the totality of the circumstances, is 'reasonably calculated' to influence shareholder votes").

127. BALOTTI ET AL., *supra* note 103, § 5.5, at 57 (citing Long Island Lighting Co. v. Barbash, 779 F.2d 793 (2d Cir. 1985)).

128. Long Island Lighting Co. v. Barbash, 779 F.2d 793, 796 (2d Cir. 1985) (citing Brown v. Chicago Rock Island & Pacific R.R., 328 F.2d 122 (7th Cir. 1964)).

129. Brown v. Chicago Rock Island & Pacific R.R., 328 F.2d 122, 125 (7th Cir. 1964) (holding that a newspaper ad was not a communication to shareholders reasonably calculated to result in procurement of proxies and, therefore, not an unlawful proxy solicitation).

130. *Id.*

131. *Long Island Lighting Co.*, 779 F.2d at 796 (citing Rule 14a-6(g); 17 C.F.R. § 14a-6(g) (1992)).

leases, and television scripts are required to be filed with the SEC in order to prevent "easy evasion" of the proxy regulations.[132] This is true even in instances where the solicitation concerns matters that are political in nature or in the "public interest."[133] Furthermore, solicitations intended to acquire future proxies are within the ambit of the proxy rules.[134] These interpretations illustrate that the SEC has defined "solicitation" in the same broad manner as "proxy."

Under the old rules there were two tiers of exemptions. Tier one exemptions were spelled out in Rule 14a-1 and were for certain garden variety acts such as a newspaper advertisement advising a shareholder where he may obtain soliciting material.[135] Solicitations under this exemption were not subject to any of the proxy rules including the anti-fraud provision.[136] Tier two exemptions allowed a shareholder to communicate with ten other shareholders before becoming subject to the proxy rules.[137] However, this exemption was subject to the anti-fraud provision in Rule 14a-9.[138]

Once identified as a solicitation, a communication must either be preceded or accompanied by a proxy statement.[139] A proxy statement is a written statement containing information required by regulation to be given to shareholders as a prerequisite to solicitation.[140] The cost of this mailing is often so immense, that for an individual investor the cost far outweighs any benefits the individual investor will receive.[141]

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132. *Id.*

133. *Id.* (quoting Medical Comm. for Human Rights v. SEC, 432 F.2d 659, 667 (D.C. Cir. 1970)).

134. Studebaker Corp. v. Gittlin, 360 F.2d 692, 694 (2d Cir. 1966). In *Studebaker*, the defendant solicited authorizations from shareholders to obtain shareholder lists from the corporation in the course of a proxy fight. *Id.* The court held that the authorizations were only sought for the purpose of seeking future proxies, and, hence, were covered by the proxy rules. *Id.*

135. 17 C.F.R. § 240.14a-2(a)(6) (1992).

136. *Id.* § 240.14a-2(a).

137. *Id.* § 240.14a-2(b)(1).

138. *Id.* § 240.14a-2(b).

139. *Id.* § 240.14a-3(a).

140. 15 U.S.C. § 78n (1988 & Supp. V 1993). The proxy statement and its contents are one of the focal points of the proxy solicitation process under § 14(a).

141. *See 1992 Final Proxy Amendments*, *supra* note 21, at S-4 (recognizing that the mailing costs alone could exceed hundreds of thousands of dollars).

2. *Perceived Problems in the Regulation of Shareholder Communication*

In the last several years, the federal proxy system has achieved heightened significance as a method of gaining corporate control. In the past decade, markets for corporate control were driven by corporate raiders or management, making coercive tender offers fueled by junk bonds. Currently, junk bond markets have dried up. Tender offers have virtually evaporated and both state corporate law and corporate boards have erected significant barriers to hostile takeovers.[142] The new economic landscape and rise of the institutional investor, coupled with the past success of shareholder activists, however limited, create an environment amenable to proxy contests.[143] In the 1990s, the weapon in the fight for corporate control will be debate, not debt.[144]

In the case of any communication declared a solicitation that is disseminated in the market, all shareholders are deemed solicited. *Cf.* BALOTTI ET AL., *supra* note 103, § 5.5, at 57-58.

142. Jonathan Peterson, *Junk Bonds: A Revolt that Failed Wall Street: The Economic Highlights of The 1980's Growing Economy Are A Peril in the Downturn of the '90s*, L.A. TIMES, Nov. 22, 1990, at A1. As one commentator observed, "[t]he legacy of the 1980's [sic] is mainly a financial one—manifested in the bankruptcy of Drexel Burnham Lambert, the imprisonment of Michael Milken and Ivan Boesky, and the retreat of corporate raiders." POUND, *supra* note 11, at 92.

143. During the 1991 proxy season, corporate governance issues dominated the agenda. But as of June 1992, the number of corporate governance proposals had dropped from the 1991 high. *Fewer Governance Proposals Seen in '92; Tactic of Opposing Board Slates Emerges*, Corporate Counsel Wkly. (BNA) 2 (June 17, 1992). The decrease was not attributed to decreased activism; to the contrary, it was attributed to increased activism and success in "behind-the-scenes diplomacy." *Id.* Since the institutional investors achieved such success in influencing corporate governance via shareholder proposals, they have achieved a new status and, also, have discovered that many companies are now willing to negotiate with them. *Institutions May Use Negotiations More in 1992 to Change Corporate Governance*, 24 Sec. Reg. & L. Rep. (BNA) No. 1, at 13 (Jan. 3, 1992).

Shareholder activism has also begun to emerge in Europe and Asia. Andrew Sollinger, *Global Custody; Voter's Rights*, INSTITUTIONAL INVESTOR, Nov. 1991, at 160. Currently, in countries in these regions, it is very difficult to vote your shares. For example, in France share votes must be cast in person or by a third-party agent unaffiliated with management at the shareholder meeting. *Id.* In response, numerous global proxy services have been established to vote proxy shares. *Id.*

144. Pound, *supra* note 11, at 83. Professor Pound notes that there are several political vehicles which may be utilized to effectuate change on corporate governance issues. *Id.* He cites shadow management committees, independent director slates, outside expert directors, shareholder committees, proxy campaigns. *Id.* at 83-84. In his article, Professor Pound discusses several examples of corpora-

As the chapter ends on the corporate raider, another powerful suitor comes to the forefront: the institutional investor. The institutional investor, due to vast collective holdings, wields the power in this new environment to effectuate corporate change. Furthermore, with the decline in merger activity, institutions are looking for the high returns they received in the 1980s. Institutions can realize higher returns by participating in the management of companies in which they own stock.

Before the recently enacted reform, the federal proxy system impeded institutional investors from bidding for corporate control.[145] As a result, the proxy rules became the subject of much criticism for their shortcomings in relation to corporate governance issues.[146] Both critics and the Commission have agreed that the federal proxy rules prior to their amendment "create[d] unnecessary regulatory impediments to communication among shareholders and others to the effective use of shareholder voting rights."[147] Moreover, proponents of reform argue that the proxy rules have diminished the role of the

tions where these newly politicized methods for corporate control are utilized. *Id.* at 85, 89. He concludes these new methods are in the best interests of corporate America and are "in tune . . . with the dictates of the American governance ideal." *Id.* at 93.

145. In their seminal work, Berle and Means noted in 1932 that professional managers had disenfranchised shareholders via the proxy machinery. BERLE & MEANS, *supra* note 75, at 81-88. In 1957, Professor Berle characterized the shareholder meeting as "a kind of ancient meaningless ritual." ADOLF A. BERLE, JR., ECONOMIC POWER AND THE FREE SOCIETY 7 (1957).

146. *See, e.g.*, Letter from CalPERS, to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission (Nov. 3, 1989) *in* 1 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 298, 298 (PLI Corp. Law and Practice Course Handbook Series No. 712, 1990) ("[t]he proxy system represents the primary medium through which the dialogue of corporate governance, between shareholders and the public companies they own, is conducted. . . . [and] [d]espite marked changes in shareholder demographics in the last two decades, the distribution of share ownership remains widespread, and the proxy process is the principle means by which outside shareholders can play an ongoing and meaningful role in the governance of publicly held entities"). *See also* John Pound, *After Takeovers, Quiet Diplomacy*, WALL ST. J., June 8, 1992, at A10 (supporting change in corporate governance through the proxy system); Myron Magnet, *Directors Wake Up!*, FORTUNE, June 15, 1992, at 85 (reporting the ineffective cultures that have developed in corporate board rooms).

147. *1992 Final Proxy Amendments*, *supra* note 21, at S-2. *See also* Letter from CalPERS, to Jonathan G. Katz, Secretary of the Securities and Exchange Commission (July 29, 1992) (agreeing with the Commission that the rules "create unnecessary regulatory impediments to free and open shareholder communication and effective use of the shareholder franchise, and that change is necessary").

shareholder in corporate governance and serve to "suffocate shareholder input or insulate management."[148] Suppressing shareholder communication removes management from the scrutiny of the shareholders, the owners of the corporation. The broad definition of "solicitation" created a significant chilling effect on shareholder communication.[149] Institutional investors, fearful of being found after the fact to have triggered the panoply of securities laws and stringent regulatory provisions, have refrained from voicing opinions or communicating with other shareholders without extensive prefiling.[150]

The Commission has stated that "modifications in the current rules are desirable to reduce these burdens and to achieve the purpose set forth in the Exchange Act,"[151] to assure "fair, informed, and effective shareholder suffrage."[152] In 1990, reacting to the perceived shortcomings of the proxy system and the changing shareholder demographics, the Commission undertook its own comprehensive review of the proxy rules.[153]

3. *Amendments to Rule 14a-2: A New Exemption from the Proxy Regulations*

The SEC's first amendment was to Rule 14a-2(b)(1),[154] which exempts certain disinterested solicitations from proxy

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Critics also argued that "[t]he proxy rules in their present form have evolved and been shaped by an environment that reflects an underlying philosophy of protecting registrants from shareholder involvement." Letter from CalPERS, to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission (Nov. 3, 1989) *in* 1 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 295, 304 (PLI Corp. Law and Practice Course Handbook Series No. 712, 1990).

148. Letter from CalPERS, to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission (Nov. 3, 1989) *in* 1 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 295, 304 (PLI Corp. Law and Practice Course Handbook Series No. 712, 1990).

149. *1992 Final Proxy Amendments*, *supra* note 21, at S-4.

150. *Id.* at S-3 to S-4.

151. *Id.* at S-2.

152. *1991 Proposal*, *supra* note 23, at 950. *See also* H.R. REP. NO. 1383, 73d Cong., 2d Sess. 13, 14 (1934) (discussing the importance of fair and effective shareholder suffrage).

153. Letter from CalPERS to the Securities and Exchange Commission 5 (Aug. 25, 1992) (on file with the SEC).

154. *1992 Final Proxy Amendments*, *supra* note 21, at S-1.

regulation.[155] This amendment was the most debated and controversial proposal during the solicitation period.[156] The amendment adds a new exemption from the provisions of all of the proxy rules except Rule 14a-9,[157] the proxy rules' anti-fraud provision. Solicitations conducted by persons who are not seeking proxy authority and do not have a substantial interest in the subject matter of the vote are no longer regulated by the proxy rules.[158] Such "disinterested parties" are absolutely free to communicate with other shareholders either orally or in writing without becoming entangled in the morass of the proxy regulations.[159]

Under the exemption, all oral communications are excluded from proxy regulation and filing is only required for certain written solicitations.[160] This amendment lies at the heart of the Commission's reforms, which seek to "promot[e] free discussion, debate and learning among shareholders" and not "plac[e] restraints on that process."[161]

The exclusion of oral communications in both the Commission's 1991 proposal and the 1992 reproposal drew serious criti-

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155. 17 C.F.R. § 240.14a-2 (1992). The SEC never changed the definition of "solicitation;" it merely created certain exemptions and a safe harbor.

156. *1992 Reproposal, supra* note 24, at 951.

157. 17 C.F.R. § 240.14a-9 (1992).

158. *1992 Final Proxy Amendments, supra* note 21, at S-19. The amendments do not apply to the following:

> [a]ny solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization.

Id. at S-19 to S-20.

159. *Id.* at S-6. The Business Roundtable does not oppose this amendment. However, Co-chairman H. Brewster Atwater, Jr., does warn that:

> [w]e don't want the SEC to regulate conversations between small shareholders at the company picnic, but we do think that the large institutional shareholders with big enough holdings to influence the outcome of a proxy contest are soliciting shareholder votes, the rest of the shareholders have a right and need to know about it.

Management, Institutions Agree Reforms Will Shape '93 Season, ISSUE ALERT 1 (Institutional Shareholders Services, Inc. ed., 1992).

160. *1992 Final Proxy Amendments, supra* note 21, at S-6.

161. *Id.* at S-5.

cism from the business community.[162] Due to the increased size of the institutional investor, the business community was concerned about "secret back-room lobbying" between institutional investors.[163] They also cited the frequency of oral communication as the manner in which most solicitations occurred.[164] As a safeguard, however, these communications are subject to the anti-fraud provisions. Therefore, fraudulent speech under this exemption can be attacked in a lawsuit by management or other shareholders.[165]

162. *See, e.g.*, Letter from H. Brewster Atwater, co-chairman, Business Roundtable, to the Securities and Exchange Commission 2 (Sept. 18, 1992) (on file with the SEC) (suggesting the imposition of a 5% ownership to remain regulated); Letter from Robert E. Healing, Corporate Counsel, General Electric to the Securities and Exchange Commission, 4 (Aug. 28, 1992) (on file with the SEC) (contending these amendments subvert disclosure principles); Letter from David H. Knutson, Associate Secretary, Chase Manhattan Corp. to the Securities and Exchange Commission, 2 (Aug. 28, 1992) (on file with the SEC) ("[o]ral solicitation should not be exempt . . . [t]his would frustrate disclosure, subvert proposed Notice Form 14 and drive or attract solicitation activities"); Letter from Richard H. Troy, Chairman, American Society of Corporate Secretaries, Inc., to the Securities and Exchange Commission (Aug. 4, 1992) (on file with the SEC) (arguing against allowing unregulated oral solicitations).

163. Letter from the Business Roundtable to the Securities and Exchange Commission (Sept. 18, 1991) (on file with the SEC).

164. *Id.*

165. The existence of a private right of action under § 14a-9 is well settled. Roosevelt v. E.I. Du Pont de Nemours & Co., 958 F.2d 416, 418-25 (D.C. Cir. 1992). This rule prohibits the following:

> [n]o solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

17 C.F.R. § 240.14a-9(a) (1993).

One commentator noted that Rule 14a-9 "has probably been one of the most frequently litigated provisions in the federal securities statutes." WATERS, *supra* note 125, at 316. Parties have litigated whether a private action exists, whether the plaintiff has standing, who is liable, whether there was causation, and, at the heart of the rule, whether the misleading or false statements were "material." *Id.* at 317-77.

This rule is broadly applied and is similar to the SEC's Rule 10b-5 which applies to fraud in the purchase or sale of a security. Unlike Rule 10b-5, if liability is established money damages are rarely awarded; relief is instead equitable and comes in the form of injunctive relief, a corrective disclosure, or a re-solicitation

Written materials are also exempted from proxy regulation. In contrast to oral communications, however, this exemption is subject to three significant conditions.[166] The three new provisions were added in response to the great deal of controversy concerning the SEC's distinction between written and oral solicitations.[167]

The first condition requires that beneficial owners of more than $5 million of a company's securities file written notice[168] with the SEC.[169] The second condition requires that those who are required to file, i.e., owners of $5 million or more of a security, must do so within three days after the solicitation material

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order of the proxies. *See, e.g.*, J.I. Case Co. v. Borak, 377 U.S. 426, 433 (1964) (finding that federal jurisdiction existed to grant all necessary remedial relief); Telvest, Inc. v. Wisconsin Real Estate Inv. Trust, 489 F. Supp. 250 (E.D. Wis.), *modified*, 781 F.2d 589 (7th Cir. 1986) (ordering a corrective disclosure). *But see* Mills v. Electric Auto-Lite Co., 396 U.S. 375, 389 (1970) (awarding damages but "only to the extent that they can be shown").

166. *1992 Final Proxy Amendments, supra* note 21, at S-7. The SEC's original proposal exempted all solicitations for the proxy regulations, including written communications. *1991 Proposal, supra* note 23, at 975. *See also 1992 Final Proxy Amendments, supra* note 21, at S-6 (discussing the reversal of the SEC's position on written solicitations). In the final amendments, the SEC retreated from their initial position of complete exemption for all oral and written communications, to require filing of written solicitations for certain large shareholders. *Id.* at S-6. The SEC reported that much of the controversy in response to the reproposal centered on the SEC's distinction between oral and written communications. *Id.*

167. *1992 Final Proxy Amendments, supra* note 21, at S-7.

168. The contents of the notice required to be filed include, the name and address of the party relying on the exemption, the name of the registrant, and identification of the written soliciting materials that are *materially different*. 17 C.F.R. § 240.14a-103 (1993). The United States Supreme Court concluded that in the proxy solicitation context "[a]n omitted fact is material if there is substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." TSC Industries v. Northway, Inc., 426 U.S. 438, 449 (1976).

169. 17 C.F.R. § 240.14a-6(g)(1) (1993). The dollar amount required to trigger the statute, as required by the final amendments, currently $5 million, will be adjusted annually to account for inflation. *1992 Final Proxy Amendments, supra* note 21, at S-8. The adjustment will be calculated by multiplying the $5 million threshold by the Consumer Price Annual Average for All Items Index for All Urban Consumers (CPI-U). *Id.* The updated dollar threshold figure will be announced at the beginning of each year. *Id.*

The $5 million limitation was adopted from a comment letter. *See 1992 Final Proxy Amendments, supra* note 21, at S-6. The SEC did not adopt another suggestion which would have required a soliciting party and a party solicited who own more than 5% of the company's shares to file any oral communication made between themselves with the Commission. *See id.*

is given to the shareholders.[170] The SEC emphasizes that the purpose of the notice is to bring the information into the public domain and, thus, it is not a disclosure document subject to SEC liability.[171] Finally, the third condition extends the law to both officers and directors who are soliciting proxies without use of corporate funds.[172]

The new exemption from the proxy rules provided in Rule 14-a-2 provides a list of interested persons who can not rely on the exemption.[173] The list includes individuals classified as insiders,[174] competing bidders,[175] certain financially interested

170. 17 C.F.R. § 240.14a-6(g)(1) (1993). Once received by the SEC, the new notice form will be publicly available. *1992 Final Proxy Amendments*, *supra* note 21, at S-8. The time period was reduced because of concern about what would transpire during the interim waiting period. *Id.* Persons required to submit a notice filing must send copies of the materials to the SEC and any national exchange on which the securities are listed within three days of the date of dissemination of the materials. *Id.* The Commission expressed that any "concerns about less sophisticated shareholders that gave rise to the ten day period have been mitigated," by the fact that the notice requirement only applies to large shareholders. *Id.*

171. *1992 Final Proxy Amendments*, *supra* note 21, at S-8. Certain communications are exempt from the notice filing regardless of the solicitor's size. These are as follows: speeches in a public forum; press releases; and published or broadcast opinions, statements, or advertisements. *Id.* at S-9. These communications are all publicly made and, thus, are already in the public domain. *Id.* However, press releases that are not disseminated by a news service are not exempt unless they are not disseminated to any other shareholder. *Id.* In the situation where a shareholder employs a company to telephone shareholders and read communications from a script, these communications are deemed written communications and may qualify as a written solicitation under the amendments' provisions. *Id.*

172. *Id.* at S-7.

173. The original proposal, only listed in a note, provides four examples of persons who could not qualify as under this exemption. *1991 Proposal*, *supra* note 23, at 983. The reproposal provided the following synopsis of the proposal's initial text:

> a. an affiliate, officer or director of the issuer or an ineligible party; b. a competing bidder; c. an interested person of a registered investment company; d. a person who receives compensation directly or indirectly from any of the above; and e. a person acting on behalf of a person soliciting proxy authority or who is otherwise ineligible.

1992 Reproposal, *supra* note 24, at 954.

174. This classification includes the registrant or an affiliate or associate of the registrant; an officer or director of the registrant or anyone serving in a similar capacity; an officer, director, affiliate or associate of a person not entitled to an exemption within this subsection; and any nominee for directorship for which proxies are being solicited. 17 C.F.R. § 240.14a-2(b)(1)(i)-(iv) (1993). When applied to corporate inside personnel, the rules permit exemption when the person conducts the proxy at his own personal expense. *1992 Final Proxy Amendments*, *supra* note 21, at S-7. This classification also disqualifies "[a]ny person who is re-

parties,[176] registered investment companies,[177] and agents of any ineligible person.[178] These categories were not permitted to take advantage of the exemption due to the inherent potential for abuse their situations impose.[179]

4. *Amendments to Rules 14a-1 and 14a-3: Exemption for Certain Media Communications*

As noted above, the definition of "solicitation" in the proxy regulations directly affects whether or not a communication is regulated by these rules.[180] Historically, the definition of solicitation in the rules is written in broad language and likewise has been given a broad interpretation by the courts.[181] In order to exempt certain communications from falling within the definition of solicitation and the subsequent purview of the proxy rules, the Commission has created a "safe harbor" from the definition of solicitation for certain shareholder communications.[182]

The safe harbor permits public announcements of a shareholder's voting intentions and/or voting rationale by specifically

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quired to report beneficial ownership of the registrant's equity securities on a Schedule 13D . . . ." 17 C.F.R. § 240.14a-2(b)(1)(vi) (1993). In essence, this removes a parent corporation from the exception regarding solicitation of subsidiary corporation proxies.

175. 17 C.F.R. § 240.14a-2(b)(1)(v) (1993). This section excludes:

> [a]ny person soliciting in opposition to a merger, recapitalization, reorganization, sale of assets or other extraordinary transaction recommended or approved by the board of directors of the registrant who is proposing or intends to propose an alternative transaction to which such person or one of its affiliates is a party.

Id. § 240.14a-2(b)(1)(v).

176. 17 C.F.R. § 240.14a-2(b)(1)(ix) (1993). This section requires that the financial interest be one which "would not be shared pro rata by all other holders of the same class of securities, other than a benefit arising from the person's employment with the registrant . . . ." *Id.* A person who receives compensation from an ineligible person is also exempted. *See id.*

177. 17 C.F.R. § 240.14a-2(b)(1)(viii) (1993). This exception includes "interested person" as defined by § 2(a)(19) of the Investment Company Act, 15 U.S.C. § 80a-2 (1988 & Supp. IV 1992). *Id.*

178. 17 C.F.R. § 240.14a-2(b)(1)(x) (1993).

179. *See 1991 Proposal, supra* note 23, at 953-55.

180. *See supra* notes 124-25 and accompanying text.

181. *See supra* part IV.B.1.

182. *1992 Final Proxy Amendments, supra* note 21, at S-9. All announcements not qualifying for safe harbor protection are still subject to a determination under the definition provided by the rules as to whether or not they are solicitations. *Id.*

excluding such public statements from the definition of solicitation in Rule 14a-1.[183] This amendment, therefore, allows shareholders to publicly announce how they intend to vote and

183. *1992 Final Proxy Amendments*, *supra* note 21, at S-9. Before the amendments, there were several exemptions from the definition of solicitation. Any solicitation by record owners to beneficial owners, i.e., a solicitation by a broker to the shareholder, and vice versa, were exempt from proxy regulation. 17 C.F.R. § 240.14a-2(a)(1)-(2) (1992). Furthermore, instances where a security purchaser wishes to "solicit and obtain the seller's proxy" when the sale occurs after the record date were exempt from proxy filing. 4 LOSS & SELIGMAN, *supra* note 17, at 1956. *See also id.* at 1956 n.97 (discussing at what point a buyer of a security becomes a beneficial owner, especially when the sale is contingent on a buyer's contractual duty to perform).

Solicitations involved in the selling of securities registered under the Securities Act were also exempted from proxy regulation. 17 C.F.R. § 240.14a-2(a)(3) (1992). The caveat to this exemption is that it does not apply to securities to be issued in either a reclassification of securities, merger, consolidation, or a transfer of assets. *Id.* These are all transactions of the character specified in paragraph (a) of Rule 145 of the Securities Act. These transactions do not, however, escape regulation; they are required to comply with regulations 14A and 14C under Form S-4. Again, this exemption eliminates duplicative filing. WATERS, *supra* note 125, at 31.

The Rule also contained an exemption which parallels the "tombstone ad" exemption in the Securities Act. *Compare* 1 LOSS & SELIGMAN, *supra* note 17, at 466-77 *with* 17 C.F.R. § 240.14a-2(a)(6) (1992). Tombstone ads are newspaper advertisements and inform security holders where they may obtain proxy soliciting material. WATERS, *supra* note 125, at 31. They "may only name the registrant, state the reason for the advertisement, and identify the proposal to be acted upon by the security holder." *Id.* The purpose of allowing these ads is to reach beneficial owners who have not responded to soliciting materials.

Other solicitations exempted include those related to 1978 Bankruptcy Reform Act Chapter 11 reorganization (as amended) and solicitations connected with the Public Utility Holding Company Act of 1935. 17 C.F.R. § 240.14a-2(a)(4)-(5) (1992). The rationale behind these exemptions is avoidance of duplicative regulation. 4 LOSS & SELIGMAN, *supra* note 17, at 1955.

Furthermore, Rule 14a-2 limited rule 14a-2(b)(1) and 14a-2(b)(2) of its pre-amendment exemptions to exemption from all proxy regulations except the anti-fraud provision. 17 C.F.R. § 240.14a-2(b) (1992). Rule 14a-2(b)(1) exempts non-registrant solicitation for groups of less than ten shareholders. *Id.* § 240.14a-2(b)(1). *See* 4 LOSS & SELIGMAN, *supra* note 17, at 1957-58. Under this rule, whether or not a proxy is granted is of no consequence. *Id.* It is the number of solicitations that affects the exemption. *Id.* Rule 14a-2(b)(2) exempts solicitation by one person in the form of advice "in the ordinary course of his business." 17 C.F.R. § 240.14a-2(b)(2)(i) (1992). Under the 14a(b)(2) exemption, an advisor cannot receive payment from anyone except the "recipient(s)" of the advice, and must fully disclose any relationship with the registrants and any other possibly conflicting interests of the recipient. *Id.* § 240.14a-2(b)(2)(ii)-(iii) (1992). Similarly, the advisor cannot be acting "on behalf" of individuals soliciting proxies or participating in a Rule 14a-11 election. *Id.* § 240.14a-2(b)(2)(iv).

why.[184] Hence, this is a very effective and inexpensive way to communicate with other shareholders.[185] Moreover, announcement of opposition or support for either management or insurgent nominees is likely to have a significant effect on other shareholders, particularly announcements by large institutions.[186] Additionally, the new safe harbor exempts the public announcement from all proxy rules, including Rule 14a-9, and does not restrict the number of releases or times the announcements can be made.[187]

The exemption also applies to an unsolicited communication in response to information requested by another shareholder[188] and any communications by a fiduciary to its beneficiaries explaining how it intends to vote the proxies.[189] Moreover, officers and directors who are shareholders are permitted to take advantage of the safe harbor.[190]

In a similar amendment, the Commission amended Rule 14a-3 to facilitate the use of the media in shareholder communi-

184. *1992 Final Proxy Amendments*, *supra* note 21, at S-1, S-9.

185. All an investor would have to do is draft a press release and fax it to the press.

186. This is evident from the massive public campaign for the shareholder approval or disapproval of the Centel/Sprint merger which was approved by a narrow margin of 1% over strong institutional lobbying to the contrary. Fran Hawthorne, *What The New SEC Rules Do For Activism*, INSTITUTIONAL INVESTOR, Apr. 1993, at 47, 48. Eagle Asset Management took advantage of the safe harbor to vote with management in favor of the merger. *Id.*

187. *1992 Final Proxy Amendments*, *supra* note 21, at S-9. The provision was adopted over strong corporate protest. The Business Roundtable strongly urged that this exemption should be limited to a one-time announcement. Letter from the Business Roundtable to the Securities and Exchange Commission (Aug. 28, 1992) (on file with the SEC). Multiple announcements would be solely utilized for the purpose of influencing shareholders, regardless of the stated purpose. *Id.* Currently, the exemption would "permit a shareholder, for example, to publish newspaper advertisements on a daily basis, arguments favoring one side or another in an election or other proxy contest, free from any oversight under the proxy rules." *Id.*

188. 17 C.F.R. § 240.14a-1(l)(2)(iv)(C) (1993).

189. *Id.* § 240.14a-1(l)(2)(iv)(B). This amendment also drew criticism from the Business Roundtable. Letter from the Business Roundtable to the Securities and Exchange Commission (Aug. 28, 1992) (on file with the SEC). By exemption from this rule, the Roundtable contended that the amendment would leave "neither the Commission nor other interested parties any recourse against a shareholder who makes a public announcement containing intentionally false and fraudulent statements of even highly material facts." *Id.*

190. *Id.*

cation. Rule 14a-3, as amended, no longer requires the delivery of a proxy statement to every shareholder for certain forums of communication. Forums listed in the amended rule include: "communication[s] made by means of speeches in public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media, newspaper, magazine or other bona fide publication disseminated on a regular basis."[191] The new rules are, however, subject to two conditions: no form of proxy, consent, or authorization accompanies the public communication,[192] and a definitive proxy must be on file with the Commission at the time the communication is made.[193] These revisions purport to reduce the potentially immense costs of filing and revitalize the use of the public media in proxy contests.[194]

5. *Amendments to Rule 14a-7: Shareholder Lists*

The amended rules permit the registrant, the corporation registered with the SEC, upon receipt of a written request[195] for

191. 17 C.F.R. § 240.14a-3(f) (1993). Before the amendment, these communications were not exempt by any provision of the rules, rather they fell within the definition of "solicitation" and required filing.

192. 17 C.F.R. § 240.14a-3(f)(1) (1993).

193. *Id.* § 240.14a-3(f)(2).

194. *1992 Final Proxy Amendments, supra* note 21, at S-10. This amendment also balances the proxy system because prior to amendment, the corporation could make public comments about the insurgent, and hold press conferences while insurgents would be required to file, and mail all shareholders a proxy card before they could speak. *See, e.g.*, Joel Chernoff, *SEC Seeks to Ease Proxy Communication*, PENSIONS & INVESTMENTS, July 6, 1992, at 17 (noting that Bob Monk probably would have prevailed in a constitutional challenge to the SEC's current rules). Under this system an insurgent couldn't even rebut management, answer questions raised by the media nor defend their position without incurring significant costs.

195. All that is necessary to trigger the registrant's obligations is for the shareholder to make a written request for either a shareholder list or mailing of their soliciting material. *1992 Reproposal, supra* note 24, at 959. The written requests for shareholder lists will remain non-public information. *Id.* The Commission abandoned a proposal to require disclosure of requests for shareholder lists "as of the date" of proxy or information statement distribution. *1992 Final Proxy Amendments, supra* note 21, at S-15. The implications of unfair action on the registrant's part influenced the Commission's rejection of this proposed amendment. *Id.*

a shareholder list by a record holder or a beneficial owner[196] either to:

> (1) provide a requesting shareholder with a list of holders of securities of a class from which proxies have been solicited or are to be solicited on management's behalf in connection with a shareholder meeting or action by consent or authorization; or (2) mail the requesting shareholder's soliciting materials to shareholders or subgroups of shareholders of that class.[197]

The registrant has the option of either providing a shareholder list or mailing the soliciting shareholder's materials as long as the solicitation does not relate to a roll-up transaction or to a going private transaction.[198] In the event that either a roll-up or going private transaction is involved, the choice of a list or mailing becomes available to the requesting shareholder.[199]

Once the statute is triggered, the registrant has five business days after the shareholder's request to mail out required

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196. In order for a beneficial owner to utilize this rule through its agent, the registrant must be provided with some type of certification of beneficial ownership from the beneficial owner. 17 C.F.R. § 240.14a-7(c) (1993).

197. *1992 Final Proxy Amendments*, *supra* note 21, at S-13. Allowing management to choose whether to mail the lists or include the materials with management's material represents a significant compromise by the Commission. The original proposal entirely eliminated management's right to choose and rather established a federal right for a shareholder's list. *1991 Proposal*, *supra* note 23, at 979. This may have been perceived as necessary because under state law, the corporation can require a shareholder who requests a shareholder list to demonstrate in court that he has a proper purpose for requesting the list. *See, e.g.*, DEL. CODE ANN. tit. 8, § 220(b) (1993) (defining "proper purpose" as "a purpose reasonably related to such person's interests as a stockholder"); General Time Corp. v. Talley Indus., 240 A.2d 755, 756 (Del. 1968) (stating that the propriety of inspection must be determined upon the facts of the particular case). This delay and expense is often fatal to the shareholder's plight.

Commentators argued that the commission had exceeded its authority by providing a federal right to a shareholder list and invaded the province of state corporate law. *1992 Final Proxy Amendments*, *supra* note 21, at S-13 (citing Letter from the Business Roundtable to the Securities and Exchange Commission (Aug. 28, 1992) (on file with the SEC)); *see also* Business Roundtable v. The Securities and Exchange Commission, 905 F.2d 406, 417 (1st Cir. 1990) (holding that the SEC had exceeded its powers by enacting "one-share-one-vote" rule, because corporate voting is within the auspices of state corporate law). The SEC ceded to these pressures and did not reverse the presumption that management may choose to either send the materials or mail the shareholder list.

198. *1992 Final Proxy Amendments*, *supra* note 21, at S-13. For a discussion of going private and roll-up transactions see *infra* notes 230-31.

199. *1992 Final Proxy Amendments*, *supra* note 21, at S-13.

materials.[200] If the registrant chooses to mail the materials for the shareholder, the amended list of materials includes: notification as to which option the registrant has chosen;[201] the approximate number of record holders and beneficial owners management either has or plans to solicit;[202] and the estimated cost of mailing a proxy statement, proxy form, or other proxy material.[203] Shareholders are required to reimburse the company for any reasonable expenses incurred in regard to mailing of the shareholder's material.[204] Since the shareholders do not have a war chest equal to management, shareholders may choose to have management target the shareholder's communications to a specific group of shareholders, usually large holders.

If the registrant chooses to mail the shareholder lists or is required to because of the nature of the transaction, they must include: the most recent list containing the beneficial owners' names, addresses, and equity positions provided that the beneficial owners do not object to disclosure of this information.[205]

200. 17 C.F.R. § 240.14a-7(a)(1) (1993). This is a significant amendment because under the old rules management used to be able to delay mailing the insurgent's materials until it was ready to mail its own materials, and, hence, could counter many of the insurgent's claims. 17 C.F.R. § 240.14a-7(a)(1) (1992). Now they must be mailed within five days. The length of time provided for delivery was lengthened in the amendments from the reproposal which required delivery within two business days. *1992 Reproposal, supra* note 24, at 976.

201. 17 C.F.R. § 240.14a-7(a)(1)(i) (1993).

202. *Id.* § 240.14a-7(a)(1)(ii).

203. *Id.* § 240.14a-7(a)(1)(iii). The estimate must also include "the estimated costs of any bank, broker, and similar person through whom the registrant has solicited or intends to solicit beneficial owners in connection with the security holder meeting or action." *Id.*

204. *Id.* § 240.14a-7(e).

205. *Id.* § 240.14a-7(a)(2)(ii). The original proposal required the registrant to provide the "names, addresses, and security holdings of both record and non-objecting beneficial owners ('NOBO') or consenting beneficial owners ('COBOS')". *1991 Proposal, supra* note 23, at 979. The reproposal and amendments reduce the registrant's obligations under the proposal in regard to beneficial owner lists. The reproposal only required the registrant to provide beneficial owner information which is available at the time of request. *1992 Reproposal, supra* note 24, at 961. Therefore, the registrant is not required to track down and obtain a list of beneficial owners; they merely have to share any lists of beneficial owners they have already acquired. Critics of the beneficial list requirements believe disclosure of these lists may breach the list's confidentiality or by furnishing third parties their names, addresses, and equity positions, invade the beneficial owner's privacy. *Id.* at 962-63. The Commission rebutted this position by stating that state corporate law specifically recognizes a right to access for such shareholder list requests. *Id.*

These lists must be either updated daily or at the shortest reasonable intervals.[206]

Shareholder list recipients must provide documented certification that the lists will not be used in any matter not corresponding to the proxies solicited and/or the accompanying meeting.[207] The recipient must also agree not to disclose the list information to any person other than the beneficial owner or any parties necessary to the distribution[208] and that they will return the list at the end of the solicitation.[209] The shareholder agreements are not filed with the SEC,[210] rather they are contracts, whose breach is actionable as a contract action. Once the shareholder has used the lists, they must be returned and all copies must be destroyed.[211]

C. *Filing and Prefiling Amendments*

1. *The Old Rules and Perceived Inadequacies*

In addition to legal costs and compliance costs amassed under the Commission's communication regulation, pre-filing and/or filing requirements for most soliciting material also have a significant chilling effect on shareholder activism.[212] Propo-

at 962. The final amendments require that the registrant provide "a reasonably current list of beneficial owners obtained by the registrant pursuant to Rule 14a-13(b) (the 'NOBO/COBO list') if the registrant has obtained such a list or (updated list) for its own use prior to the meeting or other shareholder action." *1992 Final Proxy Amendments*, *supra* note 21, at S-14.

206. *1992 Final Proxy Amendments*, *supra* note 21, at S-14. The registrant's duty to update the proxy materials continues until the record date. Ownership after the record date, the date which determines a voter's eligibility, would be immaterial to any proxy vote, and, therefore, is not required to be disclosed by the registrant. *Id.*

207. 17 C.F.R. § 240.14a-7(c)(2)(i) (1993).

208. *Id.* § 240.14a-7(c)(2)(ii).

209. *Id.* § 240.14a-7(d).

210. *1992 Final Proxy Amendments*, *supra* note 21, at S-15.

211. 17 C.F.R. § 240.14a-7(d) (1993). The treatment of these lists is similar to the treatment of tender offers under Rule 14-d-5(e)(4). *Id.* § 240.14d-5(e)(4).

212. Letter from CalPERS to Linda C. Quinn, Director of the Division of Corporate Finance, Securities and Exchange Commission (Nov. 3, 1989) *in* 1 22ND ANNUAL INSTITUTE ON SECURITIES REGULATION 295, 304 (PLI Corp. Law and Practice Course Handbook Series No. 712, 1990). Under the old rules certain "plain vanilla" issues were exempted from the pre-filing and filing requirements. Plain vanilla issues were routine issues that did not require a proxy statement to be filed in preliminary form and reviewed by the SEC because they were deemed so garden variety as to not warrant the time and expense required to file. These routine

nents of reform argue that the rules are so vague as to require time consuming SEC review in all cases. Pre-amendment Rule 14a-6 required preliminary filing of all proxy statements as well as any additional proxy soliciting materials ten business days before release.[213] Pre-amendment Rules 14a-11(e) and 14a-12 also required the filing of the preliminary forms of all released materials five days before the distribution of the proxy statement.[214] Pre-amendment Rule 14c-5(a) also required preliminary filing for information statements with the SEC.[215]

Under this pre-filing system, the Commission would review the proxy material and issue a comment.[216] The registrant would then be expected to incorporate the comments and file amended material.[217] The Commission was often criticized for reducing the quality and substance of the communications during its pre-screenings.[218] Parties involved in the transaction, such as the registrant or institutional investors, are aware of the corporation's financial activities and composition. Therefore, they are better suited than the Commission to identify any inaccuracies in soliciting materials. Under liberal shareholder communication rules, the investor or registrant can point out inaccuracies to fellow shareholders. The Commission finds this process more cost effective than reviewing the materials themselves.[219] Hence, under the new rules, pre-filing in most circumstances is no longer necessary.[220]

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matters were specified in Rule 14a-6 and included: uncontested election for directors, ratification or elections of independent accountants, and uncontested 14(a) proposals. 17 C.F.R. §§ 240.14a-6(a)(1)-(3), notes (1)-(3) (1992).

213. 17 C.F.R. § 240.14a-6(a) (1992).

214. *Id.* §§ 240.14a-11(e), -12(b). A two-day preliminary filing deadline was required with respect to election contests. *Id.* § 240.14a-11(e). A similar two-day requirement was also imposed upon matters in opposition to tender offers or "other publicized activity." *Id.* § 240.14a-12.

215. *Id.* § 240.14c-5(a).

216. WATERS, *supra* note 125, at 139-40. Moreover, all material filed was non-public information.

217. *Id.*

218. *1992 Final Proxy Amendments, supra* note 21, at S-11.

219. *Id.*

220. *Id.* This however assumes that a party involved in a transaction will reveal relevant information with the same frequency as the SEC, which is a party neutral to the transaction.

2. *Amendments to Rules 14a-6, 14a-11, 14a-12 and 14c-5: Exempting Solicitations from Preliminary Filing*

The Commission amended Rules 14a-6, 14a-11, 14a-12, and 14c-5 to eliminate prior review by the Commission of most proxy soliciting material: filing is required only "in definitive form at the time of dissemination."[221] Preliminary filing is only required for forms of proxy, written proxy statements,[222] and information statements.[223] Materials not subject to pre-filing must now either be filed with the Commission and national exchanges on the same day they are published, or delivered directly to the shareholders.[224] Moreover, once filed, the party can begin to solicit with the preliminary filing statement and need no longer wait for approval prior to soliciting. The Commission believes these amendments represent the "most cost-efficient means" to remedy problems associated with pre-screening.[225]

In a related matter, the Commission adopted a new policy governing the public status of preliminarily filed proxies, proxy statements,[226] and information statements.[227] Under the new rules, "all preliminary filed proxy statements, forms of proxy, and information statements will be available to the public upon filing with the Commission."[228] Therefore, management must be prepared to defend its position immediately upon filing.

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221. *Id.*

222. *Id.* at S-21 (codified at 17 C.F.R. § 240.14a-6(a) (1993)).

223. *Id.* at S-25 (codified at 17 C.F.R. § 240.14c-2(a) (1993)). Previously, only materials relating to routine matters in which there was no opposition were exempted from the prefiling requirement. WATERS, *supra* note 125, at 134.

224. *1992 Final Proxy Amendments*, *supra* note 21, at S-11.

225. *Id.*

226. 17 C.F.R. § 240.14a-6(e)(1) (1993).

227. 17 C.F.R. § 240.14a-5(d)(1) (1993).

228. *1992 Final Proxy Amendments*, *supra* note 21, at S-13. The Commission initially proposed to make public all preliminary materials. *Id.* at S-12. *See 1991 Proposal*, *supra* note 23, at 978.

The proposal presented the following:

> [a]lthough the proposals would not dispense with preliminary filing of the written proxy statement or form of proxy, the proposed amendments would eliminate the non-public treatment of preliminary proxy statements. Under the proposed approach, preliminary proxy materials would be treated in a manner similar to registration statements required by Section 5 of the Securities Act of 1933.

Id.

Preliminary materials for certain business combinations, filed according to Item 14 of Schedule 14A (mergers, consolidations, acquisitions, and similar matters) represent the only exception to this new rule, and may be confidential at the registrant's discretion.[229] "Going private" transactions[230] and "roll-up" transactions[231] are excluded from the confidentiality option and are made public upon filing.[232] In support of this treatment, the Commission noted "the need for confidentiality [for roll-up and going private transactions] appears significantly less compelling, and the benefits of disclosure concomitantly greater."[233] Both of these transactions have troubled the Commission[234] in the past and thus did not receive the exemption.[235]

The 1992 reproposal included a proposed rule which granted confidentiality upon request for proxies filed for various business combinations under Item 14 of Schedule 14A: solicitations dealing with mergers, consolidations, acquisitions, and other comparable situations. *1992 Reproposal, supra* note 24, at 958. The confidentiality option was only available if the underlying matter had not been made public. *Id.* The reproposal provided the same treatment for preliminary information statements filed for business combinations under Item 14 of Schedule 14A. *Id.*

229. 17 C.F.R. § 240.14c-5(e)(2) (1993). In order to receive confidential treatment the registrants must appropriately mark the material as "Confidential, For Use of the Commission only." *Id.* § 240.14c-5(e)(1)(ii).

230. In a going private transaction, management regains possession of its equity securities causing its stock to be delisted from a national exchange or cease to be traded on an inter-dealer network. There exist several basic techniques to take a corporation private. These are the following: (1) a cash tender by management, or an affiliated entity; (2) a merger with another company wholly owned by management or an affiliated entity; (3) an exchange offer by management or an affiliate; and (4) a reverse stock split. *See generally*, Mary C. Burson, Note, *Securities Law: An Argument for Recognition of an Implied Private Cause of Action for Shareholders Under Section 13(e) of the Securities and Exchange Act of 1934 in the Context of Going Private*, 64 NOTRE DAME L. REV. 606, 608-09 (1989).

231. A "roll-up" is the "consolidation, merger, restructuring or repackaging of a group of limited partnerships." George Yearsich et al., *Securities Law Aspects of Partnerships in* PARTNERSHIPS: UPA, ULPA, SECURITIES, TAXATION AND BANKRUPTCY 995, 1097 (A.B.A. - A.L.I. Resource Materials 10th ed. 1992). In a roll-up transaction "several generally nontraded partnerships . . . are merged into a new investment vehicle listed on a stock exchange or quoted in NASDAQ." *Id.*

232. *See* 17 C.F.R. § 240.14a-5(e)(2)(i) (1993).

233. *1992 Reproposal, supra* note 24, at 958.

234. Dean Foust, *'Roll ups' are Raising Brows in Congress*, BUS. WK., Mar. 18, 1991, at 116. The SEC requires extensive disclosure in going private and other transactions because in such transactions the corporate insiders have conflicting interests. Ted J. Fiflis, *Responsibility of Investment Bankers to Shareholders*, 70 WASH. U. L.Q. 497, 498-99 (1992). Management serves as both the buyer and the seller of the corporation and, therefore, the SEC requires extensive disclosure regarding "fairness opinions," and other necessary information to insure there is no

The Commission believes making these materials public will "expedite shareholder access to material information concerning the subject matter of the solicitation and allow for a more meaningful opportunity to respond to the proposed solicitation."[236]

D. *Amendments to the Presentation of Management Proposals*

1. *Old Rules and Perceived Inadequacies*

Prior to the amendments, management proposals were often "bundled" or grouped in such a manner that several matters were advanced under one proposal. The practical result of this grouping could require that a shareholder vote for a proposal he did not support in order to vote for a matter he did support. Management's authority to "bundle" matters was derived from the pre-amendment Rule 14a-4(a) which permitted a

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misdealing on behalf of management. *Id.* On October 30, 1991, addressing these concerns, the SEC issued rules providing enhanced disclosure for roll-up transactions. Abigail Arms, *Current Issues and Rulemaking Projects: Division of Corporate Finance, in* ADVANCED SECURITIES LAW WORKSHOP 1992 67, 132 (PLI Corp. Law and Practice Course Handbook Series 1992). The SEC's new regulations for roll-ups and existing going private regulations have been criticized for ineffectively protecting investors. *See generally* Deborah A. Demott, *Rollups of Limited Partnerships: Questions of Regulation and Fairness*, 70 WASH. U. L.Q. 617, 631-33 (1992) (concluding that the SEC response to roll-ups has been less than ideal); A.A. Sommer, Jr., *"Going Private" Seventeen Years Later*, 70 WASH. U. L.Q. 571, 573-75 (1992) (tracing the SEC regulation of going private transactions and concluding that the disclosure requirements do not deter such transactions).

235. Moreover, prior to amendment, the broad definition of solicitation complicated any efforts by investors to organize in opposition of the roll-up transaction. Demott, *supra* note 234, at 623.

236. *1992 Reproposal, supra* note 24, at 957-58. Commentators argued that preliminary materials should remain nonpublic. Letter from the Business Roundtable to The Securities and Exchange Commission (Aug. 28, 1992) (on file with the SEC). They argued that making such materials public prior to review by the Commission, a step still required for proxies, could result in misleading information being placed in the marketplace. Hence, "making such materials public may do more harm than good." WATERS, *supra* note 125, at 500. In the final amendments, the Commission discounted such arguments, stating that

> the Commission does not believe there is a real difference in this respect between preliminary proxy materials and other documents . . . and periodic reports. In each case, staff comment may result in amendments after the filings have been publicly available and disseminated, and may have been relied upon by the market.

1992 Final Proxy Amendments, supra note 21, at S-12.

"group of related matters" to be presented in the proxy.[237] Some commentators contended that the Commission has once again invaded an area typically governed by state corporate law and, hence, the Commission lacked authority to enact this rule.[238]

One Commentator compared corporate bundling to the bundling that occurs in United States legislation:[239]

> [w]e feel that "bundling" may lead to abuses similar to those seen every day in the U.S. Congress where unrelated, little-supported, parochial matters are frequently attached to bills having enthusiastic universal support, resulting in the "catch-22" situation of accepting the undesirable proposal to get the benefit of the desirable proposal or foregoing the desirable proposal to defeat the undesirable proposal. Being compelled to make Hobson's choices is not in the best interest of shareholders.[240]

In comparison with Congressional packaging of proposals, unbundling is similar to a line item veto.

2. *Amendments to Rules 14a-4(a) and (b): Unbundling Management's Proposals*

Rules 14a-4(a) & (b) were amended to change the presentation of matters on the proxy to provide increased efficiency to shareholder suffrage.[241] The amended rules prohibit management from bundling unrelated matters in proposals placed for a shareholder vote. Instead, the registrant must clearly identify "each separate matter intended to be acted upon."[242] The amendments still allow issues to be contingent upon each other, provided voting consequences are explicitly stated. However, the contingencies may no longer be bundled.[243] Further, the amendments require that the shareholder be permitted to

237. 17 C.F.R. § 240.14a-4(a)(3) (1992).

238. *1992 Final Proxy Amendments, supra* note 21, at S-16.

239. Letter from Oppenheimer Capital, to the Securities and Exchange Commission (Aug. 19, 1992) (on file with the SEC).

240. *Id.*

241. *1992 Final Proxy Amendments, supra* note 21, at S-15 to S-16; *see generally* 17 C.F.R. § 240.14a-4(a)-(b) (1993).

242. 17 C.F.R. § 240.14a-4(a)(3) (1993).

243. *1992 Final Proxy Amendments, supra* note 21, at S-15. Management can say "proposal 1 will not be given effect unless proposal 2 is accepted," however, they can not present both proposals as one for a shareholder vote. This may be difficult to apply in practice because different types of proposals may have many different features which could arguably be the basis for a separate proposal.

either approve, disapprove, or abstain with respect to each separate matter.[244]

E. *Election Contests and Reporting*

1. *Old Rules and Perceived Inadequacies*

Prior to the Commission's 1992 revisions, the proxy rules in conjunction with state corporate law served to impede minority representation on the board of directors. State law generally allowed the shareholder to submit one proxy card in connection with a solicitation, either that of management or that of the dissident. Federal securities law did not allow the naming of nominees on any form of proxy unless the nominees consented to be listed on the dissident proxy statement and "serve if elected."[245] Since management nominees rarely, if ever, consented to be named on dissident slates, shareholders supporting a dissident slate were effectively deprived of an opportunity to vote the remaining positions on the board of directors.[246]

Institutional investors tried some creative self-help to remedy this situation by stapling cards together and crossing out the names of directors they did not want to support. The Commission believed that management did not have to count these votes because of the variation in the execution of the cards.[247] After a couple of these decisions, shareholders did not dare to be creative in finding ways to split their votes.

244. 17 C.F.R. § 240.14a-4(b)(1) (1993).

245. *Id.* § 240.14a-4(d) (1992).

246. *1992 Final Proxy Amendments*, *supra* note 21, at S-16. For example, if ten board positions were being elected and the dissident slate consisted of three nominees, a shareholder supporting a dissident slate could only send in the dissident's proxy. Any considerations the shareholder had concerning the other seven board positions would be conceded. Furthermore, the seven votes not cast would be classified as abstentions. Abstentions reduce the total amount of votes required to become elected because the total number of votes are reduced by abstentions. In the above example, if 50 out of 100 shares are voted for the dissident slate, those proxies will not be included in the votes for the remaining seven directors on management's slate. Therefore, management's slate will only need 26 votes (26/50 > 50%), as opposed to 51 votes, to be elected. For more discussion on the mathematical anomalies of "vote splitting," *see* Gilson, Gordon & Pound, *How Proxy Rules Discourage Constructive Engagement: Regulatory Barriers to Electing a Minority of Directors*, 17 J. CORP. L. 29 (1992).

247. Interview with Catherine Dixon, Counsel to Chairman Wallman, United States Securities and Exchange Commission (Nov. 11, 1994).

Furthermore, there was a concern by ERISA fund managers that by voting for a short slate, they might breach fiduciary duties owed to their constituencies. This concern was generated after a Department of Labor determination that a share's vote was an economic asset of the fund and cannot be wasted, and that doing so resulted in an actionable breach.[248]

Under the amended rules, the shareholder will no longer be dissuaded from supporting a "short slate" because of reluctance to forfeit a portion of his voting power. Also removed is the fear of breaching a fiduciary duty and the use of self help to support a full slate.

2. *Amendments to Rule 14a-4(d): Permission to Round Out Dissident Slates with Bona Fide Nominees*

The amendments to the "Bonafide Nominee Rule" permit a party soliciting proxies for a minority of the board, i.e., a dissident shareholder, to include management's nominees in its slate, even if such nominees do not consent.[249] As amended, a "universal ballot results, where a soliciting shareholder's proxy card can provide a space for company nominees, alongside the soliciting shareholder's nominees."[250] The new proxy card clearly delineates a dissident shareholder's nominees from

248. Letter from the Department of Labor, Pension & Welfare Programs, dated Feb. 23, 1988 *in* 1988 ERISA LEXIS 19, *5. *See supra* note 70 and accompanying text.

249. 17 C.F.R. § 240.14a-4(d) (1993). The SEC also amended the first sentence of paragraph (a) of Rule 14c-2. *Id.* § 240.14c-2(a). This amendment clarified previous changes to shareholder communication regulation implemented in January of 1992. *1992 Final Proxy Amendments, supra* note 21, at S-12. The 1992 revision conformed the proxy regulations with the Shareholder Communications Improvement Act of 1990. *Id.* at S-18 (citing the Exchange Act, Rel. No. 30147 and the Investment Company Act, Rel. No. 18467, 57 Fed. Reg. 1096 (1992)). Specifically, the pre-revision sentence of paragraph (a) of Rule 14c-2 was vague and could be interpreted to have extended information statement delivery requirements to "meetings of holders of unregistered securities where the registrant had registered a different class of securities under Section 12 of the Exchange Act." *Id.* This was not the intention of the revisions and Rule 14c-2(a) was amended to clearly indicate that the Rule only applies "to meetings of holders of a class of securities registered pursuant to section 12 of the Exchange Act or a class of securities issued by an investment company registered under the Investment Company Act of 1940." *Id.*

250. *1992 Final Proxy Amendments, supra* note 21, at S-16.

those selected from management[251] by requiring the insurgent to list those management nominees that will *not* be voted for with its proxy rather than the ones that will be voted for.[252]

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251. The SEC provided a sample proxy statement under the new rules. *Id.* at S-17 to S-18. This sample appears as follows:

PROXY
ABC Corporation
ANNUAL MEETING OF SHAREHOLDERS

This Proxy is Solicited by the Shareholder Committee to Revitalize ABC Corporation.

The undersigned hereby appoints Joseph Robert et al. as proxies and revokes any previous proxies with respect to the matters covered by this proxy.

ELECTION OF DIRECTORS:

1. *Shareholder Committee Nominees* — Election of Joseph Robert, Mary White, and Kevin Black

FOR all nominees [ ] WITHHOLD AUTHORITY for all nominees [ ]

Instruction: To withhold authority to vote for election of one or more persons nominated by the Shareholder Committee, mark FOR above and cross out name(s) of persons with respect to whom authority is withheld.

2. *Company Nominees*

The Shareholder Committee intends to use this proxy to vote for persons who have been nominated by ABC Corporation to serve as directors, other than the company nominees listed below. You may withhold authority to vote for one or more additional company nominees, by writing the name of the nominee(s) below. You Should refer to the proxy statement and form of proxy distributed by the Company for the names, background, qualifications and other information concerning the company's nominees.

There is no assurance that any of company's nominees will serve as directors if any of the Shareholder Committee's nominees are elected to the board.

Company nominees with respect to whom Shareholder Committee is NOT seeking authority to vote for and WILL NOT exercise any such authority:

Jane Doe, John Jones, Roger Roy

Write in below the names of any additional company nominees for which authority to vote is withheld:

____________________ ____________________

____________________ ____________________

Dated:____________________ ____________________

Signature

Id.

252. The original proposal by the SEC allowed the insurgents to list their nominees alongside of those management's nominees chosen to round out the slate. After an uproar by the corporate community, the SEC made this creative change to avoid confusing shareholders and lending the reputations of management's nominees to the dissident slate. *See, e.g.*, Letter from the Business Round-

Clear identification and separation of management nominees avoids shareholder confusion as to which nominees are management's and which are the insurgent's. Furthermore, clear separation avoids the misleading appearance that the insurgent's nominees have greater stature while allowing the insurgent to present a full slate of directors.

3. *Amendments to Forms 10-K, 10-Q & Schedule 14A: "Enhanced Disclosure Regarding Voting Results and Tabulation Policies"*[253]

Forms 10-K and 10-Q[254] were amended to require a description of matters voted on by shareholders during the proxy period.[255] Additionally, the amended forms are required to "state the number of votes cast for, against, or withheld, as well as the number of abstentions and broker non-votes as to each matter, including a separate tabulation with respect to each nominee for office."[256] This is intended to reinforce a movement started by institutional investors in the 1980s called "just vote no" campaigns.[257] Under these proposals, shareholders withhold their votes in uncontested election contests to show their dissatisfac-

table to the Securities and Exchange Commission (Aug. 28, 1992) (on file with the SEC) (urging that inclusion of a nationally prominent manager on a dissident slate, "despite the language on the card, [may mislead investors] into believing the insurgent's slate has greater luster than it in fact has").

253. *1992 Reproposal*, *supra* note 24, at 964.

254. These forms are required by the SEC to be filed periodically with the Commission by publicly traded companies registered under section 12 of the Securities and Exchange Act of 1934. *See* 17 C.F.R. § 249.310 (1991). Form 10-K is "designed to provide detailed information about the registrant's financial condition, business, and management." Waters, *supra* note 125, at 188. The two forms differ in the periods which they cover and must be filed, and the amount of information required to be reported. The Form 10-K is required to be filed annually while the Form 10-Q is filed quarterly. Richard W. Jennings et al., Securities Regulation 151-53 (1992). Since Form 10-Q is required to be filed with more frequency, the Commission's disclosure requirements for the 10-Q are less comprehensive than those regarding Form 10-K. *Id.*

255. *1992 Reproposal*, *supra* note 24, at 965. This amendment has remained virtually unchanged throughout the two proposals and the amended rules. *1992 Final Proxy Amendments*, *supra* note 21, at S-26.

256. 17 C.F.R. §§ 240.10K Item 4(c), 10Q Item 4(c) (1993).

257. Coined from the Nancy Reagan's "just say no [to drugs]" program. For an elaborate discussion of the costs and benefits of "just vote no" campaigns, *see generally* Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 Stan. L. Rev. 857 (1993). Professor Grundfest concludes that " 'just vote no' [campaigns] can responsibly prod boards to step up

tion with the present directors.[258] The new rules advance these proposals by requiring corporations to report the number of votes received and withheld for each nominee up for election.

The amended rules require reporting of information regarding the voting procedures. Increased disclosure was provided by amending Item 21 of Schedule 14A, the voting procedures. Under this new section, the registrant is required to report the following information: the vote required for approval or election; the method by which the votes were counted, except for auditor approval; and the effect of abstentions and broker nonvotes.[259] Disclosure will illustrate to the shareholder the effect of voting practices and avoid decisions influenced by creative voting procedures.[260]

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their oversight of corporate performance and can discourage well-managed firms from resting on their laurels." *Id.* at 937.

258. *See, e.g.*, Robert A.G. Monks, *To Change a Company, Change the Board*, WALL ST. J., Apr. 27, 1993, at A20 (stating he will withhold proxy authority on 132,000 shares of Westinghouse common for management's incumbent directoral nominees because of the board's "mismanagement"); *Chief of Activist Fund 'Frightens' PR Seminar*, P.R. SERVICES, July 1992, *available in* LEXIS, News Library, Arcnws File (noting that at the Champion International Corporation annual election "nearly 10 percent of the vote was withheld to show stockholder disapproval of the company's performance (Champion ranked 429 on the Standard & Poor's 500 in terms of stockholder return in the 1987-91 period)").

The mere threat of these campaigns by large institutional investors has resulted in concessions by management and directors. *See, e.g.*, Allison Leigh Cowan, *Kodak Chief Wins Support of Key Investor*, N.Y. TIMES, May 6, 1993, at D4 (reporting that after CalPERS impliedly threatened to engage in a "just vote no" campaign, management granted Dale Hanson, head of CalPERS, a meeting with management, after which he agreed to give Kodak's incumbents an opportunity to turn the company around).

259. 17 C.F.R. Schedule 14A, Item 21 (a)-(b) (1993). These various provisions regulating voting may be required under state corporate law, in the corporation's by-laws or the corporation's charter. The Commission's amendments only regulate disclosure and do not invade the jurisdiction of state corporate law. These amendments purport to codify current Commission interpretation of Schedule 14A under Item 21. *1992 Final Proxy Amendments, supra* note 21, at S-15.

260. This was enacted because a number of shareholder proposals were actually drawing more affirmative votes than negative votes, yet, nonetheless getting defeated because of the way management tabulated the votes. This result could occur because management often phrased the test for getting a shareholder proposal passed as needing "a majority of the shares present at the meeting." This means that shareholders who choose to abstain had their votes figured in the denominator, requiring a shareholder proposal to get a majority of the shares voting *and* abstaining to prevail. This may be contrary to the desires of an abstaining shareholder who believes his nonvote is neutral, neither helping nor hindering the proposal. The amendments are intended to remedy this situation by requiring the

4. *Disclosure in Election Contests*

The SEC also eliminated the requirement of filing Schedule 14b which obliged insurgents to list a very detailed background disclosure about the participants in the solicitation and which had to be filed before the commencement of the solicitation.[261] Eliminated with the Schedule 14b is advance warning to management that there will be an election contest. Furthermore, under Rule 14a-11 for election contests and Rule 14a-12 for other types of contested solicitations, solicitation can commence as long as information is filed simultaneously with publication or distribution to shareholders.[262] Once you have used that provision you have a current obligation to disseminate a proxy as soon as practicable.[263] Before any filing, a shareholder is allowed to alert other shareholders that this will be a contest year, and therefore, management's card should not merely be executed upon receipt, and that materials explaining the other side's position will be forwarded to them shortly.[264]

V. Evaluation

A. *Overview*

In amending the proxy rules, the SEC aspired to adequately balance freedom of communication with the rights of market participants to acquire accurate information about a corporation.[265] Many of the amended rules have achieved this goal by increasing shareholder suffrage, increasing monitoring

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corporation to disclose the effects that nonvotes have on the proposals. 17 C.F.R. § 14a-101 Items 21 (a)-(b) (1993). Furthermore, the effect of broker nonvotes must be disclosed to the shareholder. *Id.* Broker nonvotes are when broker held shares are present at the annual meeting, yet because the broker didn't receive timely instructions from their clients on how to vote the shares and since the broker lacks authority to vote the shares, the shares are not voted.

261. *1992 Final Proxy Amendments*, *supra* note 21, at S-10 n.43.

262. *Id.* at S-13.

263. *Id.* at S-10.

264. This communication is called a "stop, look and listen" letter. *See, e.g.*, Unicorp Financial Corp. v. First Union Real Estate Equity and Mortgage Investments, 515 F. Supp. 249, 255 (S.D. Ohio 1981). There is no content restriction in this type of communication; a shareholder may introduce their themes.

265. Barbara Franklin, *SEC Seeks Freer Speech; Shareholder Communications Proposal Debated*, N.Y. L.J., July 2, 1992, at 5. As one commentator stated, the real issue is whether or not "the SEC struck an appropriate balance between two valid objectives—freedom of communication, and provision of adequate infor-

of corporate management and influencing corporate success. However, an alarming trend has emerged. Institutional investors have garnered the newfound power of the proxy rules to directly intimidate management and have thus skirted the proxy rules. This institutional investor activity has decreased discourse to the entire market contrary to the SEC's intent in amending the proxy rules. The danger posed by this conduct is significant because the interests of large institutional investors, particularly pension funds, often differ from the interests of individual shareholders. Moreover, these risks are significant because this new technique is beyond the reach of existing regulatory barriers, specifically section 13(d) of the Exchange Act and Regulation 13DG. Furthermore, despite the new kinship between institutional investors and management, complete deregulation of oral solicitations presents a danger that the proxy solicitation procedure will be abused as a method of gaining control.

B. *Beneficial Amendments and Responsible Institutional Influence*

Many of the SEC's amendments further shareholder suffrage, remove unnecessary regulation, reduce proxy compliance costs and restore a balance between shareholders and management, achieving the desired goals of the review process. The proxy amendments which achieve these goals are those which eliminate pre-filing and prior SEC review, unbundle management's proposals, establish a Bona Fide Nominee Rule and enhance voting, reporting and tabulating. Before amendment, management could, and did, utilize the proxy machinery to stifle or substantially curtail shareholder democracy.[266] The old rules significantly favored management and via these amendments, the SEC has restored some balance to the proxy system.

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mation to the marketplace and other shareholders on things happening affecting the company." *Id.* (quoting R. Todd Lang, Partner at Weil, Gotshal & Manges).

266. For a discussion of how management presented proposals before the unbundling amendment to pass proposals otherwise unacceptable to shareholders, *see supra* text accompanying notes 237-40. For a discussion on how the proxy rules were utilized prior to the Bonafide Nominee Rule to defeat insurgents on a short slate, *see supra* text accompanying notes 245-48. Finally, for a discussion how management utilized the shareholder list rules to hamper insurgents, *see supra* notes 246, 260 and accompanying text.

Moreover, these amendments do not favor any group of shareholders nor empower any shareholder to influence management outside the proxy system. The changes are consistent with clear congressional intent that the rules should be neutral as between shareholders.[267]

Both the creation of a safe harbor, as well as various exceptions to the definition of a solicitation as applied to small shareholders,[268] achieve the beneficial goal of facilitating shareholder suffrage. Small shareholders and large shareholders must be distinguished. Communications with individual investors do not pose any significant dangers of market impropriety in proxy matters. The small investor, unlike an institutional investor, is typically only interested in protecting the value of his investment. Moreover, the small investor typically lacks the interest, time, or resources to significantly affect the market, as opposed to the potential impact of institutional investors. One of the only ways that small investors can affect the market is if they coordinate and agree to act in concert. If large enough, this activity will trigger disclosure under 13D of the Exchange Act. Thus, the amendments, as applied to small investors are not contrary to the preservation of market integrity, an important tenet of the federal securities laws.

Acting alone, however, large institutional investors often are not subject to the restraint of 13D. If institutional investors act responsibly and help to foster long-term growth, institutional activism could work hand in hand with these amendments.

It appears that institutional investors have responsibly assumed this new role as monitors of management. There are many reported instances of beneficial activity by institutional

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267. *See* Letter from Stephen Bainbridge to the Securities and Exchange Commission, (Aug. 28, 1992) (on file with the SEC) (citing *Stock Exchange Practices: Hearing Before the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 6673, 7710-14 (1933-34) ("what we had essentially in mind was putting every stockholder in a corporation . . . on an equal footing with every other, if such a stockholder desired to associate with him other stockholders for what purpose he has in mind, and making it thereby possible for every stockholder from whom a proxy is solicited to know definitely what the purpose was of the person soliciting the proxy")).

268. For the purposes of this rule, small shareholders are those owning less than either five percent of the outstanding shares or shares with a market value of one million dollars in a particular security.

investors in the market since the new proxy rules have taken effect. Under one such strategy, institutional investor organizations such as the Institutional Shareholders Services Inc. (ISSI) have targeted company performance, focusing on under-performing companies, in their activist efforts under the new proxy rules.[269] The President of ISSI proclaimed the continuity of the organization's 1993 focus on poorly performing companies.[270]

Similarly, the Council of Institutional Investors, a group of the largest public pension funds,[271] generated a target list of under-performing companies for activism in the 1994 proxy season.[272] Many funds have also adopted computer programs that identify poor performers in their portfolios.[273] Of great significance was the fact that TIAA-CREF, the world's largest pension fund, indicated that, it too, would be taking a similar activist stance in the future.[274] Its policy indicates that it would look for more independent directors, linkage between compensation and performance for executives, and require that directors own company stock.[275]

Many pension funds, including CalPERS, have decided to pursue investment strategies that use activism to improve underperforming companies.[276] CalPERS has its own ten most

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269. *Heard Says Poor Performers are Focus of Institutional Investors*, 25 Sec. Reg. & L. Rep. (BNA) No. 48, Dec. 17, 1993, at 1690.

270. *Id.* At the same time, the statement acknowledged that other institutions were still pursuing social causes such as animal testing and environmental concerns which had replaced more obsolete social concerns such as disinvestment in South Africa. *Id.* at 1690-91. *See also* Christine Phillips, *Social Activists Focus on the Environment*, PENSIONS AND INVESTMENTS, Apr. 5, 1993, at 16 (noting that in 1993 the number of shareholder resolutions on environmental matters surpassed the number of South Africa-related resolutions).

271. David A. Vise, *Turning the Proxy Into a Power Tool; Investors Use Clout Gained in SEC Rules*, WASH. POST, Mar. 10, 1993, at F1. The Council, only 8 years old, represents over $500 billion in assets. *See also* Anne Saker, *When These Investors Talk, CEOS, Companies Quake*, GANNETT NEWS SERVICE, Mar. 25, 1993, *available in* LEXIS, News Library, Arcnws File.

272. *Institutions Gear Up for the Proxy Season*, INSIGHTS, Nov. 1993, at 32 [hereinafter *Institutions Gear Up*].

273. Martin Dickson, *Crusaders In the Capitalist Cause*, FIN. TIMES, Mar. 17, 1993, at 17.

274. *Institutions Gear Up*, *supra* note 272, at 32.

275. *Id.*

276. Dickson, *supra* note 273, at 17.

wanted list of underperforming companies in its portfolio.[277] CalPERS placed these companies and their managements on notice of its dissatisfaction and sent twenty-two warning letters to companies dangerously close to falling below CalPERS expectations.[278] Other funds have incorporated similar programs in hopes of attracting fund money for this new relational investing.[279]

To the credit of the institutional investor, management is taking notice of institutional activity. Institutional activism has resulted in several high profile shake-ups and outright dismissal of the nation's top executives.[280] Among the fallen stars, were the CEOs of General Motors, Digital Equipment, Compaq, Goodyear, Hartmarx, Imcera, and Tenneco.[281] Moreover, the CEO's of IBM, Sears, and Westinghouse have all had to concede to various institutional demands to avoid dismissal.[282] One common concession by corporations was the separation of the CEO and Chairman of the Board positions. These positions were often held by the same person, a practice which effectively removed the board's ability to oversee management.[283] Likewise, CEOs of small and medium sized firms also felt the pres-

277. *Bigger They Are, Harder they Fall; '93 Tough Year for Executives*, PLAIN DEALER, Jan. 2, 1994, at 1E [hereinafter *Bigger They Are*].

278. *Id.* On the other hand, Professor Romano also reports that CalPERS, in 1992, decided to pursue investing over $375 million dollars into single family home construction after being influenced by the Governor to invest in California. *Id.*

279. *See, e.g.*, Mary C. Driscoll, *Loaded for Bear*, CFO, July 1993, at 27, 28-29 (reporting that Lens, Inc., a targeting investment fund, hopes to lead the trend away from fund indexing to relational investing by attracting "$1 billion from large pension funds that follow an index approach to equity investing").

In the same way that companies are being targeted, investors are being targeted by management as well. Management is looking for investors that will be stable and productive in their relations with the corporation. John Wilcox & Richard Wines, *Investor Targeting: A Quantitative Approach to Reaching Institutions*, INSIGHTS, May 1993, at 14.

280. Thomas Stewart, *The King is Dead*, FORTUNE, Jan. 11, 1993, at 34; *Bigger They Are*, *supra* note 277, at 1E.

281. Stewart, *supra* note 280, at 34.

282. *Id.*

283. *Id.*; L.M. Sixell, *Company Boards Grow Independent*, HOUSTON CHRON., Oct. 26, 1993, at 1. Other common proposals by shareholders are removal of golden parachute contracts, enactment of confidential voting, repealing of classified boards, creation of independent nominating board committees, increasing the number of outside directors, creation of compensation limits, and creation of shareholder advisory committees. INVESTOR RESPONSIBILITY RESEARCH CENTER, CORPORATE GOVERNANCE SERVICE VOTING RESULTS 1991-1992 at 3 (1994).

sures of institutional influence, some through dismissal and others through concession.[284] One commentator states that "'the CEO will look less like an emperor than like a Congressman, trying to represent his various constituents and, to the extent he succeeds, being reelected.'"[285]

The effect hasn't been lost on corporate boards, who are acting "like the B-school textbooks say they are supposed to. They asked management tough questions and stopped being rubber stamps . . . ."[286] Thus, the institutional investor is at the head of what many call a great "cultural change" in corporate governance.[287] The institutional investor is being characterized as the catalyst for performance in corporate America. The proxy rule amendments are credited with facilitating and legitimizing the efforts of institutional investors to effect change in corporate performance.[288] However, while corporate governance appears to have improved and institutional investors appear to be acting responsibly, alarming trends and regulatory gaps in the present proxy regulatory system have arisen.

C. *Dangerous Developments: Skirting the Proxy Rules—Institutional Investors v. Individual Investors*

The securities laws were founded and legitimized by the principle of shareholder democracy and the investor protection that shareholder democracy ensures.[289] These objectives are better achieved "by promoting free discussion, debate and learning among shareholders and interested persons, than by placing restraints on that process to ensure that management has the ability to address every point raised in the exchange of views."[290] However, the new proxy amendments often only in-

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284. *Bigger They Are*, *supra* note 277, at 1E.

285. Stewart, *supra* note 280, at 34 (quoting John Pound, professor at Harvard University's John F. Kennedy School of Government).

286. *Id.* at 34.

287. Vineeta Anand, *Executive Update, Corporate Governance*, INVESTOR'S BUS. DAILY, Jan. 25, 1993, at 4 (quoting Bernard S. Black, law professor at Columbia Law School).

288. *Bigger They Are*, *supra* note 277, at 1E; *see also*, Fran Hawthorne, *What the New SEC Rules Do for Activism*, INSTITUTIONAL INVESTOR, Apr. 1993, at 47-48; *infra* text accompanying notes 293-98.

289. J. I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).

290. *1992 Final Proxy Amendments*, *supra* note 21, at S-16 to S-17.

crease the voice of institutional shareholders at the expense of excluding the individual shareholder.[291]

Institutional investors are contributing a great deal to the discourse between themselves and management at the expense of disclosure. Disclosure to individual investors, the market and potential market participants has significantly decreased. The SEC's method for increasing discourse has resulted in greater control of information and disclosure by institutional investors. Management, by reacting and favoring the institutional investor, has helped to contribute to the prejudice and dilution of the individual investors' rights, discouraging their investment in the market.[292]

Recent activity has shown that institutions are not simply interested in adding to the stream of discourse, but rather have used their liberated power to intimidate management.[293] One commentator has called the new rules "irrelevant," concluding that the "real power of the rules is that they don't have to be used: Just the threat that big institutions will marshal forces has been enough to get managements to sit down with major shareholders to head off complaints."[294] Often the institutional influence occurs behind-the-scenes without media scrutiny or

291. The authors of this article do not argue that large institutional investors, owners of the corporate equity, should be divorced from their voting rights, however, neither should regulators turn a blind eye to their activities. As one commentator noted "[i]t is not simply a question of a stockholder's right to speak; he has always had this right. It is a question of stockholder's right to know what others are saying - and how they are trying to affect his investment." Letter from American Society of Corporate Secretaries, Inc. to the Securities and Exchange Commission 4 (Aug. 4, 1992) (on file with the SEC).

292. *Id. See also Editorial, Investors, Managers Must Co-Operate*, FIN. POST, May 29, 1993, at S1 (discussing recent heated debate concerning the rights of individual investors, institutional investors, and management). One commentator stated that "it is wrong to cast institutional investors as 'saints' and corporate management as 'sinners'. More informed and active shareholders can be beneficial to management. But a confrontational attitude can divert management's attention and embroil the investors too much in the affairs of the companies in which they hold equity." *Id.* Another stated " '[n]ow is the time for the shareholders and the institutions to be studied,' . . . [w]e know little or nothing about how these major investor types exercise their shareholding responsibilities. To whom are the financial institutions accountable?" *Id.*

293. Fran Hawthorne, *What the New SEC Rules Do for Activism*, INSTITUTIONAL INVESTOR, Apr. 1993, at 47.

294. *Id.* However, as one commentator posited " '[a]nyone who wants to use the power can use disproportionate leverage because others don't use the vote.' " Joel Chernoff, *Institutions Strengthen Grip on Companies*, PENSIONS AND INVEST-

individual investor awareness.[295] The amendments have simply given the institutional investor a tactical edge over management and individual investors.[296] Managers and institutions now prefer quiet negotiations instead of proxy contests.[297] As such, the institutional investor is more apt to influence or even dictate its wishes to management.

Thus, the institutional investor's views will only reach management in many instances, and individual investors will never realize their rights have been compromised. Nor will this discourse ever affect their decisions because they are shut out of back room discussions between management and institutions. Furthermore, the shareholders elected the directors to run the corporation; the shareholders never elected the institutional investor to manage their investment. Some view institutional investor board representation as the inevitable evolution of the responsible institutional investor, evidencing its true intention as a long term and active player in the success of the company.[298] Despite the institutional investor's possible conflicts of interests, the individual investor will still retain its right to delegate to the board, be aware of its actions under required disclosure and have state corporate law remedies available to hold managers and directors accountable.

D. *Significance of Institutional Favoritism: Conflicting Interests*

Favoritism and unequal treatment of institutions and individual investors have significant consequences for the equity markets. Participation of both the individual investor and the institutional investor are essential to the future growth and viability of our equity markets. Institutional investors, because of

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MENTS, Mar. 8, 1993, at 1 (quoting Carolyn Brancato, Executive Director of Columbia University Institutional Investor Project).

295. Vise, *supra* note 271, at F1; *see also* Richard W. Stevenson, *Large Foot in the Board-Room Door*, N.Y. TIMES, June 6, 1991, at D1 (noting that CalPERS often advances its interests with behind-the-scenes negotiations).

296. Dickson, *supra* note 273, at 17.

297. *Id.* at 17; *New Rules Empowering Shareholders Take Hold; Regulation: As the First Proxy Season Under SEC's Reforms Approaches, There's Plenty of Action in Corporate Boardrooms*, L.A. TIMES, January 2, 1993, at D2.

298. Judith H. Dobrzynski, *Relationship Investing: A New Shareholder Is Emerging — Patient and Involved*, BUS. WK., Mar. 15, 1993, at 68-69.

their size, may benefit our markets if they act as responsible monitors of management. Equally important is the individual investor who, though comprised of small investors, constitute forty-seven percent of the equity markets.[299] Individual investor protection and future participation maintains the U.S. market's depth and liquidity, one of the primary strengths of our markets. The market's liquid nature allows for greater economic growth because capital can easily shift to new ventures based on market preferences. Therefore, individual shareholder protection and continued confidence in our market, through a market as clear of misinformation and fraud as possible, is of paramount concern.

Due to their preference for the institutional investor, the current rules threaten our market. In order to understand the significance of the rules' preference, we must first analyze the parallel and conflicting interests of these two shareholder groups. Furthermore, special attention must be paid to certain political characteristics of the institutional investor and how the rules, to date, have enabled the institutional investor to act.[300]

Since institutional investors are highly diversified investors, their risks may not be aligned with the interests of smaller undiversified investors. Individual investors seek to maximize their return on investment. The institutional investor, too, is concerned with maximizing his return, but this is often a maximization in the aggregate, which is referred to as indexing. Institutional investors, through large holdings or indexed portfolios, have eliminated individual risk or unsystematic risk,[301] and only possess market risk.[302] In other words, indexed institutional investors not only own all of the companies in a

299. *See* Coffee, *supra* note 4, at 5.

300. Value judgments as to which group is a greater benefit to the markets are misplaced in the context of securities regulation. Of far more concern is whether the objectives of the institutions are or are not parallel with individual shareholders or even other institutions, not that the institution's objectives are correct or incorrect. The SEC was not established to encourage one form of investment or corporate strategy over another; its primary obligation is to ensure that anyone investing can make an informed decision. In the absence of regulation or by favoring one group of investors over another, information can be distorted or fraudulently conveyed in order to further these ulterior motives.

301. Unsystematic risk is "company specific risk . . . caused by things such as lawsuits, strikes, successful and unsuccessful marketing programs, winning and

particular industry, "they own all of the industries that constitute the business component of the national economy."[303] Due to their large holdings, institutions make decisions on a much larger scale, which may be divergent from a decision based on the success of an individual company.[304]

In considering the consequences of any act, institutions, which are not concerned with systematic risks, may support an action adverse to other shareholders. For example, " '[t]he bankruptcy of an airline, for example, might be a disaster for its employees and managers who lose jobs, but a matter of indifference to its investors who own shares in other airline companies that obtain the bankrupt company's routes.' "[305] Therefore, in allowing diversified institutional investors to govern a corporation, they are permitted the gains, while the downside risk of unsuccessful business policies will be borne by the corporation's other shareholders. Those bearing the risk will be the undiversified, typically smaller shareholders and employees. In this respect, the shareholder communication deregulation is similar to the Savings & Loan deregulation: the diversified institutional investor is allowed to gamble with other people's money and jobs. They enjoy the benefits of higher return from investor induced assumption of debt, yet don't share the costs or potential bankruptcy, due to diversification.[306]

Institutional investors often operate under the political interests of their constituencies, which may significantly diverge from those of the individual investor. This type of policy is termed "social investing,"[307] because decisions are controlled or affected by a wide variety of individuals, who may pressure the

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losing major contracts, and other events that are unique to a particular firm." WESTON & BRIGHAM, *supra* note 120, at 191.

302. Market risk "on the other hand, stems from factors which affect all firms simultaneously, such as a war, inflation, recessions, and high interest rates." *Id.*

303. MONKS & MINOW, *supra* note 14, at 261.

304. While this group is represented as the minority due to the difficulty in representing a single voice, they consist of approximately 47% of the equity markets. *See* Coffee, *supra* note 4, at 5.

305. Donald Margotta, *The Separation of Ownership and Responsibility in the Modern Corporation*, BUS. HORIZONS, Jan./Feb. 1989, at 76 (quoting Daniel Fischel, BUS. LAWYER, August 1985, at 1442).

306. Letter from Donald G. Margotta, Professor, Northeastern University, to the Securities and Exchange Commission (Aug. 21, 1992) (on file with the SEC).

307. MONKS & MINOW, *supra* note 14, at 221.

institution to invest in securities for benefits unrelated to their direct investment. Social investment can be summarized as investment decisions based not on traditional concerns of "minimizing risk and maximizing return," but on a basis ancillary or unrelated to traditional financial concerns.[308] The justification for social investment comes from a desire to maximize other "intangibles" that benefit either beneficiaries or the common good.[309]

Political interests have run a broad spectrum, depending upon the institutions' constituencies. For example, corporate pension funds often make decisions based on the interests of the corporation that funds it or the corporation's employees rather than maximizing the return of the securities they own.[310] Corporations are required to contribute to their employee's pension plans and thus the continued economic health of the fund is "inextricably linked to the health of its corporate sponsor."[311] Analogously, trade unions, through their members' pension funds, have exerted influence to further labor interests.[312] The new proxy regulations will give all trade unions greater share-

308. MONKS & MINOW, *supra* note 14, at 221-22. Sponsoring investments based upon political views rather than economic concerns is also considered social investing. *Id.* The converse of investing, divestment, in "otherwise investment worthy" companies that promote an ideal politically or morally adverse to the parties concerned is also considered "social investing." *Id.* An excellent example of this form of social investing is divestment from corporations conducting business with South Africa. This divestiture is based upon political disagreement, not upon traditional notions of valuation such as financial risk or profit maximization.

309. *Id.*

310. TWENTIETH CENTURY FUND, ABUSE ON WALL STREET: CONFLICTS OF INTEREST IN THE SECURITIES MARKETS 579 (1980) (report to the Twentieth Century Fund Steering Committee on Conflicts of Interest in the Securities Markets) [hereinafter TWENTIETH CENTURY FUND].

311. THE BATTLE FOR CORPORATE CONTROL, *supra* note 18, at 75 n.8. Subsequent to the junk bond market crash, corporate pension funds were in jeopardy of being underfunded. In the 1980s, corporate fund managers who believed they were making solid investments did a disservice to their funds' constituents, the corporations' employees. During this epoch, pension fund investors, desirous of a high yield investment, purchased junk bonds. The funds' investments, due to their large aggregate size, stabilized the junk bond markets, thus preserving these instruments for corporate raiders, who, with little or no capital up front took over corporations. The new owners often "busted-up" or sold off profitable assets of the corporation. Hence, the employee's invested retirement funds were essentially utilized to eliminate their jobs.

312. TWENTIETH CENTURY FUND, *supra* note 310, at 337.

holder influence to further union interests, potentially contrary to the interests of the individual investor.

Perhaps the most striking conflicts are the potential and realized conflicts of interest involving the public pension funds. Public pensions are subject to influences directed at their managers: government officials. Public pension funds are vulnerable to this type of activity because they are not subject to the fiduciary restrictions that private funds endure under ERISA.[313] Since state and local governments often serve as sounding boards for special interests groups, public pension plans are almost guaranteed to be entrenched in decisions affected by politics. For example, a public pension may invest in otherwise risky or undesirable investments that promote social welfare, such as investment in city municipal bonds.[314] Governments can exert a great deal of power through state controlled pension plans to effectuate their own interests, often different than the interests of other shareholders and management.

Professor Roberta Romano catalogues several instances of failed corporate policy that resulted from political meddling in corporate affairs. These examples demonstrate in whose benefit the state pension funds often act and the potential of these acts to be in direct contradiction with the goals of other shareholders. In one example, the State of Pennsylvania influenced the Pennsylvania Public School Employees and State Employees Retirement Fund into contributing to the financing of an in-state Volkswagen plant.[315] The plant was a failure and the investment suffered.[316] The Volkswagen plant closed in 1988 and it took the state four years to place Sony in the plant, at a cost of forgiving $40 million of the original loan, and providing more state subsidized financing and job training grants.[317] Pennsylvania's past history as a staunch supporter of stakeholder rights,[318] especially where the stakeholder is an employee, only portends further activism in activities that should only focus on

313. Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 800-01 (1993).

314. TWENTIETH CENTURY FUND, *supra* note 310, at 283-84.

315. Romano, *supra* note 313, at 803-04.

316. *Id.*

317. *Id.*

318. Stakeholders are the proper recipients of the returns or investment capital in the pension fund.

business interests. Such interests include pursuing the best investment possible or focusing on the long term growth of the company.

In one instance, a pension fund financed a large portion of a leveraged buy-out of a local corporation in order to preserve state jobs.[319] The fund's $25 million dollar investment progressed from being a short term "bridge loan," to a long term equity investment and, finally, to the precarious position of debt after the company filed for bankruptcy.[320] Another fund targeted investments in local business, including local steel mills and savings and loans, both of which failed.[321] Furthermore, many funds practice an investment policy that involves purchasing privately insured mortgage-backed, pass-through securities that increase the access of local housing markets to capital.[322] In the instances provided by Professor Romano, the investments were riskier than the prevailing market norm yet produced less return.[323]

In many states, the mandates to pursue policies that benefit the home state are enshrined by state statute.[324] A serious problem arises under these state policies: investment activity that can only increase the value of a fund's portfolio, such as diversification, are avoided. This occurred in Minnesota in 1988 when organized labor protested and blocked a movement to begin pension fund investment in international markets.[325]

The Clinton Administration has issued a cautious statement concerning the use of pension funds to further politically inspired ventures. On March 26, 1993, The Secretary of Labor, Robert Reich, promoted the use of pension fund investments in the nation's infrastructure only if the investments did not "sac-

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319. Romano, *supra* note 313, at 805.

320. *Id.* (discussing the investment activities of the Connecticut Pension Fund).

321. *Id.* (discussing the investment activities of the Kansas Pension Fund).

322. *Id.* (citing Public Employee Pension Plans: Joint Hearing Before the Subcomm. on Oversight of the House Ways and Means Comm. and the Subcomm. on Labor-Management Relations of the House Comm. on Education and Labor, 98 Cong., 1st Sess. 68 (1983)).

323. Romano, *supra* note 313, at 805.

324. *Id.* at 808-09.

325. *Id.* at 806.

rifice financial returns."[326] He stressed that placing the health of any of the public pension funds in jeopardy was contrary to sound public policy.[327] He also stated that a bi-partisan commission's recommendation to create a government sponsored corporation to rally pension fund investment in the infrastructure was still under review by the administration.[328] The full position of the administration on this issue is unknown, but it is quite obvious that the Secretary of Labor's announcement did not view social investing which resulted in high risk and low returns as a sound investment policy.

The new focus on good business versus good politics, which mirrors a view towards long term investment and governance activity by institutional investors, may be the herald of a new age for responsibility among institutional investors. But is the new focus on good business a political move for power on the part of the institutional investor? Or perhaps it is simply the result of the wave of ire brought on by abuses by management in the recent past, abuses in which the institutions played a great role. Like any trend, this new focus will soon be forgotten by the more opportunist of the institutional investors, who will manipulate institutional funds for the sake of special interests and hidden agendas. The question of whether or not it is proper to pursue political agendas does not even need to be answered. After all, as the CEO of CalPERS stated, the impetus behind a pension fund's investment strategy is that the strategy matches the fund's payout schedules.[329] There should be no misconception as to the ultimate loyalty of a pension fund, it is to itself. There is nothing improper about this fact, until we entrust other people's interests and investments to the institutional investor without allowing for an environment of complete disclosure. Is it prudent to allow the successes of the many responsible funds to distract us from the indiscretions of those who might do great damage to the integrity of our market and economy?

326. *Reich Says Pension Funds Should Not Sacrifice Return for Public Benefits*, Pensions & Benefits Daily (BNA) 699 (Mar. 29, 1993).

327. *Id.*

328. *Id.*

329. Dobrzynski, *supra* note 298, at 68-69.

E. *Unregulated Oral Communications: Dangers of Abuse and a Cost Effective Remedy.*

In the first year of the new SEC proxy rules a great deal of institutional activism has been beneficial. However, "good intentions don't control power; only power does,"[330] and through the amended proxy rules the Commission may have given insurgent shareholders more power than corporate management in proxy contests without concomitant responsibility.[331] It seems that in the excitement over the new accountability for management and the shift in power from management to the institutional investor, few are questioning the new power that the institutional investor holds. In order for the recent amendments to be successful, institutional investors will have to act in a responsible and prudent manner since certain conduct will go unregulated. In light of institutional investor participation in the misdealing of the '80s[332] and the political influences that pervade the institutional investor, such a delegation or assumption that institutions will always act responsibly, absent regulation, may be misplaced.[333]

The new proxy contest rules provide institutional investors an advantage in the means for corporate acquisition in the 1990's.

Institutional investors, without any fear of violating proxy rules, are able and capable of disseminating any information they please, through oral communications, concerning corporate boards and management practices, including inaccurate or fraudulent assertions. This new environment has the potential to attract corporate raiders, foster tender offers, revitalize debt financing, generate huge transactional fees, and renew collusive

330. *Debate, Can Pension Funds Lead the Ownership Revolution?*, HARV. BUS. REV., May-June 1991, at 166, 168.

331. Playing favorites between incumbent management and insurgent shareholders is contrary to clear congressional intent that the proxy rules are to be neutral. *See, e.g.*, S. 550, 90th Cong., 1st Sess. § 3 (1967) (stating the intent of an analogous legislative act, the Williams Act, is to "avoid tipping the balance of regulation in favor of management or in favor of the person making the takeover bid").

332. *See* Letter from Thomson, Hine and Flory, to the Securities and Exchange Commission (Aug. 21, 1992) (entitled "The Commission's Perspective: Playing The Wrong Favorites") (on file with the SEC). Many of the institutional investors were major players involved in the improprieties in the boom market of the 1980s. *Id.*

333. *Id.*

behavior similar to that occurring in the last decade.[334] Even if the problems of the 1980s do not resurface, the conflicting interests that guide a market controlled by one block or coalition of votes without any regulation will certainly affect both the integrity of the market as a whole and the interests of individual investors.

Current proxy legislation, a reaction to those excesses, should not play favorites with these investors nor should they remove regulation regarding their actions in contests for control.[335] As one commentator stated:

> [the] suggested solution [to corporate inefficiency, self dealing, and stagnation] is essentially to get institutional [investors] more involved in the companies that they invest in. They will solve the problem by adopting long-run investment goals. But in my opinion, institutional [investors] are the problem, and they are not likely to be the solution.[336]

There are a multitude of short-run maneuvers that institutional investors can engage in without selling their investments. Any transaction that converts its equity into a new form at the expense of other shareholders qualifies as such a maneuver.

For example, if a corporate raider launched a proxy contest to seize control of the board of directors, suggesting a wholesale liquidation, an institutional investor, desirous of the short-profits, could solicit other institutional shareholders to vote for the insurgent's slate.[337] The institutional investor could make unlimited oral statements, advance arguments about the corpora-

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334. While the number of tenders has significantly decreased in the past five years, the nature of the market is cyclical. Proxy contests were primary sources of gaining corporate control in the late '60s and '70s and now twenty years later, in an admittedly different form, they have returned to prominence in the market for corporate control. Similarly, the methods utilized in the '80s, while presently rare, will at some later date, or in some recycled form, return.

335. Letter from Thomson, Hine and Flory, *supra* note 332.

336. THE BATTLE FOR CORPORATE CONTROL, *supra* note 18, at 81.

337. Letter from The Business Roundtable to the Securities and Exchange Commission (Aug. 28, 1992) (on file with the SEC). The Business Roundtable provides another example in its comment letter. This example is as follows:

> Institutional Investor A solicits other institutional investors to vote against a management proposal (e.g., the sale of a division or adoption of corporate governance changes), calling and personally visiting fellow investors to urge them to vote against the proposal. No agreement or other orchestrated action is suggested. Other shareholders would not know of this effort and

tion's value, the insurgent's slate, or current management, as long as the statements are not fraudulent, without any public disclosure or SEC review.[338] The transpiration of these events without any opportunity for management response would give the insurgents a tremendous advantage. As one commentator noted, "the ball game could be over, as a practical matter, before anyone else even knew there was to be a contest."[339]

To remedy this dilemma the SEC should require disclosure of exempted solicitations in control contests or contested election. Investors would not have to send materials to any other shareholder or management; public filing would suffice. This will place management on notice and allow management to respond to or rebut the content of the communication resulting in an increasing shareholder discourse and shareholder democracy. Furthermore, this remedy would be consistent with the historical application of the federal securities laws by applying the law on the basis of substance rather than upon an actor's identity.[340] This remedy is also consistent with the congressional intent of ensuring that all material necessary for in-

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> management would not have an opportunity to respond or explain its proposal further.

Id.

338. *Id.* Similarly, "it would be perfectly permissible for a corporate raider planning to launch a proxy contest for control of a target company's board to phone or meet personally with large, powerful institutional investors and solicit their support for his effort without disclosing his activities until much later when he actually sent out proxy cards." *Secret Communications Loophole Attacked by Roundtable*, PR Newswire Association, Inc., Oct. 16, 1992, *available in* LEXIS, News Library, Arcnws File (quoting H. Brewster Atwater, Co-chairman, Business Roundtable Corporate Task Force).

339. *Id.*

340. Under the amended rules, the SEC's exemption from solicitation allows a person's status to become the basis for exemption. Almost everyone connected with the registrant, from associates to officers, cannot rely upon the exemption, while those that can utilize the exemption consist mostly of "institutional shareholders, proxy voting advisors and shareholder organizations." Letter from John F. Olsen, Chair, Federal Regulation of Securities Committee, American Bar Association, to the Securities and Exchange Commission (Aug. 16, 1992) (on file with the SEC). The American Bar Association further posits that the correct way to remedy a structure bias in the proxy rules towards management is to create exemptions based on the information, not the actor. *Id.*

formed shareholder suffrage be available for every equity security bought on a public exchange.[341]

F. *The Sufficiency and Insufficiency of Other Regulatory Barriers*

Even if an institutional investor can take advantage of the new exemption from the definition of solicitation and thus escape liability under Rule 14a-9, it is still subject to liability under section 13d of the Exchange Act and Regulation 13D-G.[342] The mere threat of litigation or even filing a 13D under these sections involves substantial litigation risks. One commentator notes that "[p]roponents are commonly sued by the SEC or the company's managers for various real or imagined misdisclosure."[343] Due to these risks, actual or perceived, the SEC envisioned that this regulation would provide protection to discourage unreported combinations of institutional investor voting power and collusive conduct.[344]

The dangers under this section are twofold. First, under 13D, any group of shareholders that collectively owns more than five percent of a corporation's voting stock incurs a filing obligation if they agree to vote in a particular manner.[345] Under Rule 13D, two or more persons form a "group" when they agree to act together for the purpose of voting securities. An agreement can be proven by circumstantial evidence and parallel conduct by a group of shareholders.[346] Then, once an agreement

341. *See, e.g.*, J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964) (stating "[t]he purpose of the proxy rules is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation"); H.R. Rep. No. 1383, 73d Cong., 2d Sess. 13 (1934) (acknowledging that "fair corporate suffrage is an important right that should attach to every security bought on a public exchange").

342. Catherine T. Dixon, *The Post Proxy Reform Era: Remaining Pitfalls for the Unwary Activist Shareholder*, CORP. GOVERNANCE ADVISOR, Oct./Nov. 1993, at 12.

343. Bernard S. Black, *Beyond Proxy Reform*, INSIGHTS, Mar., 1993, at 2, 3.

344. *1992 Final Proxy Amendments*, *supra* note 21, at S-4 n.26.

345. *See* 15 U.S.C § 78m(d)(1) (1988 & Supp. V 1994) (requiring "beneficial owners" of 5% to file); 17 C.F.R. § 240.13d-3(a) (1993) (defining beneficial owner).

346. SEC v. Savoy Indus., 587 F.2d 1149, 1162 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). The breadth of this section and managements' utilization of these rules can be demonstrated by a recent example at General Motors Corporation (GM). The New York State and Local Retirement Systems and CalPERS independently wrote and urged that various candidates be considered by the GM board

is proven, the group is attributed with beneficial ownership of all the shares of its members at the time of the agreement and all members incur a filing obligation.[347] The rules' broad and uncertain application presents significant deterrents to risk averse shareholders who wish to form voting coalitions.[348]

Secondly, an institutional investor who is already a 13G filer[349] incurs another risk when becoming actively involved in corporate governance. Under 13(d) an owner in excess of five percent of a corporate security must file a Schedule 13D. However, certain institutional investors who acquire "in the ordinary course of his business and not for the purpose nor with the effect of changing or influencing the control of the issuer . . ." and are required to file under 13(d) may file a Schedule 13G, a shorter and less frequently filed form.[350] Therefore, if an insti-

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and that they be consulted when management formatted new policies. GM threatened to seek disciplinary action from the SEC. Colleen D. Ball, Comment, *Regulation 14A and 13D: Impediments to Pension Fund Participation in Corporate Governance*, 1991 WIS. L. REV. 175, 180 (citing a telephone interview with Richard Koppes, general counsel for CalPERS Aug. 16, 1990).

347. 17 C.F.R. § 240.13d-5(b)(1) (1993). *See* Wellman v. Dickinson, 682 F.2d 355, 363 (2d Cir. 1982) (stating that "the touchstone of a group within the meaning of section 13(d) is that the members combined in furtherance of a common objective").

348. One commentator has noted that "[t]o date, neither the Commission nor its staff has been willing to address in detail the myriad of issues surrounding loss of Schedule 13G filing status and Section 13(d) group formation generated by greater institutional involvement in [corporate] governance issues." Dixon, *supra* note 342, at 14. For example, a question arises under Rule 13(d) as to what type of involvement in corporate governance is in the "ordinary course of business" for the institutional investor. Is this a static or organic concept?

349. There are only specified institutional investors who are permitted to file a 13G. These institutions are: brokers and dealers registered under section 15 of the Exchange Act; banks defined in section 3(a)(6) of the Exchange Act; insurance companies defined in section 3(a)(19) of the Exchange Act; investment companies registered under section 8 of the Investment Company Act; investment advisors registered under section 203 of the Investment Advisors Act of 1940; and employee benefit plans or pension funds subject to the provisions of ERISA. 17 C.F.R. § 240.13d-1(b)(1)(ii) (1993).

350. 17 C.F.R. § 13d-1.[Reg DG](b)(1)(i) (1993). Most institutional investors file the 13G because under Regulation 13D-G, institutions who in the ordinary course of business and with a passive intent acquire in excess of five percent of a security are required to file either a 13G or a 13D. *Id.* Since the 13G is the shorter form and requires less frequent filing, most institutional investors who are required to file, and allowed to file a 13G, do so. *Id.* However, due to the trend towards active investing by institutional investors, the Schedule 13D requirements may replace Schedule 13G requirements. *Cf.* Letter from Arthur S. Loring,

tutional investor's involvement in corporate governance is so extensive, acting alone or in a group, that their passive investment intent is deemed to have changed, they will be required to file a 13G.[351] This is a significant risk because their intent will be judged in hindsight after the violation has taken place.[352] Furthermore, if the institutional investor is deemed a member of a group with members who do not qualify for or lose their 13G status, the institutional investor will also lose 13G filing status, even without an intent to effect control.

Another significant deterrent to an institutional investor consortium is controlling person liability under the Securities Act and the Exchange Act. Many sections under these Acts incorporate the concept of controlling person liability, such as, determining who is required to file a registration statement, who is disclosed in a tender offer.[353] Under these sections a controlling person is subject to civil liability for the companies' securities violations.[354] Since the courts have applied an expansive and fact-specific definition of "control persons," this also represents a major obstacle to concerted institutional activity.[355]

These deterrents prevent any significant concerted institutional involvement without adequate disclosure to the market and management, a result consistent with the purpose of the federal securities laws and the health of the securities markets.[356] If a group holding comprising an excess of fifty percent

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Vice President, Fidelity Management & Research Co. to the Securities and Exchange Commission (Aug. 31, 1992) (on file with the SEC).

351. *See* C.F.R. § 240.13d-1(b)(1)(i) (1993). Moreover, investors must beware because if their investment intent changes 10 days prior to the meeting they will not be able to vote their proxies at that meeting. *Id.* § 240.13d-1(b)(3)(ii).

352. Moreover, a violation of section 13d could cause an investor to lose his 14a-2 exemption, therefore resulting in two causes of action, one under section 13d and another under section 14a. 17 C.F.R. § 240.14a-2(b)(vi) (1993).

353. *See generally* 4 LOSS & SELIGMAN, *supra* note 17, at 1691-1703 (detailing all the statutory sections in which control person liability concepts apply under the federal securities laws).

354. Black, *supra* note 343, at 4.

355. *Id.*

356. These were precisely management's fears. As one commentator noted: "[w]ith large amounts of stock currently held by institutional and other professional holders, corporate insiders no doubt fear that shareholder voting blocks will form as a result of "back-room" deal-making and that institutional leverage, already substantial but often fragmented, will become all but monolithic." Norman Feit, *SEC Proxy Reform: Boon for Free Expression or Back Room Deals? Controver-*

of the market could form agreements as to major corporate directives, initiatives or issues behind closed doors, without management or shareholder notice, there would be entirely no need to utilize many of the amended proxy rules. Taken to an extreme this may well result in a "politicized economy."

Under a "politicized economy" corporate decisions would no longer be left to the market but rather to the hands of coalitions of large institutional investors, similar to German and Japanese markets.[357] Accordingly, hastened by a number of markets competing for capital, our stock market would soon resemble those in Germany and Japan, highly static, stable market yet less attractive and deep.[358] Moving to convert the U.S. market in this direction was "flatly rejected" by the Subcommittee on Corporate Governance and Financial Markets of the Competitiveness Policy Council, a nonpartisan group organized under President Bush's authority.[359] Section 13(d) is a significant protection from this danger and should remain in place.[360]

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sial Changes Mean Significant Changes for Public Corporations, N.Y. L.J., Oct. 13, 1992, at 11.

357. *See supra* notes 5-6 and accompanying text.

358. *See supra* notes 5-6 and accompanying text.

359. Dan Cordtz, *Corporate Hangmen*, FIN. WORLD, Mar. 30, 1993, at 24. The proposed plan of action has come to be known as "relationship investing," which would only adopt the good aspects of the overseas systems and is seen as a cure for short term investing. Dobrzynski, *supra* note 298, at 68; *see also* Joel Chernoff & Marlene G. Star, *Three Studies Support Relationship Investing*, PENSIONS AND INVESTMENTS, Jan. 11, 1993, at 3. *But see* John Wilcox, *Relational Investing: Can it Really Work?*, N.Y. L.J., May 6, 1993, at 5. The result of relationship investing is that a group of "enlightened investors . . . give companies patient capital . . . [and] free management to focus on the long term. Over time, that should lift profits, productivity, and prospects. And that would boost U.S. competitiveness." Dobrzynski, *supra* note 298, at 68-69. The Council included the following important admonition: "[a]s the focus shifts to the performance of the corporations, the spotlight must also be directed on the management of the activist institutions." Cordtz, *supra*, at 26.

360. Various scholars have urged the removal or significant relaxation of section 13(d) because of its significant chilling effect on shareholder communication. *See, e.g.*, Black, *supra* note 343, at 2; Bernard S. Black, *Next Steps in Corporate Governance Reform: 13(d) Rules and Control Person Liability*, *in* MODERNIZING U.S. SECURITIES REGULATION: ECONOMICS AND LEGAL PERSPECTIVES 197 (Kenneth Lehn & Robert Kamphius eds., 1992); *see also* Ball, *supra* note 346, at 201.

Individual investors, often minority investors, receive limited protection from these sort of activities under other sources of law. For example, under Delaware state law, minority shareholders are only owed a fiduciary duty by majority shareholders in a sale of corporate assets or merger transactions. Allied Chem. & Dye Corp. v. Steel Tube Co. of Am., 120 A. 486, 491 (Del. Ch. 1923). In these transac-

However, there are other dangers that are not caught in the Section 13(d) regulatory net. The myriad of solicitations regarding shareholder proposals, board nominees, and performance evaluations by institutional investors will go unregulated. As one commentator noted, "[a]s a practical matter, in many cases a shareholder will be able to communicate his or her views and influence the voting of other shareholders without triggering or otherwise affecting Schedule 13D or 13G reporting obligations."[361] Nor do these rules prevent the problems discussed *inter alia* pertaining to institutional investors acting unilaterally in behind-the-scenes negotiations with management.[362]

VI. Conclusion

Corporate management in the United States has been criticized as inefficient and abusive. It has been accused of blocking takeovers as well as any restraint on its powers, motivated by the selfish desire to entrench itself in the corporation at the expense of shareholder interests and the health of the corporation. Further accusations of management misbehavior include paying itself high salaries or repurchasing the corporation with corporate funds or power accumulated though the denial of dividends or at the expense of some other shareholder interest. Securities laws, in particular the proxy regulations, have their genesis in efforts to protect the integrity of the market and

tions there is great deference to majority shareholders. In Smith v. Good Music Station, 129 A.2d 242, 247 (Del. Ch. 1957), the Delaware Chancery Court concluded "that even though a director-officer who owned half the corporation's stock received a lucrative side contract, he would still be 'somewhat restrained from "short-changing" himself' as a stockholder in negotiating an asset sale." 2 ERNEST L. FOLK III ET AL., FOLK ON DELAWARE GENERAL CORPORATE LAW § 271.6.2.3 (2d ed. 1990) (quoting *Good Music Station*, 129 A.2d 242, 247 (Del. Ch. 1957)). Minorities are also entitled to an appraisal but that is only available to stockholders forced from their equity positions in certain mergers and consolidations. *See* J. E. Calio, *New Appraisals of Old Problems, Reflections on Delaware Appraisal Proceedings*, 34 AM. BUS. L.J. 1 (1994) (criticizing the efficacy of this remedy). Therefore, unless removed from their ownership interests as the result of a proxy contest or election is this remedy effective. A minority shareholder could also file a derivative suit to enjoin the action, however, these suits are cost prohibitive and present procedural difficulties.

361. Robert Lang & David Lefkowitz, *The Shareholder Communications Rules—Implications for Shareholders and Management*, INSIGHTS, Dec. 1992, at 3.

362. *See supra* part V.C.

shareholder interests from these problems. Management's position projects itself as an easy target for criticism and suspicion, through its power as the day-to-day operator of the corporation, and as the architect of corporate policy, with its superior information about the corporation and access to corporate funds.

This imbalance of power and potential for abuse has prompted the law to develop safeguards to prevent management overreaching. Various duties and obligations are set forth by both state and federal law. Our system of corporate governance provides that directors monitor management. Shareholders can affect corporate decisions through their exercise of voter suffrage under the proxy system. These precautions are warranted. The imbalance of power between management and shareholders, however, is necessary to allow management the flexibility to effectively operate the corporation; the importance of the investment capital that management is assigned to protect necessitates a regime that regulates management conduct.

A controlling shareholder, such as a group of institutional investors, can be as equally offensive and incompetent to a free and informed market as management. A controlling shareholder can influence decisions to increase its equity in a merger at the expense of others. It can also utilize the corporation's assets to further its own means. Through its influence a controlling shareholder can compel the corporation to buy its own goods or stock or provide services below competitive market prices. Furthermore, it can influence the corporation to engage in transactions that dilute the value of the corporation but not its own interests, as can result in "greenmail." Significantly, a controlling shareholder can be as equally, if not more, inept as management in operating a corporation. In essence, it can use the corporation's assets to fulfill its own needs, which often may not coincide with other investors' needs, particularly those of an individual investor.

The main distinction between management and a controlling shareholder is that the law provides many constraints on management's actions. The same can not now be said for the controlling shareholder, especially if 13D is enforced leniently or removed completely from the regulatory scheme as some have argued should be done. The law extends no duties or obligations between the controlling shareholder and other share-

holders. Quite simply, the controlling shareholder has all the power and potential for abuse we fear in management and none of the accountability.

Often in the amendments the SEC delegates its regulatory power to the free and open discourse that may be the result of its new and less restrictive proxy regulations. However, this power has been delegated to the parties involved in the transactions. The SEC believes, perhaps erroneously, that a party to a transaction can or will assume its role as neutral umpire. The SEC's final revisions of the proxy regulation may have achieved a laudatory goal in repairing the proxy machinery. Many of the enacted proposals will increase the ability of shareholders to engage in free and open discourse to the benefit of corporate health. The regulations have arguably taken away many impediments to participation by shareholders in corporate governance through the proxy process. At the same time, they have also removed the only significant impediment to market manipulation by controlling shareholders. The amendments are virtually silent in regard to protection from this unwanted possibility. The SEC's Commentary in support and explanation of the amendments simply dismisses the potential problems without addressing them and did not foresee the "back-room" lobbying that has occurred between management and institutional investors. Originally, not even the critics of the amendments foresaw this development, instead warning of secret collusion among investors. However, more alarming and in direct contrast to the laudatory intentions of the amendments is this new activity which amounts to circumvention of the proxy system and individual investor suffrage by management and the institutional investor.

The SEC has the affirmative obligation to ensure that market integrity is never compromised with the taint of inaccurate or fraudulent information. At the same time a stagnant market in which the participants are silenced into compliance with the status quo is equally undesirable and contrary to the ideals the Commission is obligated to protect. In efforts to remedy the latter the Commission may have failed in the prevention of the former.