NEWS

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REMARKS TO
EDISON ELECTRIC INSTITUTE
SEMINAR
ON
CURRENT SEC DEVELOPMENTS
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SHAREHOLDER PROPOSAL RULE

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THE VIEWS EXPRESSED HEREIN ARE THOSE OF COMMISSIONER TREADWAY AND DO NOT NECESSARILY REPRESENT THOSE OF THE COMMISSION, OTHER COMMISSIONERS, OR THE STAFF.

Good morning. It's a pleasure to appear before an organization that fulfills such a fundamental role in the American economy. America's electric utilities are essential suppliers to both industry and the general public. The health and vitality of the electric power industry is a vital concern to all.

Because of that concern and their important social and economic role, electric power utilities probably receive more proposals from shareholders than any other single group. So I want to talk briefly about the status of our proposed amendments to Rule 14a-8, the shareholder proposal rule.

Before I go any further, perhaps I should pass out blood pressure pills as a precaution. Of all the topics under the Commission's jurisdiction, this is the one which seems to raise people's blood pressure the most. The intensity of emotion and outrage, as well as the volume of both scholarly and emotional writing on this topic, still mystifies me. Our request for comments on Rule 14a-8 has provoked a heated response from all quarters. We received more than 400 comment letters; that's about two feet of comments. Many comments were emotional, but they generally were thoughtful and constructive.

Let's start by stepping back for a moment and looking at two things: (1) some statistics; and (2) the Commission's involvement in this process.

For the year ended June, 1982, 973 shareholder proposals were submitted to 358 of approximately 9,000 public companies. 96 percent of all public companies didn't receive a single proposal. Forty-three companies received five or more proposals, accounting for approximately 350 of the 970 proposals. Almost half of all stockholders proposals submitted were either withdrawn or accepted uncontested. 1981 had similar numbers.

With those statistics in mind, let's look at the Commission's role in the process. The staff essentially arbitrates disputes through no-action letters, becoming involved in state law, social engineering, corporate policy, and political philosophy. Some argue that there is little the staff can add in these areas, which are unrelated to the Commission's goals of protecting investors and preserving the integrity of the markets.

Given the relatively small number of shareholder proposals and companies involved, and despite the imperfect process, cynics -- as well as the ultra-rational -- might well ask why so much attention is focused on so little activity? Is it cost? Is it principle? Or is it ego, on all sides? In a sense, the cost to corporations appears to be small. In response to a Commission request for cost data in 1976, only one corporation bothered to respond -- AT&T. AT&T reported that its costs, including postage, printing, employee remuneration, and outside counsel fees, totalled approximately $150,000. That represents about five cents per shareholder. I repeat, that's per shareholder, not per share.

The Commission also sought cost data in last Fall's release. This time we received more responses, but the responses still indicate that the cost is minor. For example, IBM estimated that its costs over the years were $15,000 per proposal. Southern California Edison estimated that its costs over a five-year period were $17,500 per proposal. American Electric Power estimated its costs for 1983 were $8670 per proposal. Westinghouse estimated that its total 1983 costs were $13,500 for five proposals.

So it is difficult to conclude that the issue is money. That leaves us with ego or principle. And that's borne out by the comment letters. One writer urged us to "Preserve free enterprise." Another, a state senator, said, "Allow shareholders the freedom to govern their own affairs." Finally, a banker complained of "hecklers [who] feel that they are entitled to disrupt otherwise orderly meetings", and another writer called for us to "spike the 'gadflys'."

Let's now turn to last Fall's release. First, we sought advice as to whether stockholder proposals should be regulated at all under federal law, or left to state law. The simplicity of that approach has a certain appeal, but apparently not to those people who live with the process. There was almost universal support among the commentators that there should be a federal right of access to the issuer's proxy statement. Interestingly, issuers didn't seem to find the state law approach attractive.

Going further, last Fall's release set forth three possible approaches for continued federal regulation. Proposal I would retain the current rule, with certain minor revisions. Proposal II would permit an issuer, subject to shareholder approval, to adopt its own procedures for shareholder proposals, with our rules preserving certain minimum

protections. Proposal III would require management to include any proposal proper under state law and not involving the election of directors. Under Proposal III, however, the aggregate number of proposals required to be included in a proxy statement would be limited, based upon the total number of shareholders.

Proposal I

The major revision embodied in Proposal I is a heightened eligibility requirement. A shareholder would be required to have owned for at least one year 1% of the issuer's securities eligible to vote at the meeting or securities having a market value of at least $1,000. Additionally, a shareholder could submit only one proposal a year. Proponents who engage in a general, written solicitation of proxies would not be eligible to use the provisions of Rule 14a-8 for the inclusions of a proposal in the issuer's proxy material for the same meeting.

If Rule 14a-8 is retained in modified form, the release proposed changing all time periods expressed in business days to a comparable number of calendar days. Also, two time periods would be extended. The deadline for the submissions of proposals to the issuer would be lengthened from 90 to 120 days. The deadline for the issuer to file with the Commission the reasons it believes specific proposals may be excluded would be lengthened from 50 to 60 days prior to the filing of its preliminary proxy materials.

As in 1981, the release requested comment on permitting a proponent a maximum of 500 words for a proposal and a supporting statement.

Certain changes would be made to clarify the grounds for excluding proposals as personal grievances, as unrelated to business, or as involving the same matter as another proposal. On the topic of personal grievances, the release proposed including explicitly the concept of personal interest or benefit, as follows:

> If the proposal relates to the redress of a personal claim or grievances against the issuer or any other person, or represents an attempt to further a personal interest or it is designed to result in a benefit to the proponent not shared with the other security holders at large.

With respect to matters not significantly related to the issuer's business, the release states that a totally objective standard was not feasible, but the release invited comment on including an economic significance test.

The resubmission of proposals included in prior years has been one of the most controversial provisions of the rule. Historically, the staff has interpreted "substantially the same proposal" to mean one that it is virtually identical in form as well as substance to a proposal previously included in the issuer's proxy materials. Because of growing abuses in this area, the release reproposed an idea advanced in 1976, which would permit the omission of a proposal if it "deals with substantially the same subject matter as a proposal previously submitted to security holders . . . ." No change was proposed in the alternative interpretative test, which allows omission if a proposal is comprised essentially of elements of two or more proposals that were submitted for vote in prior years and failed to receive the requisite percentages.

The release also sought comment on the advisability of discontinuing no-action letters. If this practice were discontinued, an issuer would proceed at its own risk and could be subject to suit, both by the Commission and shareholders, for improperly excluding a proposal.

Finally, the release sought comments on the idea of charging proposing stockholders a processing fee.

Proposal II

Proposal II would permit an issuer to adopt its own procedures governing shareholder proposals. The Commission would continue to regulate the submission, inclusion and exclusion of shareholder proposals (under whatever rules may generally be in effect), but a supplemental rule would permit the shareholders of an issuer to decide to what extent access to management's proxy statement would be provided to shareholders and what costs would be borne by the issuer. The issuer's plan would require initial shareholder approval and periodic reapproval. The plan, however, would be subject to some limitations. For example, overly restrictive elegibility criteria or overly broad exclusionary criteria may be prohibited.

Disagreements between an issuer and a proponent about exclusion of a proposal would be resolved according to the plan and, in the last resort, by the courts. Only in the area of personal grievances would the Commission continue to review proposals, and then only if the present practice of issuing no-action letters continued.

Amendments to an issuer's plan could be proposed by the board of directors or by any shareholder, without regard to the eligibility requirements under the plan.

In recognition of possible delays in court determination of eligibility or exclusion, the release requested comment on the feasibility of relying upon the courts to resolve disagreements.

Proposal III

Proposal III is the most ambitious of the three proposals, but in many respects the simplest. An issuer would be required to include in its proxy material all shareholder proposals which are not improper under state law and are not related to the election of directors. This approach would eliminate eleven of the existing thirteen grounds for the exclusion of proposals. Disputes regarding exclusion of a proposal would be resolved by the courts, not by the Commission's staff.

Under this approach, there would be a limit on the maximum number of proposals an issuer would be required to include, which would be based upon the total number of the issuer's shareholders.

Four arguments or principles are said to support this approach. First, the shareholder proposal process serves the public interest, is an important element of shareholder democracy, and assures some degree of management accountability, and in that sense lends validity to the notion of a corporate entity. Second, shareholder proposals provide substantial benefit at minimal cost. Third, in this area of difficult factual and legal judgments, a simpler and more predictable regulatory process would serve both issuers and proponents better. Fourth, the necessity of the Commission's staff involvement in the process would be eliminated, a small, but not unimportant, cost savings to the Commission. More importantly, however, it would relieve the staff of reaching judgments on issues beyond their expertise and not involving questions of federal law.

A Summary of the Comments

Federal Right of Access

As I indicated earlier, we received over 400 comment letters. There was almost unanimous support for the concept of a federal right of access by shareholders to the issuer's proxy statement. Only 19 writers opposed it or questioned the appropriateness of a federal right.

General Comments on the Three Proposals

There was overwhelming support for either current Rule 14a-8 or some limited modification of it, both from issuers and non-issuers. As H. J. Heinz Company said, "We support the concept of corporate democracy embodied in Rule 14a-8." One hundred commentators took the position that there should be no change; forty opposed the changes in Proposal I; and 113 generally supported Proposal I.

215 letters of comment addressed Proposal II. 174 opposed it; 23 supported it; and 18 expressing some support without endorsing the proposal. One critic characterized the idea as "off the wall."

188 letters of comment addressed Proposal III. 165 opposed it; six supported it; and 17 expressed some support without endorsing the proposal.

I think it is fair to say that this represents a clear consensus for some form of the current approach. Most commentators seemed to prefer it to alternatives as a practical matter. They generally felt that the current system was cheaper, more efficient, more consistent, and more predictable than the alternatives. For example, the State of Connecticut criticized Proposal III because of the cost that would be incurred by the state.

The letters expressed almost universal criticism of the idea of consigning the resolution of disputes to the courts, state or federal. They felt that crowded court dockets would result in delays in annual meetings, and that the courts' lack of experience in dealing with these disputes might result in further delay. By contrast, they felt that our staff had developed extensive experience that expedited treatment and resulted in consistent and uniform resolution. The letters expressed a concern that, because of the large number of courts that would be involved and the lack of precedent, the decisions would be inconsistent and unpredictable, thereby increasing litigation and costs. Furthermore, there was a concern that the lack of precedent would discourage the private resolution of the disputes.

On the question of discontinuing no-action letters, there were 131 comment letters. 127 opposed it, and only 4 supported it. The general view was that resort to the courts would be impractical. Issuers and non-issuers alike felt that the resulting litigation and its cost might have a chilling effect on the exercise of shareholder rights. Even with regard to factual disputes and questions of state law,

several commentators disagreed with the notion that the staff is not in the best position to resolve disputes. Indeed, some argued that the staff had developed an expertise in the area.

Comments on Specific Changes to Rule 14a-8

Eligibility

The question of eligibility attracted extensive comment. 207 letters addressed the issue; 142 supported some form of an eligibility requirement; 65 opposed an eligibility requirement; and 100 generally opposed any change in Rule 14a-8. So it becomes a close question. Opponents contended that such a requirement would be unfair to small shareholders, would discriminate against small shareholders or would create two classes of shareholders, large and small. Some argued, in very emotional and strident words, that it would discriminate against the young and the poor. One writer even went so far as to suggest: "Perhaps Mr. Chad [sic] should have been made Secretary of the Treasury and Don Regan, Chairman of the SEC because Merrill Lynch never found a small stockholder to be unimportant." I think that comment crystallizes the depth of emotion in this area, or if not, demonstrates a cynic's sense of humor.

Not surprisingly many issuers supported some form of an eligibility requirement. But, surprisingly, many church and citizens groups also expressed some support. Even Evelyn Y. Davis supported the $1,000 requirement. Many issuers and non-issuers alike supported a minimum holding period but opposed a minimum investment. The Federal Bar Association, for example, supported a six-month holding period.

Personal Grievances

The proposal to change the rule on excluding proposals seeking redress of a personal grievance to conform to present interpretative positions was supported by 76 of the 95 commentators who addressed the issue. Some concern was expressed, however, that the new language might exclude intellectual or social issues in which the proponent had a personal interest; and the opponents of change were concerned that the new language was too vague and would result in greater interpretive problems.

Not Significantly Related to the Issuer's Business

Of 118 comment letters, 81 supported the inclusion of an objective economic standard to determine whether a proposal is significantly related to an issuer's business. A majority

of those, however, expressed reservations about permitting a proposal to be included if it otherwise was significantly related to the issuer's business. The concern seemed to be that what we gave with one hand, we took away with the other, presenting the same interpretative problems encountered with the present rule. In addition, many believed that proposals dealing with corporate governance issues should not be excluded, and there was a concern that the term "gross earnings" was undefined.

Proposals Requiring a Report to Shareholders

The release proposed to change the existing interpretative position that proposals requesting issuers to prepare reports on specific matters or form special committees to study part of the issuer's business are not excludable. Under the revision, the staff would consider in each instance whether the subject matter of the report or committee involved a matter of ordinary business, which would permit exclusion. Of 112 commentators, 72 supported this change. Opponents asserted that reports or committee requests are directed at corporate self-examination and accountability, and that shareholders should be entitled to any information they are willing to pay for.

Resubmission of Proposals

Of 130 commentators, 87 supported a change that would permit excluding proposals that are similar in substance to a proposal from the preceding year. The change would prevent proposals from qualifying merely by changes in form. Many commentators argued, however, that the proposed standard ignores the effect that varying language can have on the outcome of a proposal.

With regard to the percentage of vote that must be obtained for a proposal to be resubmitted the following year, 25 commentators suggested a single percentage. One issuer suggested 40%, others 30% and 25%. 53 commentators urged that each of the percentages in the current three-step test be increased. Only 11 commentators urged retention of the present levels, and 2 urged reduction.

Number of Proposals and Length of Statements

There was broad support for the proposed change that would permit a proponent to allocate between a proposal and supporting statement the 500 words allowed. There was also relatively strong support for restricting a proponent to the submission of one proposal each year, although some argued that proposals would simply become more confusing as proponents sought to make all of their points in a single proposal.

CONCLUSION

Last Fall I spoke about the release before two different audiences: a group of corporate secretaries and general counsels, and a group of members of the securities bar. At the time I found their responses both surprising and interesting. As it turns out, they foreshadowed the public comment. Both audiences were outspoken in their belief that, having demonstrated a federal presence in the proxy area, it would be unfair for the Commission to abandon the field and leave it to state law. Some even characterized the proxy statement as a "federal creation."

Given the current popularity, at least among the business community, of the philosophy of deregulation, I was somewhat surprised at the near universal support for continued involvement of the federal government in an area of corporate governance. I thought that idea had gone out of vogue with the 1970's. But both the groups I spoke to last Fall and the comment letters we received on the subject appear to be asking for exactly that -- continued government involvement.

I have not yet had an opportunity to listen to the staff's recommendation on the subject, and I won't come to any conclusions before I do. But for one who came to this topic with a very skeptical view of continued federal involvement in the area, the comment letters and the discussions I have had with various people have had a strong influence. The belief is apparently widely held that this is not an improper area of involvement for a regulatory agency. Indeed, many seem to believe that the Commission's presence provides an efficiency that would otherwise be unattainable.