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Robert B. Ahdieh

Texas A&M University School of Law, [ahdieh@law.tamu.edu](mailto:ahdieh@law.tamu.edu)

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## The Dialectical Regulation of Rule 14a-8: Intersystemic Governance in Corporate Law

SINCE THE ADOPTION OF THE SARBANES-OXLEY ACT OF 2002,<sup>1</sup> there has been a resurgence of interest in what might be conceived as the *regulatory design* of corporate law. Most significantly, legal scholars have rejoined the pitched battle over the appropriate role of federal and state law in defining the requirements of corporate governance for the modern public corporation.<sup>2</sup>

Neither antagonist in this debate seems to feel much affection for the Sarbanes-Oxley Act. In the view of one group of scholars, the Act undermined the careful federalist balance between corporate and securities law, imposing federal rules on the internal affairs of the public corporation—a sphere heretofore reserved to state law.<sup>3</sup> The other side is only slightly more sympathetic to the Act: in this view, Sarbanes-Oxley was only one step on the necessary path to more comprehensive federal rules of corporate governance.<sup>4</sup>

In this brief Article, I explore a possible middle ground in this debate—a proverbial “third way” in the regulatory design of corporate law. Using the particular example of Rule 14a-8<sup>5</sup>—issued by the Securities and Exchange Commission (SEC) to encourage inclusion of shareholder proposals in proxy materials—I hope to suggest that a regulatory regime of what I term “dialectical regulation” may be a fruitful addition to existing regulatory conceptions of corporate law.<sup>6</sup>

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\* Professor of Law & Director, Center on Federalism and Intersystemic Governance, Emory University School of Law.

1. Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

2. See generally Renee M. Jones, *Rethinking Corporate Federalism in the Era of Corporate Reform*, 29 J. CORP. L. 625 (2004) (discussing the interaction, interplay, and overlap between federal and state law both before and after the Enron scandal, among the catalysts for Sarbanes-Oxley).

3. See, e.g., Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

4. See, e.g., Lucian A. Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1499–1507 (1992).

5. 17 C.F.R. § 240.14a-8 (2006).

6. See Robert B. Ahdieh, *Dialectical Regulation*, 38 CONN. L. REV. 863 (2006) [hereinafter Ahdieh, *Dialectical Regulation*]. Notably, the SEC has regularly expressed its receptivity to improvements in the implementation of Rule 14a-8. See Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 40,018, Investment Company Act Release No. 23,200, at Part I (May 21, 1998) (codified at 17 C.F.R. pt. 240); see also *Shareholders Should Have More Freedom to Vote on Firm's Business Matters, Pitt Says*, 34 SEC. REG. & L. REP. (BNA) 1578 (2002) (describing the view of then SEC chair that the SEC should eliminate “ordinary business

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I proceed in two steps: In Part I, I outline my argument in the negative, challenging the widespread, but insufficiently precise, claim that federal law has no place in corporate law.<sup>7</sup> More significantly, Part II explores my argument in the affirmative. Using Rule 14a-8 by way of example, I suggest the possible nature and utility of a regime of dialectical regulation in corporate law. Such a regime, I suggest, may be best suited to capture what Vice-Chancellor Leo Strine has described as the “symbiotic” relationship between federal securities law and the law of Delaware.<sup>8</sup>

### I. DISSECTING THE CRITIQUE OF “FEDERALIZATION” IN CORPORATE LAW

Since its adoption, the Sarbanes-Oxley Act has been widely criticized for imposing *federal* rules of corporate governance.<sup>9</sup> The Act should be condemned, in this view, for its “federalization” of corporate law.<sup>10</sup> This may be even the conventional wisdom.

What are we to make of this claim? To be more precise, does criticism of Sarbanes-Oxley for its federalization of corporate law have force as a claim of regulatory design, independent of any critique of the actual substantive rules contained in the legislation? When we dissect what the critique of federalization is actually about, I would argue it does not.

Contrary to the attendant rhetoric, the real claim is not that Sarbanes-Oxley oversteps some doctrinal bound between *federal* securities regulation and *state* corporate law. Attempts at such line-drawing—whether based on the public/private distinction or the dichotomy of process versus substance—have admittedly been made.<sup>11</sup> Each has some descriptive utility, moreover, in characterizing the general reach of federal securities law and state corporate law. Neither constitutes so sharp a distinction, however, or so impermeable a barrier, as to exclude federal law from playing *any* role in the regulation of corporate governance. At best, federal law is mostly public in nature and mostly directed to process.

Nor can the critique of federal rules of corporate law be traced to any genuine commitment to federalism—or at least federalism in its most basic terms. Both the

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exception” to Rule 14a-8’s authorization of shareholder proposals). More fundamental rethinking about the operation of the rule, however, may be in order.

7. See *infra* Part I.

8. See Transcript of Roundtable Discussion Regarding Federal Proxy Rules & State Corporation Law (May 7, 2007), available at <http://www.sec.gov/spotlight/proxyprocess/proxy-transcript050707.pdf>. Hinting at the pattern I propose, Loss and Seligman suggest a dynamic in which the SEC’s “common law” of Rule 14a-8 yields to, yet also influences, state courts’ analyses of state law. See LOUIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* 556 (5th ed. 2004).

9. See, e.g., Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, REG., Spring 2003, at 26; see also Michael Perino, *Enron’s Legislative Aftermath: Some Reflections on the Deterrence Aspects of the Sarbanes-Oxley Act of 2002*, 76 ST. JOHN’S L. REV. 671, 672–74 (2002); Larry E. Ribstein, *Market v. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 57–59 (2002).

10. See Robert B. Ahdieh, *From “Federalization” to “Mixed Governance” in Corporate Law: A Defense of Sarbanes-Oxley*, 53 BUFF. L. REV. 721, 725 (2005) [hereinafter Ahdieh, *Federalization*].

11. See *id.* at 731–34.

theory and the empirical reality of regulatory competition in corporate law sit uneasily with traditional federalist goals of local autonomy and policy diversity. The underlying dynamic of corporate law—state competition for corporate charters—rests on legislative capacity for rapid incorporation of efficient innovations of other states.<sup>12</sup> The idea here is not that diverse state rules of corporate governance will capture distinctive consumer/managerial preferences.<sup>13</sup> Rather, the relevant race—be it to the top or the bottom<sup>14</sup>—is premised on similar demand across jurisdictions, and a resulting convergence in relevant rules.<sup>15</sup> The empirical reality of Delaware's dominance, of course, bears this out.<sup>16</sup>

Critics of federal corporate law, however, may mean to invoke federalism claims of a distinct, second-order variety. A normative preference for state law, in this conception, is grounded not in the benefits of autonomy or diversity, but rather in the utility of regulatory experimentation and competition.<sup>17</sup>

Once again, recent empirical analysis is not especially helpful to this claim.<sup>18</sup> Uniformity appears to be the norm, with any competition weak at best. More importantly, the presence or absence of regulatory competition in corporate law is not inherently a question of federalism. Rather, it requires only that corporate managers enjoy access to alternative regulatory regimes. Federal law could plausibly offer one such alternative.<sup>19</sup>

The adoption of relevant rules by national versus local authorities, then, is not the issue. Rather, what allows regulatory experimentation and competition in corporate law to be conceived as a federal-state question is the traditionally mandatory

12. See Frederick Tung, *Lost in Translation: From U.S. Corporate Charter Competition to Issuer Choice in International Securities Regulation*, 39 GA. L. REV. 525, 537–38 (2005).

13. See *id.* at 539.

14. See ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993); Bebchuk, *supra* note 4, at 1435; Roberta Romano, *Law as Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985); Joel Seligman, *The Case for Federal Minimum Corporate Law Standards*, 49 MD. L. REV. 947 (1990). See generally William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974); Ralph K. Winter, Jr., *State Law, Shareholder Protection and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

15. Cf. Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 469, 483–84 (1987).

16. See Robert Daines, *The Incorporation Choice of IPO Firms*, 77 N.Y.U. L. REV. 1559, 1572 (2002) (finding that at least 95 percent of public firms choose to incorporate in Delaware if they do not incorporate in their home state).

17. See Roberta Romano, *The States as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 211 (2006) (arguing that state competition for incorporations has “spurred an innovative legal process that is responsive to a rapidly changing business environment to the benefit of firms and their investors”).

18. See William J. Carney, *The Production of Corporate Law*, 71 S. CAL. L. REV. 715, 717 (1998); cf. Symposium, *The Next Century of Corporate Law*, 25 DEL. J. CORP. L. 79, 89 (2000) (stating that “[r]ich (or overrich) as the theoretical literature on charter competition has been, the empirical literature is much thinner”).

19. See Michael Abramowicz, *Speeding Up the Crawl to the Top*, 20 YALE J. ON REG. 139, 157 (2003) (stating that “a federalist system in which states can make certain provisions of corporate law mandatory could fill the gap” in the market for corporate charters, but concluding that for several reasons states will not want to innovate).

nature of federal rules and the traditionally enabling nature of state rules.<sup>20</sup> If, on the other hand, federal rules were enabling (i.e., if federal incorporation was simply an option for public corporations) or if state rules were effectively mandatory (i.e., both mandatory versus enabling *and* difficult to escape, as suggested by California's expansive outreach statute<sup>21</sup>), the story would likely change.<sup>22</sup> Present-day opponents of federal corporate law could no longer cite the benefits of experimentation and competition to critique federal rules. Their animus toward relevant state rules, meanwhile, would be substantial. The real critique, this suggests, is not jurisdictional. It is regulatory.

Critics of Sarbanes-Oxley's federal rules of corporate law undoubtedly bewail the decline in experimentation and competition attendant to the statute. What is sacrificed, however, by this loss of competition? Not efficient regulation, or at least not regulation as ordinarily conceived. Rather, it is a species of deregulation. Sarbanes-Oxley is questioned not because it gets the rules wrong, but simply because it imposes rules. The preference for default rules, then, is not a preference for more efficient rules, but a preference for the market—specifically, a market in regulation.

A market in state corporate law, however, is no less a market than any other. The motivating force behind regulatory design in a world of default rules, negotiated via regulatory competition, is not public interest, but private incentive. If a given default rule comports with private preferences, it survives market competition; if it does not, it is waived. Analogously, if a state's corporate law regime advances private interests, it is embraced via incorporation; if not, it is abandoned.<sup>23</sup> In this dynamic, Sarbanes-Oxley's problem is not that it favors federal versus state regulation, but that it imposes public regulation where private incentive once played out, in a free(r) market dynamic.

Properly understood, then, the critique of federal rules of corporate governance is not an objection to federal law. Rather, it is to law, or at least law of the traditional, command-and-control variety. The argument is rarely articulated in these terms. Ultimately, however, criticism of federal corporate law must either rest on a broad claim of market efficiency in corporate governance, or mean nothing at all.

If criticism of federal rules of corporate governance comes down to this, however, it cannot offer any *systemic* barrier to interventions such as the Sarbanes-Oxley Act. In any given case, relevant federal rules may be unwise or unwarranted.

20. See Jill E. Fisch, *The New Federal Regulation of Corporate Governance*, 28 HARV. J.L. & PUB. POL'Y 39, 40–41 (2004). States that give corporations independence in their decisions on the allocation of risk, control, profit, and other aspects of corporate life are generally said to have “enabling” statutes. See Wilber G. Katz, *The Philosophy of Midcentury Corporation Statutes*, 23 LAW & CONTEMP. PROBS. 177, 179 (1958).

21. See CAL. CORP. CODE § 2115 (West 1990 & Supp. 2006) (stipulating conditions for foreign corporations in California that regulate, among other things, election and removal of directors, directors' standard of care, liability of directors for unlawful distributions, shareholders' right to cumulative voting, limitations on mergers, and limitations on the sale of assets).

22. See Abramowicz, *supra* note 19, at 157.

23. Ahdieh, *Federalization*, *supra* note 10, at 739.

The imposition of section 404's internal controls provisions on smaller public companies, for example, may be unjustified.<sup>24</sup> But, there is no theory to suggest that this is always so. Just as regulatory intervention in ordinary products markets may sometimes be in order, the same is true where law—be it corporate or otherwise—is the relevant product.

A federal role in corporate law, then, cannot be categorically rejected. Rather, the appropriateness of federal intervention in any given case must be assessed on the merits. Is regulation in a given area suited to some mandatory minimum? Anti-takeover practices, for example, are perennially highlighted as candidates for federal regulation.<sup>25</sup> Distinctive interest group dominance at the federal versus state level might also favor greater allocation of responsibility in a given area to one level versus the other.

Vice-Chancellor Strine has thus emphasized the distinct strengths of the SEC and the Delaware courts in various areas of corporate and securities law.<sup>26</sup> In the area of disclosure, he cites the Commission as far better suited to define the content of quarterly reports.<sup>27</sup> By contrast, he argues that Delaware courts have been more than vigorous in their protection of shareholder voting rights.<sup>28</sup> Where they see manipulation of voting procedures in ways adverse to shareholders, the very highest scrutiny is brought to bear.

To conclude that there might be occasional utility to “regulation” of the market in corporate law, however, need not lead to endorsement of any broad federal preemption of state law. No displacement at all may be required, in fact. The optimal regulatory design for corporate law might be a mixed regime of sorts—a kind of *intersystemic* governance. It is this possibility—what I have previously termed *dialectical regulation*—that I now take up.<sup>29</sup>

## II. A DIALECTICAL APPROACH TO PROXY REGULATION

What is the essential nature of a regime of dialectical regulation? At heart, such regulation rests on the combination of (1) overlap in the jurisdictional reach of independent regulatory authorities, and (2) some dependence of the latter agencies on one another, in the pursuit of their respective regulatory mandates.<sup>30</sup> Rather

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24. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); see also William J. Carney, *The Costs of Being Public After Sarbanes-Oxley: The Irony of “Going Private,”* 55 EMORY L.J. 141 (2006); Joseph A. Castelluccio III, Note, *Sarbanes-Oxley and Small Business: Section 404 and the Case for a Small Business Exemption*, 71 BROOK. L. REV. 429, 430–31 (2005).

25. See Lyman Johnson, *Sovereignty over Corporate Stock*, 16 DEL. J. CORP. L. 485, 516–17 (1991) (citing Winter, *supra* note 14, at 289); Brett H. McDonnell, *Getting Stuck Between Bottom and Top: State Competition for Corporate Charters in the Presence of Network Effects*, 31 HOFSTRA L. REV. 681, 697 (2003) [hereinafter McDonnell, *Getting Stuck*].

26. See Transcript of Roundtable Discussion, *supra* note 8.

27. See *id.* at 20:21.

28. See *id.* at 21:5.

29. See Ahdieh, *Dialectical Regulation*, *supra* note 6, at 868.

30. See *id.* at 863–65.

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than a Balkanization—or perhaps stratification, in the present case—of regulatory authority, dialectical regulation aspires to an integration of regulatory regimes.<sup>31</sup>

Robert Cover has explored this species of regulatory design under the rubric of “jurisdictional redundancy.”<sup>32</sup> In the corporate law literature, Mark Roe’s conception of federal law as “Delaware’s Competition,”<sup>33</sup> Robert Thompson’s notion of “collaborative” regulation,<sup>34</sup> Renee Jones’ exploration of “dynamic federalism,”<sup>35</sup> and much of Brett McDonnell’s work<sup>36</sup> all echo similar themes. Each explores the middle ground between federal and state governance in corporate law.

What would a regime of “dialectical regulation” look like in corporate law? The regulation of annual proxy solicitations provides a rich opportunity to explore this question. Here, if anywhere, the basic infrastructure of dialectical regulation is present, with federal and state rules closely intertwined.<sup>37</sup> In exploring how the regulation of proxy solicitations might incorporate a stronger dynamic of regulatory engagement, thus, a picture of dialectical regulation begins to take shape.

Various federal rules speak to the proxy solicitation process. Federal regulations providing for access to shareholder lists, requiring separate votes on distinct matters, and facilitating selective voting on board candidates are integral aspects of the proxy solicitation process.<sup>38</sup> Perhaps especially worth noting, however, is Rule 14a-8, promulgated by the SEC under the Securities Exchange Act of 1934.<sup>39</sup> The subject of much rethinking and reinvention over the years,<sup>40</sup> Rule 14a-8 may today be an especially promising vehicle through which to explore an entirely new regulatory approach in corporate law.

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31. See *id.* at 865.

32. See Robert M. Cover, *The Uses of Jurisdictional Redundancy: Interest, Ideology, and Innovation*, 22 WM. & MARY L. REV. 639 (1981).

33. See Mark J. Roe, *Delaware’s Competition*, 117 HARV. L. REV. 588 (2003).

34. See Robert J. Thompson, *Collaborative Corporate Governance: Listing Standards, State Law and Federal Regulation*, 38 WAKE FOREST L. REV. 961 (2003).

35. See Jones, *supra* note 2.

36. See, e.g., Brett McDonnell, *Recent Skirmishes in the Battle Over Corporate Voting and Governance*, 2 J. BUS. & TECH. L. 369 (2007) [hereinafter McDonnell, *Recent Skirmishes*]; Brett H. McDonnell, *Shareholder Bylaws, Shareholder Nominations, and Poison Pills*, 3 BERKELEY BUS. L.J. 205, 254–58 (2005) [hereinafter McDonnell, *Shareholder Bylaws*].

37. Cf. Ahdieh, *Dialectical Regulation*, *supra* note 6, at 865.

38. See Securities Exchange Act of 1934, 15 U.S.C. § 78 (2006); see also Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

39. 17 C.F.R. § 240.14a-8 (2006).

40. See *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972); see also Statement of Informal Procedures for the Rendering of Staff Advice with Respect to Shareholder Proposals, Exchange Act Release No. 12,599, Investment Company Act Release No. 9,344, 41 Fed. Reg. 29,989, 1976 WL 160411 (July 7, 1976) [hereinafter Informal Procedures]; Amendments to Rules on Shareholder Proposals, *supra* note 6. As recently as 2003, the SEC proposed amendments to Rule 14a to allow shareholder nominations of directors, to the extent permitted by state law. See Security Holder Director Nominations, Securities Act Release No. 48,626, Exchange Act Release No. 48,626, Investment Company Act Release No. 26,306 (proposed Oct. 14, 2003). While ultimately abandoned, the very possibility of such a change suggests a need to clarify the appropriate approach to Rule 14a-8.

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In simple terms, Rule 14a-8 mandates the inclusion of shareholder proposals in corporate proxy materials, assuming that certain relatively facile procedural requirements are met, and that the relevant proposal does not fall within an enumerated set of substantive exceptions.<sup>41</sup> Thus, among others—and of greatest relevance here—a proposal may be excluded when it:

*[is] not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization;*<sup>42</sup>

*if implemented, [would] cause the company to violate any state, federal, or foreign law to which it is subject;*<sup>43</sup> *[or]*

*deals with a matter relating to the company's ordinary business operations.*<sup>44</sup>

As to each of these exceptions, the SEC is called upon to analyze the relevant question.<sup>45</sup> This need arises, most commonly, when a corporation seeking to exclude a shareholder proposal from its proxy materials (as most corporations wish to do) petitions the SEC's Division of Corporation Finance for a no-action letter, based on one or more of the enumerated grounds.<sup>46</sup>

In evaluating requests under the exceptions enumerated above, the SEC's assessment turns on an evaluation of applicable law of the state of incorporation.<sup>47</sup> Under

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41. See 17 C.F.R. § 240.14a-8 (2006).

42. *Id.* § 240.14a-8(i)(1).

43. *Id.* § 240.14a-8(i)(2).

44. *Id.* § 240.14a-8(i)(7). Under the SEC's present question and answer format of Rule 14a-8, these exceptions are enumerated in paragraphs (1), (2), and (7), of Question 9. *Id.* § 240.14a-8; see Amendments to Rules on Shareholder Proposals, *supra* note 6.

45. Besides paragraphs (1), (2), and (7), there may also be some need for state law analysis under paragraph (6), allowing exclusion of a proposal where the issuer "lack[s] the power or authority to implement [it]." 17 C.F.R. § 240.14a-8(i)(6). This exception has most commonly been construed to be about third parties, however, rather than public law.

46. Alternatively, upon receipt of an objectionable shareholder proposal, corporations may go directly to federal court, seeking declaratory relief. Yet they rarely do so, as a first step.

47. The need to analyze state law is fairly explicit under paragraphs (1) and (2). It is equally central to paragraph (7), however, which evokes state law rules regarding the scope of board authority. See Amendments to Rules on Shareholder Proposals, *supra* note 6, at Part III ("The general underlying policy of this exclusion is consistent with the policy of most state corporate laws: to confine the resolution of ordinary business problems to management and the board of directors . . ."); see also *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 678 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972) (quoting a Senate hearing on amendments to Rule 14a-8, where it was stated that "[w]hile Rule X-14A-8 does not require that the ordinary business operations be determined on the basis of State law, the premise of Rule X-14A-8 is that the propriety of . . . proposals for inclusion in the proxy statement is to be determined in general by the law of the State of incorporation. . . . Consistency with this premise requires that the phrase 'ordinary business operations' in Rule X-14A-8 have the meaning attributed to it under applicable State law. To hold otherwise would be to introduce into the rule the possibility of endless and narrow interpretations based on no ascertainable standards."); *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc. (ACTWU)*, 821 F. Supp. 877, 884 n.7 (S.D.N.Y. 1993).

The SEC's fine distinction as to the role of state law in the analysis of "ordinary business operations" exception is worth noting. See *Med. Comm.*, 432 F.2d at 678 (quoting the SEC's statement that the rule does not require that "ordinary business operations be determined on the basis of State law," but should "have the



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Rule 14-a8(i)(1), for example, the Division must evaluate and define the permissible scope of shareholder versus managerial authority in the state of incorporation.<sup>48</sup>

This is not an easy analysis for a federal agency.<sup>49</sup> As Brett McDonnell and Larry Hamermesh explicitly and implicitly suggest in their contrasting readings of relevant Delaware law, it is difficult to identify the proper subjects for shareholder action under state law.<sup>50</sup> Identification of state law violations and the scope of ordinary business operations under state law is no easier.

Yet the SEC's operationalization of Rule 14a-8 has not included any mechanism of state involvement. In acting on no-action letter requests, the SEC has done little to engage those state actors best positioned to address the questions presented. Nor, for that matter, has the SEC meaningfully engaged state law itself—perhaps no surprise, given the SEC's lack of expertise in state law.<sup>51</sup>

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meaning attributed to it under applicable State law"). The point of this distinction is not self-evident. It may simply have been intended to prevent any challenge to the SEC's analysis based on citation to applicable state law. Arguably, however, it might be seen to echo the dialectical approach I propose herein. Thus, it may aim to preserve some room for an SEC "common law" of Rule 14a-8, alongside relevant state law. See LOSS & SELIGMAN, *supra* note 8, at 556 ("Inevitably the Commission (normally its staff), while purporting to find and apply a general[ly] nonexistent state law, has been building a 'common law' of its own as to what constitutes a 'proper subject' for shareholder action. It is a 'common law' that undoubtedly would yield to a contrary decision of the particular state court; but it is perhaps equally likely to influence the state courts themselves when the rare cases come to them.").

48. See Solicitation of Proxies, 19 Fed. Reg. 246, 246 (Jan. 14, 1954) (to be codified at 17 C.F.R. pt. 240) (clarifying that analysis under Rule 14a-8 is based on state law). It deserves emphasis that SEC no-action letters are, as a formal matter, merely persuasive. See *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 423 (D.C. Cir. 1992); see also *Informal Procedures*, *supra* note 40, at \*3. No-action letters are granted "deference" by state and federal courts, *Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc.* (AFSCME), 462 F.3d 121, 129 (2d Cir. 2006), but "are not binding." *Amalgamated Clothing & Textile Workers Union v. SEC*, 15 F.3d 254, 257–58 (2d Cir. 1994); see also *New York City Employees' Ret. Sys. v. SEC (NYCERS)*, 45 F.3d 7, 12 (2d Cir. 1995). As held in *NYCERS*, moreover, the SEC's decision to issue a no-action letter does not impede the right of a shareholder to bring suit against an "offending company . . . to enjoin the board to include their proposal in proxy materials." 45 F.3d at 14.

49. The SEC has itself acknowledged as much. See *Amendments to Rules on Shareholder Proposals*, *supra* note 6, at Part I. *Cf. New York City Employees' Ret. Sys. v. Dole Food Co.*, 795 F. Supp. 95, 100 (S.D.N.Y. 1992) ("The term 'ordinary business operations' is neither self-explanatory nor easy to explain."), *vacated by* 969 F.2d 1430 (2d Cir. 1992).

50. See generally McDonnell, *Shareholder Bylaws*, *supra* note 36.

51. In lieu of actual state law, the Division of Corporation Finance will occasionally make vague reference to considerations of policy. See, e.g., *Pac.-Telesis Group*, SEC No-Action Letter, 1989 WL 245523 (Feb. 2, 1989) ("In light of recent developments, including heightened state and federal interest in the social and economic implications of plant closing and relocation decisions, the staff has reconsidered its position . . ."). Even where state law is invoked, as in a number of judicial decisions regarding shareholder proposals, the analysis tends to be limited to generic constructions of "state law." See, e.g., *ACTWU*, 821 F. Supp. at 882–83 ("A shareholder proposal pertaining to 'ordinary business operations' would be improper if raised at an annual meeting, because the law of most states (including Delaware) leaves the conduct of ordinary business operations to corporate directors and officers rather than the shareholders."). *But see Grimes v. Centerior Energy Corp.*, 909 F.2d 529, 532 (D.C. Cir. 1990) (noting specific terms of applicable state law), *cert. denied*, 498 U.S. 1073 (1991); *Med. Comm.*, 432 F.2d at 680 (same). Such inattention to actual state law is not entirely surprising, given the present-day operation of Rule 14a-8 and consequently limited extent of relevant state law. See *ACTWU*, 821 F. Supp. at 884 n.7 ("However, most states, including Delaware, have not developed the law on this issue beyond the statement that the directors and officers shall manage the business affairs of the corporation."). It is espe-

As a result, whether in the affirmative or the negative, the Division of Corporation Finance's responses to no-action letter requests rarely articulate much by way of rationale. They commonly consist of little more than a single paragraph.<sup>52</sup> Instead, the Division seems to respond to no-action requests based on its gut assessment of the proposal under review and a pair of self-constructed heuristic devices, designed to offer at least the appearance of coherent analysis.<sup>53</sup>

The first metric is a disfavoring of mandatory, as opposed to precatory, shareholder proposals, as acknowledged in the notes to Rule 14a-8.<sup>54</sup> While a relatively clear and effective filter, the latter finds little basis in relevant state law, at least beyond the general trope that if a proposal is not mandatory, it cannot possibly violate state law—or restrict ordinary business operations, for that matter.<sup>55</sup>

The second heuristic device utilized by the Division is its refusal to take a position on a proposal in the face of ambiguous state law.<sup>56</sup> While seemingly understandable, this approach is ultimately circular. Given the high cost of private solicitation, this principle can be expected to determine the fate of the relevant proposal in all but the rarest of cases.<sup>57</sup> If the proposal does not reach shareholders,

cially odd with reference to the exception for “ordinary business operations,” on the other hand, given the addition of that exception as part of a set of amendments to Rule 14a-8 focused specifically on state law. See *Med. Comm.*, 432 F.2d at 678.

52. See *infra* note 77 and accompanying text. The SEC has acknowledged the cursory nature of its analysis. See *ACTWU*, 821 F. Supp. at 883 (quoting a SEC statement that staff “necessarily cannot do more in each case than make a quick analysis of the material submitted that, perforce, lacks the kind of in-depth study that would be essential to a definitive determination”).

53. See Transcript of Roundtable Discussion, *supra* note 8, at 174–75.

54. 17 C.F.R. § 240.14a-8(i)(1) (2006); SEC Legal Staff Bulletin No. 14 (CF), at 30 (July 13, 2001), available at <http://www.sec.gov/interps/legal/cfs14.htm>; see also Jason M. Loring & Keith Taylor, *Shareholder Activism: Directorial Responses to Investors' Attempts to Change the Corporate Governance Landscape*, 41 WAKE FOREST L. REV. 321, 322 (2006).

55. By the SEC's own characterization, the objection to proposals of a mandatory nature is not grounded in an analysis of any given state's law, but rather on a generic analysis of “state law” as a whole. The latter analysis is notably broad, moreover, acknowledging that “the laws of most states do not, for the most part, explicitly indicate those matters which are proper for security holders to act upon [and hence suited to mandatory shareholder action] but instead provide only that ‘the business and affairs of every corporation organized under this law shall be managed by its board of directors,’ or words to that effect.” Adoption of Amendments Relating to Proposals of Security Holders, 41 Fed. Reg. 52,994, 52,996 (Dec. 3, 1976) (to be codified at 17 C.F.R. § 240.14a-8). On this weak foundation, the SEC rests its conclusion that “[u]nder such a statute, the board may be considered to have exclusive discretion in corporate matters, absent a specific provision to the contrary in the statute itself, or the corporation's charter or bylaws.” *Id.* But the latter need not follow from the former, at least as a universal matter. More generally, the distinction between mandatory and precatory shareholder proposals has been criticized as exalting form over substance. See Lewis S. Black, Jr. & A. Gilchrist Sparks III, *The SEC as Referee—Shareholder Proposals and Rule 14a-8*, 2 J. CORP. L. 1, 6 (1976).

56. At a recent roundtable convened by the SEC to discuss proxy solicitations and state corporation law, Martin Dunn, of the Division of Corporation Finance, acknowledged this as the SEC's approach. When the SEC receives a shareholder proposal, Dunn indicated, there are often competing opinions as to whether it is permitted by state law. Rather than mediating this conflicting guidance, the Division prefers to simply exclude the proposal. See Transcript of Roundtable Discussion, *supra* note 8, at 32.

57. See John C. Coffee, Jr., *Reform of the Proxy Process*, SH095 A.L.I.-A.B.A. 1 (2003) (noting expense of solicitation and inability of shareholders to obtain reimbursement from the corporation); see also *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 672 n.12 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972).

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however, state law is likely to remain ambiguous. Intuition would also seem to favor the opposite approach. If state law is unclear, the underlying policy of Rule 14a-8 arguably should kick in, and the proposal should be included.

Each of the Division's heuristic devices can be understood as an avoidance mechanism of sorts. Faced with the difficult task of attempting to deconstruct (perhaps inherently) ambiguous state law, without the assistance of state law institutions, on a short time fuse, the Division must find a quick way out. In the devices described above, the Division has found it.

A regime of dialectical regulation under Rule 14a-8 offers a better way.<sup>58</sup> Brett McDonnell highlights an obvious step that might be taken in this direction.<sup>59</sup> In the face of ambiguous state law, as suggested above, the Division might allow proposals to go forward, declining to issue requested no-action letters.<sup>60</sup> In doing so, the Division would rely not on any claimed insight into state law, but instead on the self-evident limits of its understanding.<sup>61</sup> By permitting proposals to go forward, the Division would allow better qualified state entities to address the issues presented in due course, ultimately producing a greater degree of clarity.<sup>62</sup>

A meaningful regime of dialectical regulation, however, would not simply allow proposals to go forward on a clean slate. Rather, the Division should be charged to outline the analysis of state law that led to the staff's unwillingness to reach any definitive conclusion on its application to the shareholder proposal at hand. In the case of the Rule 14a-8(i)(1) exception for proposals "not a proper subject" for shareholder action, for example, the Division might describe—even if only briefly—its reading of the allocation of governance authority to shareholders and managers under relevant state law. To analogous effect, it could indicate what state law it thought the proposal *might* violate, under Rule 14a-8(i)(2).

SEC issuance of no-action letters based simply on the ambiguity of state law should therefore be curtailed. Rather, the Division should engage in some meaningful analysis of relevant state law and allow proposals to go forward when it ultimately finds ambiguity in applicable state rules. This prescription is even clearer when the relevant objection is the mandatory nature of the relevant proposal. At least in the absence of specific state law on point, the latter does not constitute an appropriate ground for issuance of a no-action letter. As Vice-Chancellor Strine has

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During an SEC roundtable on shareholder access to the annual proxy solicitation, Frank Balotti highlighted the problem of paying for proxy solicitations. See Transcript of Roundtable Discussion, *supra* note 8, at 40.

58. One might find some hint of a dialectical approach in the analysis of the U.S. Court of Appeals for the Third Circuit, in *SEC v. Transamerica Corp.*, 163 F.2d 511 (3d Cir. 1947), *cert. denied*, 332 U.S. 847 (1947), as the court sought to balance the goals of Rule 14a-8 with the substantive standards of Delaware law. See *id.* at 518.

59. See McDonnell, *Shareholder Bylaws*, *supra* note 36, at 254–58.

60. *Id.* at 257.

61. See *id.*

62. *Id.* at 256–57.

recently argued, the SEC would do better to allow binding proposals to go forward, leaving it to the state courts to determine how to apply state law.<sup>63</sup>

The ensuing step following refusal to issue a no-action letter, however, may not be litigation of the question presented in state courts—or clarification by the state legislature, for that matter. Rather, a public corporation that disputes the Division's determination and is unwilling to await state guidance may instead seek immediate relief in the federal courts. In such cases, however, the courts might be encouraged to exercise their discretion to certify the questions presented to the supreme court of the relevant jurisdiction, as occurred in *Teamsters v. Fleming*.<sup>64</sup>

In choosing to do so, federal courts foster an explicitly dialectical interaction. In their framing of questions for certification, as well as their subsequent interpretation and necessarily discretion-ridden application of the state court's resulting decision, federal courts may pursue a dialogue between federal and state courts at the distinctive intersection of federal and state law created by Rule 14a-8.<sup>65</sup>

The possibility of certification by federal courts calls attention to a potentially even more meaningful opportunity for dialectical engagement. In May 2007, the Delaware legislature unanimously enacted a constitutional amendment allowing the SEC to certify questions directly to the Delaware Supreme Court.<sup>66</sup> In essence, this amendment aims to prevent the SEC from guessing how Delaware law would apply to a given proposal.<sup>67</sup>

Amendments akin to Delaware's represent an advance over simply allowing a broader universe of shareholder proposals to go forward. Rather than putting a proposal through the entire process of shareholder adoption, and/or an entirely new analysis in state courts or the legislature, Delaware's amendment attempts to resolve the issue presented at its inception. Once a ripe question has been presented to the SEC, in the form of a no-action letter request arising from a particular

63. See Transcript of Roundtable Discussion, *supra* note 8, at 32–34.

64. See Int'l Bhd. of Teamsters Gen. Fund v. Fleming Cos., Inc., 173 F.3d 863 (10th Cir. 1999).

65. Cf. Ahdieh, *Dialectical Regulation*, *supra* note 6, at 883. It bears noting that such certification is now permitted by the majority of states. See Rebecca A. Cochran, *Federal Court Certifications of State Law to State Courts: A Theoretical and Empirical Study*, 29 J. LEGIS. 157, 159 (2003) ("Today, in forty-seven states, the District of Columbia, and Puerto Rico, some or all federal judges can certify a question to the state's highest court, asking that court to answer the question.").

66. S.B. 62, 144th Gen. Assem., Reg. Sess. (Del. 2007). Jeffrey Baumann has praised the amendment as "an innovative approach to questions of federalism and corporate law." Press Release, Supreme Court of Delaware, Delaware Constitutional Amendment Enacted Allowing the Securities and Exchange Commission to Bring Questions of Law Directly to the Delaware Supreme Court (May 17, 2007), available at <http://courts.delaware.gov/Courts/Supreme%20Court/pdf/?deconstamend051507pdf.pdf>.

67. Even in the absence of a certification mechanism akin to that created by Delaware, the SEC might seek the input of state courts on state law questions before it. Thus, in appropriate cases, declaratory guidance of a sort might be sought in the state courts—perhaps a viable possibility, given generally lowered standing and ripeness barriers to jurisdiction in the state courts.

67. The very genesis of this amendment suggests the utility of engagement. The idea for it arose out of a meeting of Delaware Supreme Court and Court of Chancery judges with representatives of the SEC. See Maureen Milford, *New State Law Expands Delaware's Role in Corporate Governance*, NEWS J. (Wilmington, Del.), May 19, 2007.

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shareholder proposal, the SEC can do its best to resolve the question, or otherwise turn to the state courts for guidance.

This would eliminate a major hurdle for shareholders—the need to litigate against deep-pocketed corporate managers,<sup>68</sup> who will often have strong incentives to avoid inclusion of embarrassing shareholder proposals in proxy materials.<sup>69</sup> By allowing state courts to speak to the questions presented, without need for a protracted court fight, costs are significantly reduced, while the status quo, in which one-paragraph no-action letters are the final arbiter of proxy proposals, is also displaced.<sup>70</sup>

To be sure, the extent of relevant state law—even for analysis by state courts—is limited at present, on account of the operationalization of Rule 14a-8 to date.<sup>71</sup> Given as much, the Division has been forced to rely either on a “common law” of Rule 14a-8, essentially of its own creation, or occasionally on the law of those few states with more developed rules on a given issue.<sup>72</sup> With greater involvement of state courts in the 14a-8 analysis, however, this will begin to change.

Even where certification to a relevant state is not possible in a given case, however, the SEC need not fall back on a policy of broad inclusion or exclusion of shareholder proposals. Rather, other elements of a regime of dialectical regulation might be introduced, both to increase the quality of the Division’s engagement with state law and to encourage state involvement in the process. This may be an opportune time to consider such changes in the approach to Rule 14a-8, given the SEC’s indication of some intent to consider further amendments to the rule.<sup>73</sup>

Most significantly, the Division might impose a heavier burden on managers seeking to exclude shareholder proposals, requiring documentation of clear state

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68. See Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 Nw. U. L. Rev. 1436, 1463 (1994).

69. For the moment, however, given limited resources, the SEC would appear to see such private litigation as part of the standard approach to shareholder access. See *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc. (ACTWU)*, 821 F. Supp. 877, 883 (S.D.N.Y. 1993).

70. The obstacles to shareholder litigation should not be overstated. As John Olson has pointed out, Professor Lucian Bebchuk, with far fewer resources than the average institutional investor, managed to force a settlement with a resistant corporation, in which it agreed to submit a proposed change in corporate policy to shareholder vote. See John F. Olson, *Professor Bebchuk’s Brave New World: A Reply to “The Myth of the Shareholder Franchise,”* 93 Va. L. Rev. 773, 778–79 (2007). It is not, thus, impossible for a shareholder to litigate their proposal into a corporation’s proxy materials. But it is not easy either.

71. See, e.g., *ACTWU*, 821 F. Supp. at 884 n.7 (acknowledging limited Delaware law on point); *New York City Employees’ Ret. Sys. v. Dole Food Co.*, 795 F. Supp. 95, 100 n.3 (S.D.N.Y. 1992) (noting parties’ failure to supply any relevant Hawaiian law), *vacated by* 969 F.2d 1430 (2d Cir. 1992); see also Loss & Seligman, *supra* note 8, at 556 (“[T]he difficulty is that there is simply not very much state law to use as a guide in these matters.”).

72. See *Med. Comm. for Human Rights v. SEC*, 432 F.2d 659, 677, 680 n.29 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972); see also *ACTWU*, 821 F. Supp. at 884 n.7; Loss & Seligman, *supra* note 8, at 556.

73. See, e.g., *Amendments to Rules on Shareholder Proposals*, *supra* note 6; see also Press Release, SEC, *Commission Calendars Proposed Amendment to Rule 14a-8 Governing Director Nominations by Shareholders* (Sept. 7, 2006), available at <http://www.sec.gov/news/press/2006/2006-150.htm>; E. Norman Veasey, *The Stockholder Franchise is Not a Myth: A Response to Professor Bebchuk*, 93 Va. L. Rev. 811, 822 n.42 (2007).

law or jurisprudence in order to qualify for no-action relief.<sup>74</sup> The present implementation of Rule 14a-8, by contrast, seems to set a relatively low bar for managers to clear.<sup>75</sup> Consider the representative case of a no-action letter issued to General Motors, with regard to a shareholder proposal concerning the responsibilities of its corporate directors: GM's counsel offered its detailed opinion that the proposal, if implemented, would violate Delaware law.<sup>76</sup> The SEC responded with a single paragraph:

*There appears to be some basis for your view that General Motors may exclude the proposal under rule 14a-8(i)(2). We note that in the opinion of your counsel, implementation of the proposal would cause General Motors to violate state law. Accordingly, we will not recommend enforcement action to the Commission if General Motors omits the proposal from its proxy materials in reliance on rule 14a-8(i)(2).<sup>77</sup>*

Such exclusive reliance on the analysis of the subject corporation is often defended on the grounds that a no-action letter “is an informal response, and does not amount to an official statement of the SEC’s views.”<sup>78</sup> No-action letters are thus “interpretive because they do not impose or fix legal relationships upon any of the

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74. See Amendments to Rules on Shareholder Proposals, *supra* note 6, Question 7 (codified at 17 C.F.R. § 240.14a-8(g) (2006)); Solicitation of Proxies, 19 Fed. Reg. 246, 246 (Jan. 14, 1954) (codified at 17 C.F.R. pt. 240) (noting Rule 14a-8’s placement of burden on issuer). One might reasonably characterize the Division’s present approach to Rule 14a-8, particularly with reference to its second threshold heuristic—i.e., its exclusion of proposals where relevant state law is ambiguous—as placing the burden on the shareholder. This is contrary to the formal characterization of the rule, but may arguably capture its essence. *Cf.* SEC Legal Staff Bulletin No. 14 (CF), at 30 (July 13, 2001), available at <http://www.sec.gov/interps/legal/cfs1b14.htm> (noting that proposer “should” submit opinion of counsel refuting issuer’s submission). Thus, consider the note to Rule 14a-8(i)(1), which states as follows: “Depending on the subject matter, some proposals are not considered proper under state law if they would be binding on the company if approved by shareholders. In our experience, most proposals that are cast as recommendations or requests that the board of directors take specified action are proper under state law. Accordingly, we will assume that a proposal drafted as a recommendation or suggestion is proper unless the company demonstrates otherwise.” 17 C.F.R. § 240.14a-8(i)(1) (emphasis added). The latter would seem to imply, however, that beyond this exception, the burden is *not* on the company. It may be notable, in this regard, that the SEC has been accused of “repeatedly violating its own established procedural principles, particularly those relating to management’s burden of proof in justifying the omission of proposals . . . .” *Med. Comm.*, 432 F.2d at 674.

75. See Alan R. Palmiter, *The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation*, 45 ALA. L. REV. 879 (1994).

76. See Gen. Motors Corp., SEC No-Action Letter, 2007 WL 1215030 (Apr. 19, 2007).

77. *Id.* at \*10. Such vague no-action letter language is fairly standard, across all the various Rule 14a-8 exceptions. See, e.g., XM Satellite Radio Holdings, Inc., SEC No-Action Letter, 2007 WL 1453718 (May 14, 2007).

78. See *New York City Employees’ Ret. Sys. v. SEC (NYCERS)*, 45 F.3d 7, 12 (2d Cir. 1995).

parties.”<sup>79</sup> But this misses the forest for the trees. As to the vast majority of shareholder proposals, no-action letters represent the final word on their advance.<sup>80</sup>

Given as much, the Division of Corporation Finance might also do well to bring somewhat greater formalism to the Rule 14a-8 process. Even a degree of adversarialism might be in line with the underlying dynamic. Yet it is absent for the moment.<sup>81</sup> Thus, while the process permits shareholder input, Rule 14a-8 seems to emphasize its limited relevance:

*Although Rule 14a-8(k) does not require any communications from shareholders to the Commission’s staff, the staff will always consider information concerning alleged violations of the statutes administered by the Commission, including argument as to whether or not activities proposed to be taken would be violative of the statute or rule involved. The receipt by the staff of such information, however, should not be construed as changing the staff’s informal procedures and proxy review into a formal or adversary procedure.*<sup>82</sup>

Beyond encouraging development of a clearer record of applicable state law for the Division to review, changes along the above lines might also incentivize corporations to seek declaratory relief from state courts in advance, rather than awaiting clarification by those courts after SEC action (or inaction). Further, rather than simply passing the buck to state courts, and rendering the SEC’s contribution more procedural than substantive in nature, these changes would allow the Division to be informed and thoughtful about how state law might actually apply to proposals before it. It would also avoid delaying justice for shareholders with valid proposals not self-evidently in violation of state law—proposals that are often excluded under

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79. See *id.*; see also *Am. Fed’n of State, County & Mun. Employees v. Am. Int’l Group, Inc. (AFSCME)*, 462 F.3d 121, 123 n.3 (2d Cir. 2006); *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 423 (D.C. Cir. 1992).

80. See, e.g., Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921, 924–25 (1998). Faced with a pair of extremely costly options—litigation or private solicitation—most shareholders abandon their efforts upon issuance of a no-action letter. More broadly, and perhaps more importantly, as the court acknowledged in *Medical Committee for Human Rights*, reliance on private litigation to ensure inclusion of a proposal in the annual proxy would seem to be inconsistent with the underlying spirit—and purpose—of Rule 14a-8. See 432 F.2d 659, 672 (D.C. Cir. 1970). But see *Amalgamated Clothing & Textile Workers Union v. Wal-Mart Stores, Inc. (ACTWU)*, 821 F. Supp. 877, 883 (S.D.N.Y. 1993) (noting SEC staff concerns about “its inability to enforce § 14(a) on its own through the informal no-action letter process, and . . . [the] need for its efforts to be supplemented by private enforcement in the courts”).

81. See *Roosevelt*, 958 F.2d at 423.

82. *Gen. Motors Corp.*, SEC No-Action Letter, 2007 WL 1215030, at \*10 (Apr. 19, 2007). Notably, in 1976, the SEC characterized the process even more starkly, stating that the rule does “not provide for any communications from” the shareholder proponents. See *Informal Procedures*, *supra* note 40, at \*4.

the SEC's current scheme. Given shareholders' financing of their own litigation, such changes would seem especially justified.<sup>83</sup>

In line with the dialogue that generated Delaware's constitutional amendment permitting SEC certification of questions to the state supreme court,<sup>84</sup> the SEC might also pursue a broader pattern of engagement with relevant state authorities. Depending on the relevant jurisdiction, such engagement might encompass the attorney general, the secretary of state, or even state securities market officials. SEC Chairman Christopher Cox's recent announcement of a series of roundtables to discuss and define the SEC's appropriate role in proxy regulation might be noted in this regard.<sup>85</sup> The inclusion of Delaware Chancellors Stephen Lamb and Leo Strine, in the first roundtable was significant in this vein. The absence of any state executive or legislative branch officials, on the other hand, was equally notable. Such broader engagement would be advisable at future sessions of the roundtable.

As this suggests, SEC engagement with state legislatures, while not practicable in individual cases, might also be pursued. A simple, but significant, step in this direction would involve dissemination of relevant data. Information regarding no-action letter petitions by corporate citizens of each state might be compiled annually, perhaps with appropriate Division commentary on the particular difficulties its staff faced in responding to those requests. Recurrent SEC testimony before relevant state legislative subcommittees might offer occasion to present such data. Here, of course, the give-and-take pattern of engagement at the heart of dialectical regulation is self-evident.

Some state officials have actually reached out to Congress to encourage such dialogue. In May 2007, the attorneys general of Ohio and Utah sent a joint letter to the House Financial Services and Senate Banking committees, urging them to hold hearings on what they perceived as the SEC's anti-investor approach in a number of areas.<sup>86</sup> They further offered themselves as potential witnesses, should such hearings be convened.<sup>87</sup>

Yet Congress has seemed reluctant to engage state actors. The House of Representatives has taken some action on proxy solicitations, but has proceeded without

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83. As noted above, reliance on state action versus private litigation would also seem to be more consistent with the goals underlying Rule 14a-8. See *Med. Comm.*, 432 F.2d at 672 ("There is also, it seems to us, an independent public interest in having the controversy decided in its present posture rather than in the context of a private action against the company. The primary and explicit purpose of section 14(a) is 'the protection of investors,' and the primary method of implementing this goal is through Commission regulation of proxy statements, not through private actions by individual security holders. For the small investor, personal recourse to the Commission's proxy procedures without benefit of counsel may well be the only practicable method of contesting a management decision to exclude his proxy proposal.").

84. See *supra* notes 66–67 and accompanying text.

85. See Transcript of Roundtable Discussion, *supra* note 8.

86. See Letter from Marc Dann, Ohio Att'y Gen., and Mark Shurtleff, Utah Att'y Gen., to Barney Frank, Chair, H. Comm. on Fin. Servs., et al., (May 11, 2007), available at <http://www.legalnewslines.com/content/img/f195044/AGsletter.pdf>.

87. *Id.*



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state input. In March 2007, the House Committee on Financial Services heard testimony on H.R. 1257, the Shareholder Vote on Executive Compensation Act.<sup>88</sup> Among other things, the bill would require proxy solicitation materials to disclose agreements with principal executive officers regarding golden parachute compensation, and allow a separate shareholder vote on executive compensation.<sup>89</sup> While the committee heard from academics and interest groups, however, it did not invite testimony from any state legislative, regulatory, or judicial officials.<sup>90</sup> This would have been a prime opportunity for dialogue with the states on the fundamentally intersystemic rules governing proxy solicitations.

Measured against the status quo, the innovations and adjustments proposed above might be viewed as little more than a heightened degree of SEC delegation and deference to state authorities. But this misses the point. The essence of dialectical regulation is the allocation of regulatory authority in such a fashion that no participant can effectively dictate outcomes in isolation.<sup>91</sup> Instead, optimal regulatory outcomes can arise only through the ongoing engagement of regulators in symbiotic relationship with one another.

This is what Brett McDonnell describes in the aftermath of Sarbanes-Oxley, with Delaware and the SEC each gradually shifting position, in some response to one another.<sup>92</sup> Delaware responded both judicially and legislatively to Sarbanes-Oxley, to create a more favorable regulatory environment for shareholders.<sup>93</sup> The SEC, in turn, seemed to acknowledge as much in its adoption of implementing regulations.<sup>94</sup> However, the pendulum has also swung the other way, perhaps due to the Delaware courts' and the SEC's shared sense of a potential backlash against Sarbanes-Oxley.<sup>95</sup> Attention to one another was essential for each institution, however, given their unavoidable dependence in matters of corporate governance.

This is also the potential pattern under a well-functioning Rule 14a-8. Formally, the rule grants the SEC and the federal courts near-complete autonomy from relevant state authorities, be they legislatures, regulators, or courts, in determining how to proceed. State authorities enjoy similar independence from their federal counter-

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88. H.R. 1257, 110th Cong. (2007).

89. According to the committee report on the bill, its purpose is to "provide shareholders with a meaningful say on their company's executive compensation practices without setting any caps on executive pay or micromanaging the company." H.R. REP. NO. 110-88, at 2 (2007).

90. See *Empowering Shareholders on Executive Compensation: H.R. 1257, the Shareholder Vote on Executive Compensation Act: Hearing Before the Comm. on Fin. Servs.*, 110th Cong. III (2007).

91. See generally Ahdieh, *Dialectical Regulation*, *supra* note 6, at 918-20.

92. See Brett H. McDonnell, *In the Wake of Corporate Reform: One Year in the Life of Sarbanes-Oxley*, 2004 MICH. ST. L. REV. 505.

93. See *id.*; see also Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 255 (2006); Andrew A. Lundgren, *Sarbanes-Oxley, Then Disney: The Post-Scandal Corporate-Governance Plot Thickens*, 8 DEL. L. REV. 195 (2006).

94. See Ahdieh, *Federalization*, *supra* note 10, at 728-29.

95. See, e.g., Brehm v. Eisner, 906 A.2d 27 (Del. 2006); Siobhan Hughes, *Sarbanes-Oxley Is Eased*, WALL ST. J., May 24, 2007, at C8; Kara Scannell, *SEC to Propose New Guidance on Internal Controls*, WALL ST. J., Dec. 13, 2006, at C4.

parts.<sup>96</sup> As a practical matter, however, the work of each can be expected to significantly impact the other. While the SEC is nominally free to assert whatever interpretation of state law it elects in assessing the permissibility of shareholder proposals, state courts, as well as legislatures, are likely to disregard cavalier interpretations.<sup>97</sup> Given the costs of such correction after the fact, however, states are incentivized to seek engagement with relevant federal actors, rather than simply ignoring them and imposing their will.<sup>98</sup> Ultimately, the inefficiency of an unending series of repeat plays, each requiring action and reaction by the SEC and state courts or legislatures, can be expected to drive both federal and state alike to attend more closely to one another.

There is, of course, a real cost to implementation of a regime of dialectical regulation under Rule 14a-8—delay. In significant part, the defense of the status quo distills down to a claim that there is inadequate time to do any better.<sup>99</sup> But this need not be so. The deadlines for shareholder proposals might be advanced, to allow ample time for meaningful consideration. By seeking greater and more thorough input by knowledgeable parties, meanwhile, the Division might not face any more difficult a task of analysis. The point of a dialectical approach to Rule 14a-8, meanwhile, is to develop a clearer body of applicable law. While this will require an increased investment of time on the front-end, this initially steep learning curve will eventually be climbed, permitting the resolution of no-action requests both expeditiously—and meaningfully. Finally, it is worth considering the possibility that analysis under a dialectical regime sometimes might be abstracted away from individualized cases or controversies, where more extended time is necessary for adequate review and analysis.

On the other side of the ledger, meanwhile, the greater investment of time may offer significant dividends. At the broadest level of abstraction, a regime of dialectical regulation may help to make reasoned analysis a more valued coin of the regulatory realm of corporate governance. Concretely, a series of significant benefits of dialectical regulation might be noted.

First, as the foregoing discussion suggests, a regime of dialectical regulation under Rule 14a-8 may help to foster salutary innovation.<sup>100</sup> State corporate law might be improved in ways not readily apparent, but drawn out through engage-

96. The Securities Act of 1933 and the Securities Exchange Act of 1934 both contain savings clauses, preserving the continued viability of state securities statutes. See Pub. L. No. 73-22, § 18(c), 48 Stat. 74 (codified as amended at 15 U.S.C. § 77r(c) (2000)); Pub. L. No. 73-291, § 28(a), 48 Stat. 881 (codified as amended at 15 U.S.C. § 78bb(a) (2000)).

97. See Robert B. Ahdieh, *Between Dialogue and Decree: International Review of National Courts*, 79 N.Y.U. L. Rev. 2029, 2078 n.214 (2004) [hereinafter Ahdieh, *Dialogue*]; cf. Nagy, *supra* note 80, at 1011 (stating that with respect to Rule 14a-8, which rests on state law interpretation, SEC staff is “far removed from its area of expertise”).

98. Cf. Ahdieh, *Dialogue*, *supra* note 97, at 2094–95.

99. See *Roosevelt v. E.I. Du Pont de Nemours & Co.*, 958 F.2d 416, 423 (D.C. Cir. 1992); Informal Procedures, *supra* note 40, at \*3.

100. See Ahdieh, *Dialectical Regulation*, *supra* note 6, at 890–93.

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ment with regulators beyond the state orbit.<sup>101</sup> In this conception, a regime of dialectical regulation—akin to regulatory competition—may serve as a source of new ideas.<sup>102</sup> Further, it may help to catalyze their implementation. Take the rise of institutional investors during the final decades of the twentieth century, for example. Such investors, of course, are better able to pursue changes in corporate governance—and policy generally—than ordinary investors.<sup>103</sup> Regulatory modifications responsive to the latter might be encouraged by greater engagement of state regulators and the SEC.

Dialectical regulation's encouragement of innovation may also be important in another respect. Rapidly changing—and increasingly global—financial markets demand artful approaches to problems that cross both horizontal and vertical jurisdictional boundaries.<sup>104</sup> Such approaches may best be identified where regulatory entities are themselves engaged with one another across those boundaries.

Quality control may be a related by-product of intersystemic regulatory engagement, as experience and information are pooled. This is particularly evident in the operation of Rule 14a-8, as the SEC struggles to assess the legal implications of including or excluding particular shareholder proposals.<sup>105</sup> Through greater interaction between state courts and regulators—the ground-level executors of state corporate law—and the SEC, the margin of error in SEC decisions will necessarily be narrowed.<sup>106</sup>

If the role of dialectical regulation in facilitating innovation is a story of utility-enhancing change, meanwhile, its role in overcoming inertia is the negative counter story. Here, the emphasis is not change designed to achieve optimality, but resistance to change generally, a pattern far more widespread in legal regimes than commonly acknowledged.<sup>107</sup> Instability of a sort, fostered by forced engagement with regulatory actors outside one's own regime, may help to interrupt such patterns of inertia.<sup>108</sup> The SEC's persistence in encouraging foreign regulators to join in its attack on insider trading has thus resulted in the emergence of insider trading

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101. See *id.* at 891; Cover, *supra* note 32, at 672–73.

102. See Robert A. Schapiro, *Toward a Theory of Interactive Federalism*, 91 IOWA L. REV. 243, 284, 288–90 (2005).

103. See Robert B. Ahdieh, *Making Markets: Network Effects and the Role of Law in the Creation of Strong Securities Markets*, 76 S. CAL. L. REV. 277, 294 n.64 (2003).

104. See Ahdieh, *Dialectical Regulation*, *supra* note 6, at 883; John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757, 1772–73 (2002); see also Concept Release, Request for Comments, Exchange Act Release No. 38,672, 62 Fed. Reg. 30,485, 488 n.8 (June 4, 1997).

105. See Concept Release, *supra* note 104.

106. See Ahdieh, *Dialectical Regulation*, *supra* note 6, at 888; William J. Carney, *The Impact of Competition on Regulation*, 52 EMORY L.J. 1285, 1293 (2003).

107. See Clayton P. Gillette, *Lock-In Effects in Law and Norms*, 78 B.U. L. REV. 813 (1998).

108. See Ahdieh, *Dialogue*, *supra* note 97, at 2066–68.

rules worldwide.<sup>109</sup> Changes in the regulation of particular anti-takeover protections, as new protections have risen to the fore, may likewise suggest relevant examples.

The engagement of regulatory agencies with legislatures may be particularly important in this vein. Legislatures may have certain particular sensitivities to problems in need of a solution.<sup>110</sup> Because of the direct influence of interest groups, constituents, and businesses that are impacted by inefficiencies in the law, lawmakers will often be among the first to be motivated to act.<sup>111</sup> Because legislatures often lack substantive expertise to solve such problems on their own, however, a dialectical framework encouraging recurrent interaction between legislatures and regulatory agencies able to define and analyze the issue more precisely may be especially important.<sup>112</sup> Rather than the traditional conception, in which agencies come into play primarily at the implementation phase, rather than in issue-definition, analysis, and agenda-setting, a regime of dialectical regulation may facilitate heightened cooperation and knowledge-sharing among players throughout the life-cycle of a regulatory question.<sup>113</sup>

Finally, dialectical regulation may also allow for more effective control of systemic (and perhaps individual) bias, including the assertedly pro-managerial biases of state law.<sup>114</sup> It has long been suggested that distinct interest groups are distinctly oriented to advocate among state versus federal corporate and securities law regulators.<sup>115</sup> A regime of dialectical regulation might be expected to facilitate a heightened balance of competing interests in the design and implementation of relevant rules of corporate governance.<sup>116</sup>

This is not to question that there are real issues with a dialectical regime. I have already noted the delay attendant to it, at least early on. Additionally, it is necessary to consistently guard against the collapse of dialectical structures into a wholesale

109. See Ahdieh, *Dialectical Regulation*, *supra* note 6, at 865–66; John G. Moon, *The Dangerous Territoriality of American Securities Law: A Proposal for an Integrated Global Securities Market*, 21 NW. J. INT'L L. & BUS. 131, 133 (2000).

110. See John Mixon & Gordon Otto, *Continuous Quality Improvement, Law, and Legal Education*, 43 EMORY L.J. 393, 426 (1994).

111. See James Brudney, *Congressional Accountability and Denial: Speech or Debate Clause and Conflict of Interest Challenges to Unionization of Congressional Employees*, 36 HARV. J. ON LEGIS. 1, 44 (1999).

112. See Mixon & Otto, *supra* note 110, at 414–16 (advocating a collaborative system between government branches to ensure quality control).

113. See *id.*; see also Ahdieh, *Dialectical Regulation*, *supra* note 6, at 892.

114. See McDonnell, *Getting Stuck*, *supra* note 25, at 692–96.

115. See *id.*

116. Recall, in this vein, the aforementioned attorneys general letter to congressional leaders, calling attention to the perceived negative impact of various SEC rulings on investor interests. See *supra* note 86 and accompanying text. In particular, the attorneys general highlighted the SEC's opposition to the Second Circuit's pro-shareholder ruling in *Am. Fed'n of State, County & Mun. Employees v. Am. Int'l Group, Inc.* (AFSCME), 462 F.3d 121, 123 n.3 (2d Cir. 2006). There, the court found that the SEC's interpretation of Rule 14a-8 in its *amicus curiae* brief need not be accorded significant deference, given its inconsistency with prior SEC interpretations of the rule. See *id.* at 129. Rule 14a-8's interactive scheme, in this case, might be seen to have called attention to some bias of the Commission, in favor of managerial interests.

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shift to either federal or state rules, obviating the benefits of the dialectical regime. Intersystemic regulatory regimes, finally, are more prone to shirking by responsible authorities, and ills associated with “regulatory gaps.”<sup>117</sup> I do not propose, as such, any universal shift to dialectical regulation. At least in certain circumstances, however, dialectical regulation may be an important instrument in the regulatory toolkit of the modern administrative state.

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While this thumbnail sketch necessarily brushes over significant questions in the design and implementation of a regime of dialectical regulation in corporate law, it suggests the potential for such a regime to play a greater role in corporate governance. Sarbanes-Oxley and the debate it engendered may thus have created an opportunity to move beyond the longstanding dichotomy of federal versus state corporate law, to a new regime of dialectical regulation. A new approach to Rule 14a-8 may be a first step in this direction. The result of so much rethinking and reinvention over the years, long recognized for its “symbolic significance” in the regulation of corporate governance,<sup>118</sup> Rule 14a-8 may today be a promising locus for an entirely new paradigm of intersystemic regulatory engagement.

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117. See William W. Buzbee, *A Theory of Regulatory Gaps*, 89 IOWA L. REV. 1 (2003).

118. See LOSS & SELIGMAN, *supra* note 8, at 573.