Administrative Law - Securities and Exchange Commission's Determinations Governing Security Holders' Proxy Proposals Held Subject to Judicial Review

Thomas J. Montgomery

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ADMINISTRATIVE LAW—Securities and Exchange Commission's Determinations Governing Security Holders' Proxy Proposals Held Subject to Judicial Review.

The Medical Committee for Human Rights acquired five shares of Dow Chemical Company stock by gift. On March 11, 1968, the Committee wrote to the Secretary of Dow requesting that a resolution to amend the charter of Dow Chemical be sent to the shareholders. The proposed amendment sought to place a limitation upon the corporation's sale of napalm. The Committee stated that their objection was based on concern for human life, but that it had also been informed by its investment advisors that the sale of napalm was detrimental to the company's business. Copies of this letter were forwarded to the President and General Counsel of Dow Chemical Company and to the Securities and Exchange Commission.

On March 21, 1968, the General Counsel of Dow sent a return

1. RESOLVED, that the shareholders of the Dow Chemical Company request the Board of Directors, in accordance with the laws of the State of Delaware, and the Composite Certificate of Incorporation of the Dow Chemical Company, to adopt a resolution setting forth an amendment to the Composite Certificate of Incorporation of the Dow Chemical Company that napalm shall not be sold to any buyer unless that buyer gives reasonable assurance that the substance will not be used on or against human beings.

2. The letter concluded,

It is now clear from company statements and press reports that it is increasingly hard to recruit the highly intelligent, well-motivated, young college men so important for company growth. There is, as well, an adverse impact on our global business, which our advisors indicate, suffers as a result of the public reaction to this product.

3. The statutory basis for the federal regulation of proxy solicitations was established by section 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(a) (1964) which provides:

- Shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 12 of this title.

Pursuant to its rule making authority delegated by the section, the Securities and Exchange Commission has promulgated Rule 14a-8, 17 C.F.R. 240.14a-8 which governs the proposals of security holders. Rule 14-8(a) provides in part:

If any security holder entitled to vote at a meeting of security holders of the issuer shall submit to the management of the issuer, within the time hereinafter specified, a proposal which is accompanied by notice of his intention to present the proposal for action at the meeting, the management shall set forth the proposal in its proxy statement and shall identify it in its form of proxy and provide means by which security holders can make the specification provided for by Rule 14a-4(b).
letter advising the Medical Committee that the proposal was received too late for inclusion in the 1968 proxy statement, but that the matter would be considered for inclusion in the 1969 proxy materials sent to the shareholders. A copy of this letter was filed with the Commission.

Subsequently, on January 17, 1969, the Secretary of Dow Chemical informed the Medical Committee that Dow intended to omit the resolution from its proxy statement, and enclosed an opinion memorandum from Dow's General Counsel. In that memorandum he stated that it was his opinion that the proposal related to the ordinary business operations of the Company, and was one motivated primarily by a general political, social, or similar cause. On February 3, 1969, the Medical Committee responded to Dow's General Counsel, contending that he had misconstrued the nature of their proposal in his memorandum and submitted a revised proposal to prohibit the manufacture of napalm.

On the same date, the Committee sent a letter to the Securities and Exchange Commission requesting a staff review of Dow's decision if it refused to submit the revised proposal to the shareholders and oral argument before the Commission if the staff agreed with Dow's decision.

Shortly thereafter, Dow informed the Medical Committee and the Commission by letter that it intended to omit the proposal from its proxy statement for the reasons indicated in their letter of January 17. Soon after a letter was sent to Dow by the Commission's Chief Counsel of the Division of Corporate Finance stating that the Division would not recommend any action be taken if the proposal were omitted.

The Medical Committee requested a review by the Commission of the decision in a letter and submitted a memorandum of legal arguments supporting the resolutions and challenging the Division's decision.

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4. Rule 14a-8(c)(2), 17 C.F.R. 240.14a-8(c)(2) permits management to omit a proposal if it clearly appears that the proposal is submitted by the security holder primarily for the purpose of enforcing a personal claim . . . against the issuer or primarily for the purpose of promoting general economic, political, racial, religious, social or similar cause.

Rule 14a-8(c)(5), 17 C.F.R. 240.14a-8(c)(5) permits management to omit a proposal if the proposal consists of a recommendation or request that the management take action with respect to a matter relating to the conduct of the ordinary business operations of the issuer.

5. RESOLVED, that the shareholders of the Dow Chemical Company request that the Board of Directors, in accordance with the laws (sic) of the Dow Chemical Company, consider the advisability of adopting a resolution setting forth an amendment to the Composite Certificate of Incorporation of the Dow Chemical Company that the company shall not make napalm.
sion recommending no action be taken. Finally, on April 2, 1969, both the Medical Committee and Dow were informed by letter that the Commission had approved the recommendation of the Division of Corporation Finance.

On May 29, 1969, the Medical Committee filed a petition to review the order of the Securities and Exchange Commission in the United States Court of Appeals for the District of Columbia. The Commission's motion to dismiss the petition for lack of jurisdiction was denied.

The court was confronted with three issues bearing on its jurisdiction to review. The first issue was whether the review was timely sought. The second issue was whether there was a reviewable order at all. Finally, assuming that review was proper, the third issue concerned the determination of the scope of review.

On these jurisdictional issues, the Court of Appeals held: (1) that the petition of the Medical Committee had been timely filed because the period for review did not begin to run until the Medical Committee had been given adequate notice; (2) that there was a reviewable order because the Commission's procedural regulations governing proxy proposals are possessed of sufficient adversariness and formality to render its final proxy determinations amenable to judicial review, and because the Medical Committee was aggrieved for purposes of the Act; and (3) that the court was authorized to conduct a limited review to examine the validity of the legal framework within which the administrative discretion was exercised.

Having decided that the court had limited jurisdiction to review the agency determination the court concluded that on the present state of the record it was unable to determine the legal basis for the Commission's action and therefore remanded the cause to the Commission "for a more illuminating consideration and decision."

The decision in Medical Committee for Human Rights v. Securities and Exchange Commission⁷ is significant because it marks the first time that the Commission's determinations governing security holder's proxy proposals have been subjected to judicial review. On its face it appears that the Court of Appeals has facilitated the procedure for a security holder with few shares and limited resources who seeks inclusion of proxy proposals in management's proxy materials. On a

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7. 432 F.2d 659 (D.C. Cir. 1970).
broader basis, the court’s conclusion that a Commission determination without a formal hearing is sufficiently formal and adversary in nature to support judicial review may provide support for an increased activity by the courts in overseeing administrative action.

The jurisdiction of the Court of Appeals was based on section 25(a) of the Securities Exchange Act of 1934, which provides in part:

Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order . . . in the Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part.8

The first objection raised by the Commission was that the Court of Appeals was without jurisdiction because the Medical Committee had failed to file its petition for review within sixty days after entry of the Commission order. Relying upon section 22(k) of its Rules of Practice,9 the Commission contended that the date of entry of the alleged order was the date that the Commission decided not to take action with regard to the proposal. The decision regarding the petitioner’s proxy proposal was made on March 24, 1969, and on that date the petitioner was notified of that decision by telephone. Since the petitioner did not file its petition until May 29, 1969, which was 66 days later, the Commission concluded that the petition was untimely.

The court, however, noted that the petitioner did not receive any written information concerning the Commission’s decision until a letter was mailed to them on April 2. The court stated that:

Rule 22(k) together with the 60 day statutory period for filing petitions for review, evidences an attempt by Congress and the Commission to strike a balance between the need to have Commission orders operate with finality, and the aggrieved party’s need to have both adequate notice of the substance of the decision, and sufficient time to prepare his petition.10

9. Section 22(k), 17 C.F.R. 201.22(k) (1970) provides:
   In computing any period of time involving the date of the entry of an order by the Commission, the date of the entry shall be (1) the date of the adoption of the order by the Commission . . . or (2) in the case of orders reflecting action taken pursuant to delegated authority, the date when such action is taken . . . . The order shall be available for inspection by the public from and after the date of entry by any person entitled to inspect it.
10. 432 F.2d at 665.
The court viewed the telephone call to petitioner as insufficient for this purpose and decided that the date written notice was sent more adequately reflects the intent of Congress. Since 60 days had not elapsed since the letter was mailed, the court concluded that the petition was not barred by reason of untimeliness.

The next issue the court considered was whether the Commission’s determination not to take action should Dow decide to omit the Medical Committee’s proposal was a reviewable order. Relying on the United States Supreme Court’s decision in *Abbott Laboratories v. Gardner,*¹¹ the court restated the principle that there is a strong presumption in favor of the court’s power to review administrative action.

Despite the strong presumption in favor of judicial review, the court recognized that the Congressional intent underlying an act may nevertheless preclude judicial review of administrative action.¹² The Commission reasoned that since the Securities Exchange Act contains various sections where provisions for adjudicatory proceedings involving the opportunity for an evidentiary hearing are set forth,¹³ and since section 14a of the Act, which provides for proxy solicitations does not provide for an evidentiary hearing; Congress did not intend for there to be judicial review of the Commission’s proxy determinations.

The court, however, noted that neither sections 14a nor 25a expressly exclude review, nor is there any indication in the legislative history of the Act that Congress so intended. The court was not convinced that Congressional failure to provide for evidentiary hearings in proxy matters indicated an intent to preclude review.¹⁴

The Commission, however, further contended that the very language of section 25a precludes judicial review. It argued that, within the meaning of the statute, the Medical Committee did not qualify as an aggrieved person, the Commission’s no-action letter was not an order,

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¹⁴. The court cited Professor Jaffe:

The mere fact that some acts are made reviewable should not suffice to support an implication of exclusion as to others. The right to review is too important to be excluded on such slender and indeterminate evidence of legislative intent.

and finally, the procedure that had been followed in issuing the no action letter did not constitute a proceeding.

The court found that "whether a particular action is a reviewable order can be subdivided into two general categories." The first consideration was whether the administrative action operated with final effect upon a particular individual, entity, or group. From this determination the court could infer that the Medical Committee had standing to sue, or was aggrieved for purposes of section 25a. The second consideration concerned the formalities surrounding the administrative action because the statutory terms "order" and "proceeding" suggest some formal characteristics. In viewing these two criteria the court emphasized that pragmatic considerations would prevail over purely doctrinal arguments against reviewability.

Turning first to the question of standing or aggrievement, the court considered the final effect of the Commission's order upon the Medical Committee. Recognizing that the action ended the proceedings before the Commission, there was no difficulty in the determination that the order was final. The problem was in determining whether it had the necessary adverse effect upon the Committee. It was contended that the effect was not adverse because the Medical Committee still had the option of instituting a private action against Dow in the appropriate district court. Thus it had an available alternate cause of action. The effect of such an alternate course of action upon the question of aggrievement has been considered by the cases of Abbott Laboratories v. Gardner and Isbrandtsen v. United States. In Abbott, a group of drug manufacturers sought declaratory and injunctive relief against regulations promulgated by the Commissioner of Food and Drugs. The regulations required that drug labels and advertising designate the established name of the drug every time its trade name was used. However, the regulations had not been enforced against the plaintiffs prior to the time the suit was filed. The Supreme Court in Abbott found that the regulations operated with final effect upon the petitioners because they had only two equally onerous alternatives open to them. If they wished to comply with the regulations, they would have to incur sizable expenses because they would have to change all their labels, advertisements, and promotional materials; and in addition, de-

15. 432 F.2d at 666.
16. Id. at 667. See also L. Jaffe op. cit. 419.
17. See n. 11, supra.
stroy all stocks of printed matter, and invest heavily in new supplies. The alternative to compliance risked criminal and civil penalties for the unlawful distribution of misbranded drugs.

Isbrandtsen involved a petition by an independent steamship line to review an order of the Federal Maritime Board permitting a proposed dual rate system of an association of competing steamship lines to go into effect before the petitioner had an opportunity for a hearing. The Board insisted that in declining to hold a hearing before the rates went into effect, it took only interlocutory action of a discretionary nature such as is not ordinarily reviewable. The court found that the action by the Board operated with final effect upon the petitioner because by the denial of the request for an immediate hearing, the Board would cause petitioner to suffer "real, immediate, and incalculable harm."  

It would appear that where the alternative course of action imposes additional difficulties upon the parties seeking review, such parties will be considered aggrieved for purposes of judicial review.

Relying primarily on the final effect of the Commission's decision upon the Medical Committee, the court in the instant case found that the Medical Committee was aggrieved for purposes of section 25(a) of the Securities Exchange Act, notwithstanding the fact that it still had the right to institute a private action against Dow in a federal district court. The court stated two reasons for this conclusion: (1) because the Medical Committee had undergone a two-stage administrative proceeding compelled by the risk that failure to do so would preclude any judicial relief and, therefore, had its recourse to an authoritative judicial determination delayed; (2) because the Medical Committee would have the added burden in a private action of overcoming an adverse Committee determination.

The court based its conclusion that the Medical Committee had

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19. Id. at 55.
20. Id. at 56. Isbrandtsen, who carried almost 1/3 of shipping volume in the area, was the only non-member competing with the association. Under the proposed rate system, shippers who refused to agree in writing to employ Isbrandtsen's competitors exclusively would be charged, for the same transportation and service, tariffs which were nine and one-half percent higher than those charged shippers who had executed agreements with the competitors. Once this contract had been entered into, a single shipment with Isbrandtsen would result in the shipper's being required to pay the association, as liquidated damages, fifty percent of the freight charge which the shipper would have paid had such shipment been made in an association vessel.
23. 432 F.2d at 667.
been compelled to undergo a two-stage administrative proceeding on *Peck v. Greyhound.*\(^{24}\) The plaintiff in *Peck*, who was the owner of three shares of stock in the defendant corporation, sought a temporary injunction against the defendant from soliciting proxies and from holding an upcoming stockholder's meeting. The plaintiff had requested that his proposal entitled "A Recommendation that Management Consider the Advisability of Abolishing the Segregated Seating System in the South," be included in management's proxy materials. The defendant corporation notified the plaintiff and the Commission that it intended to exclude the proposal because it was not a proper subject for action by shareholders as it dealt with matters which were of a general political, social or economic nature. The Commission directed the Assistant Director of Corporation Finance of the Commission to advise the corporation that the proposal need not be included in its proxy materials. The district court denied the motion for a temporary injunction because in the court's opinion the plaintiff had not pursued the available administrative remedies to obtain a review by the Commission of the interpretation of the Assistant Director.\(^{25}\) But since the facts indicate that the Commission had already passed upon the merits of the plaintiff's proposal, it is not clear what further action *Peck* could have taken within the administrative structure. Nevertheless, it would appear that the Court of Appeals in the instant case at least inferentially indicated that one who has been notified of a staff no action recommendation must seek relief from the Commission before instituting an action in a federal district court.\(^{26}\)

As support for its conclusion that the Medical Committee had been aggrieved because it had incurred the burden of overcoming an adverse Commission determination, the court cited *Union Pacific R. Co. v. Chicago & N.W. R. Co.*\(^{27}\) which holds that the Commission's interpre-

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\(^{25}\) Id. at 681.

\(^{26}\) The decision in *Peck* has been criticized as a "good example of the court's misunderstanding of the Commission's informal review procedures." Aranow and Einhorn, *Proxy Contests for Corporate Control*, 465 n.9 (2d ed. 1968). Although the commentators do not elaborate, it can be inferred that they were referring to the court's adoption of the exhaustion of administrative remedies doctrine because as they point out, "the total lack in the internal rules of the Commission for any procedures permitting review by the Commissioner of a staff member's determination that a given matter is (or is not) a violation, no meaningful exhaustion of administrative remedies could be accomplished." at 465. The validity of the *Peck* holding is doubtful in light of the U.S. Supreme Court's holding in *J.I. Case Co. v. Borak*, supra n. 22, which guarantees the shareholder's right to institute a private action against the company in a federal district court as a supplement to Commission enforcement. The holding in *Case* does not require the shareholder to seek relief from the Commission before he institutes his action against the company.

\(^{27}\) 226 F. Supp. 400 (N.D. Ill. 1964).
tation of its rules is entitled to judicial deference. In determining what weight should be given to the Commission’s failure to take action, the Union Pacific court pointed out a distinction between the situation where the Commission permits the filing of information but fails to take any action, in which case the failure to take action would not carry any weight, and the situation,

[W]here as here, circumstances assure that agency consideration has been given to the merits of a question in which case the determinations and positions of the responsible authorities of the S.E.C. carry significant weight and command deference in the courts.²⁸

For the principle set forth in Union Pacific to have any validity here, the Court of Appeals had to find some indication that there had been a legal interpretation of the proxy rules by the Commission. It is possible that the court found its evidence in the letter of the Commission’s Chief Counsel of the Division of Corporation Finance to Dow in which he stated that “for reasons stated in your letter and the accompanying opinion of counsel . . . this Division will not recommend any action.” The Commission approved this recommendation. If this approval by the Commission would be considered by a district court to be a legal determination then that court would give deference to the Commission’s interpretation. Thus the Medical Committee would incur an additional burden supporting the court’s determination that the Committee was an aggrieved party.

Having determined that the Commission’s action operated with final effect, and that therefore the Medical Committee was aggrieved for purposes of section 25a, the court proceeded to determine whether the Commission’s decision possessed sufficient formality to be a reviewable order.

The necessity for a formal action is also inherent in the language of section 25a, which requires a “proceeding.” The Commission argued that the informal nature of their proxy opinions do not give rise to a proceeding.²⁹

²⁸ Id. at 406.
²⁹ This view had been outlined in the Letter of Byron D. Woodside, Director of the Commission’s Division of Corporation Finance (52-56 Transfer Binder) CCH Fed. Sec. L. Rep. Ch. 90, 659 (March 4, 1954) at 92,002.

The circumstances surrounding the letter were similar to the circumstances in the present case. The shareholder to whom the letter was written had requested that the Commission take steps to compel management to include the shareholder’s proposal in management’s proxy materials. After the filing of opposing statements by shareholders and management, and the hearing of statements in support of the proposal, the Commission ultimately reached the conclusion that it would not object if the company de-
The Commission further contended that Rule 14a-8 did no more than establish a standard concerning shareholder proposals to which management must conform and, through a filing requirement, provide a means by which the Commission could judge the necessity for enforcement action. The Commission stated that its consideration of evidence submitted and arguments by interested parties, and the courtesy of a response to a complaining party, did not turn an exercise of discretion into an adjudication, convert the complainant into a party to a proceeding, or transform the Commission’s determination not to bring an enforcement action into an “order” of the Commission by which the complainant is aggrieved.

Although no case had expressly so held, it had been generally assumed that the Commission’s proxy determinations did not give rise to a formal reviewable proceeding. For example, in Klastorin v. Roth, there is dicta to the effect that review by the Commission of proxy material under Rule 14 is merely informal in nature. Legal commentators have been in general agreement with this opinion.

Nevertheless, the court found that the procedure presented in Rule 14a-8 was possessed of enough formality to render the determination of the Commission reviewable. The court pointed out that the procedures denominated “informal” by the Commission generally involve negotiation between the Commission and one private party, and normally culminate in a letter of advice to the party from a Commission staff member. In the case of the stockholder proxy proposals, there are two interested private parties, management and the shareholder.

The added formality brought about by having adverse parties was a determined to exclude the proposal from its proxy materials. The Commission noted that nothing the Commission had done had in any way prejudiced the right of the petitioner to institute an original action against the company in a federal district court to test the correctness of its proposal. Finally, the Commission stated that, “Reviewable orders under the Securities Exchange Act of 1934 are only those which are entered in a proceeding under the Act to which the person seeking review has been a party.”

Id. at 92,003.
31. Id. at 19.
32. 358 F.2d 182 (2d Cir. 1965).
33. Id. at 183, n. 2.

Rather these decisions must be understood in their context as informal administrative determinations not directly subject to review by Courts of Appeal.

See also, p. 43, Aranow and Einhorn, Proxy Contests for Corporate Control, supra, n. 26; III Loss, Securities Regulation 1896 (1961), as supplemented IV Loss at 4026 (1969); 1 Davis, Administrative Law Treatise, Section 4.09 (1958).
significant distinction. The court was further influenced by a Commission release concerning rule 14a—8 which stated that the rule places the burden of proof upon management to show that a particular security holder's proposal is not a proper one for inclusion in management's proxy material.\textsuperscript{35} The Commission contended that neither the release nor the rule indicated that the burden should be upon management in an administrative proceeding before the Commission. The court disregarded the Commission's contention and concluded that the Commission's procedural regulations governing proxy proposals incorporate the basic theory of an adversary encounter.

Having decided that the Commission's procedures possess sufficient attributes of finality and formality to warrant judicial review of final proxy determinations, the court had little difficulty with the fact that the Commission's decision was couched in terms of "no-action" rather than in the form of a decree binding a party to perform or refrain from some particular act.\textsuperscript{36} Quoting \textit{Rochester Telephone Corporation v. United States},\textsuperscript{37} the court stated:

\begin{quote}
An order of the Commission dismissing a complaint on the merits and maintaining the status quo is an exercise of administrative function, no more and no less, than an order directing some change in status.\textsuperscript{38}
\end{quote}

The court found further support for its argument in section 10(e) of the Administrative Procedure Act which provides judicial relief for "agency action unlawfully withheld or unreasonably delayed."\textsuperscript{39} The court recognized that failure to act might involve a permissible exercise of administrative discretion, and that review might be precluded for that reason, but implied that failure to act, in and of itself, would not preclude judicial review, if that inaction operated with final effect upon the petitioner.

The court next turned to the question of whether a district court, where a private enforcement action would be filed, was a more appropriate forum for the adjudication of the petitioner's claim than the Court of Appeals. The case that firmly established the right of a private party to institute an action against his corporation for a violation of the Securities Exchange Act was \textit{J.I. Case Co. v. Borak}.\textsuperscript{40}

\begin{footnotes}
\textsuperscript{36} 432 F.2d at 668.
\textsuperscript{37} 307 U.S. 125 (1939).
\textsuperscript{38} \textit{Id.} at 141.
\textsuperscript{40} See, n. 22, supra.
\end{footnotes}
The United States Supreme Court ruled that while the language of 14(a) makes no specific reference to a private right of action, among its chief purposes is the "protection of investors" which implies the availability of judicial relief where necessary to achieve that result.\footnote{Id. at 432.} Since section 27\footnote{15 U.S.C. 78aa.} grants the district court jurisdiction of all suits in equity or actions at law brought to enforce any liability or duty created under the Act, the Court concluded that private parties have a right under section 27 to bring suit for violation of section 14(a) of the Act.

Relying primarily upon pragmatic considerations in favor of reviewability, and purporting to follow the rationale of the Supreme Court in \textit{Case}, the Court of Appeals concluded that the district court was not a more appropriate forum. The court noted that the petitioner did not seek any relief which was peculiarly within the competence of the district court; but merely sought to have the cause remanded so that the Commission, in accordance with proper standards, could make an enlightened determination of whether enforcement action would be appropriate. Furthermore, the court stated that it saw no practical or theoretical virtues in commanding a course of action which "would result in equal inconvenience" to the petitioners, the Commission, and the overcrowded courts, and "would constitute circuitous routes for the determination of issues easily and directly determinable by review in this court."\footnote{432 F.2d at 668.} Finally, the court felt that by allowing review in the Court of Appeals, it was furthering the intent of Congress to aid the small investor by making the Commission look carefully at the merits of the shareholder's proposal.

The primary purpose of section 14(a) is the protection of the investors and the primary method of implementing this goal is through Commission regulation of proxy statements not through private actions by individual security holders.\footnote{Id. at 672.} Thus, using the rationale of the Supreme Court in \textit{Case}, the protection of investors, the Court of Appeals determined that the remedy provided by \textit{Case} does not always afford the investor sufficient protection.

The final objection of the Commission to the jurisdiction of the Court of Appeals was that the Commission's decisions as to whether enforcement procedures should be instituted are wholly discretionary\footnote{5 U.S.C. 701(a), 702, which provides:}
and not subject to judicial review under section 10 of the Administrative Procedure Act.

There are two prevailing interpretations of section 10. The first is espoused by Professor Davis. He contends that:

So far as the action is by law "committed" to agency discretion, it is not reviewable—even for arbitrariness or abuse of discretion; it is not committed to agency discretion to the extent that it is reviewable.

In other words, some discretion is reviewable for abuse and some is not. Whether the discretion is reviewable depends upon whether the statute involved requires or only permits the exercise of discretion. If the agency's decision is pursuant to a permissive type statute the discretion is not reviewable for abuse. If, on the other hand, the decision was required to be made, it would be reviewable even though it involved the exercise of some degree of discretion. Since section 2119 of the Securities Exchange Act, which governs the Commission's discretion to investigate and prosecute, is phrased in broad permissive terms, it seems that under the Davis interpretation of section 10 of the Administrative Procedure Act, the Commission's determinations not to take action under the proxy rules would not be subject to review by the Court of Appeals—even for arbitrariness.

A second interpretation is espoused by Professor Berger. He interprets the word "discretion" as limited to sound discretion, a discretion which is not exercised arbitrarily.

... except to the extent that (1) statutes preclude judicial review; or (2) agency action is committed to agency discretion by law. RIGHT OF REVIEW—A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof.

As originally enacted, Administrative Procedure Act 10, 60 Stat. 243 (1946) provided:

Except so far as (1) statutes preclude judicial review, or (2) agency action is by law committed to agency discretion, (a) Right of Review—Any person suffering legal wrong because of any agency action, or adversely affected or aggrieved by such action within the meaning of any relevant statute, shall be entitled to judicial review thereof.

47. Id. at 80.
48. See generally, Davis, supra note 45 at Supp. 21-22.
49. See, e.g. 15 U.S.C. 78u(a) which provides:

The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of this chapter or any rule or regulation thereunder.

See also 15 U.S.C. 78u(e) which provides:

Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court...

An arbitrary finding is outside the administrative discretion conferred by the statute, an officer exceeds his authority by making a determination which is arbitrary or capricious; discretion does not extend to arbitrary and unreasonable action.\textsuperscript{51}

Under this interpretation, section 10 would not preclude judicial review of the Commission’s proxy determinations if there was evidence that the Commission had acted arbitrarily.

The Court of Appeals seems to have adopted an analysis consistent with Berger. Although the court did not expressly hold that the Commission had acted arbitrarily or abused its discretion, it noted that the Commission had been accused of many “procedural sins” in its regulation of proxies, many of which, the Court of Appeals believed could be curtailed or eliminated through judicial review. A list of these “procedural sins” would include (1) approving management’s decision to omit a shareholder’s proposal without requiring management to show that it had carried the burden of proof; (2) allowing non-lawyers to decide complex legal problems raised in proxy disputes; and (3) affording inconsistent treatment to similar factual situations for no apparent reason.\textsuperscript{52} These practices, the court stated, “encourages management to file shotgun objections to a shareholder proposal, urging every mildly plausible legal argument in the hope that the Commission will accept one of them.”\textsuperscript{53} The result of this approach would be that the shareholder would not know for what reason his proposal had been rejected and therefore would be at a loss about where to start to cure the defect. The court concluded:

Viewed in this light, “discretion” can be merely another manifestation of the venerable bureaucratic technique of exclusion by attrition, of disposing of controversies through calculated non-decisions that will eventually cause eager supplicants to give up in frustration and stop bothering the agency.\textsuperscript{54}

By permitting judicial review in these circumstances the court reasoned that it was assuring that the investing public could obtain, “vigorous, efficient, and evenhanded implementation of the concepts of corporate democracy embodied in the proxy rules.”\textsuperscript{55}

Having decided that the Court of Appeals could review an arbitrary determination not to take action, the court proceeded to establish a limit on review because,

\textsuperscript{51} Id. at 968-69.
\textsuperscript{52} 432 F.2d at 674, see also, Clusserath n. 34, supra, at 37.
\textsuperscript{53} See Clusserath n. 34, supra, at 43.
\textsuperscript{54} 432 F.2d at 674.
\textsuperscript{55} Id.
[N]ot all proxy proposals can or should be given detailed consideration by the full Commission, and even the boldest advocates of judicial review recognize that the agencies' internal management decisions and allocations of priorities are not proper subject of inquiry by the courts.\textsuperscript{56} The court indicated that this case did not fall into that category. Rather the court found this case to be one where "the full Commission has exercised its discretion to review this controversy, and . . . it has ostensibly acted in accord with a very dubious legal theory."\textsuperscript{57} It thus appears that the court deems review proper only where the Commission has itself acted and where this action is predicated on a legal theory. The scope of review will apparently be limited in such a case to the appropriateness of the Commission's interpretation of the legal theory involved.

The extent to which the full Commission actually made a legal determination in the instant case is not clear. The facts do not indicate that the full Commission ever considered the merits of the petitioner's proposal. At most there was a ratification of the staff position which ratification may or may not have been based on an approval of the staff's interpretation of the proxy rules. It was probably for this reason that the court remanded the cause to the Commission to make this legal determination. Even though the court stated that review depended upon the Commission deciding to review a staff position, on the basis of this case it appears that any time the Commission reviews a staff decision on a no action letter judicial review of the legal principles may be applicable.

Nevertheless, stating again that "among the chief purposes of section 14(a) is the protection of investors; which certainly implies the availability of judicial relief to achieve that result,"\textsuperscript{58} the court concluded that partial review of the merits of the controversy would not project it into an area which was committed by law to agency discretion.

Having decided the jurisdictional issues the court afforded the limited review it had held appropriate to the merits of the petitioner's proposal. The Medical Committee contended that its resolution could not, consistently with the Congressional intent underlying section 14(a), be properly deemed a proposal which was either motivated by general political and moral concerns, or related to the conduct of Dow's ordinary business operations. Because the Commission had

\textsuperscript{56} Id.
\textsuperscript{57} Id. at 675.
\textsuperscript{58} Id. at 675-76.
not addressed itself to any possible grounds for allowing Dow to exclude the Medical Committee's proposal, and because there was nothing in the record to indicate how it had reached the result it had, the court remanded the controversy "for a more illuminating consideration and decision." The court then proceeded to explain its difficulties with the position taken by Dow and apparently ratified by the Commission.

After a review of the development of the proxy rules in general, and the permissible exclusions under Rule 14a—8(c)(2) and 8(c)(5) in particular, the court determined that the two exceptions were, on their face, consistent with the legislative purpose underlying section 14(a). The court noted that proxy solicitations were intended by Congress to enhance corporate democracy, not provide a forum for irrelevant matters or involve shareholders in the clearly daily business operations of the company. However, the court noted that when the two exclusions are broadly applied, they could be construed to permit the exclusion of practically any shareholder proposal on the grounds of being either too general or too specific.

The court considered the arguments, advanced by Dow, in favor of exclusion of the proposal under 14a—8(c)(5) which permits management to exclude shareholder's proposals which relate to ordinary business operations. Dow contended that the decision to manufacture a product rests with management, and to amend the Certificate of Incorporation to permit shareholders to challenge that determination would violate the state statute under which the company is incorporated. The court pointed out that the Delaware General Corporation law provides that a company's Certificate of Incorporation may be amended to "change, substitute, enlarge or diminish the nature of the company's business." Since Dow did not suggest why this provision is inapplicable to the present case or what law the proposal violated, the court believed it was highly questionable whether Dow had sustained the burden of proof necessary to support exclusion under 14a—8(c)(5).

Turning to the arguments advanced in favor of exclusion under Rule 14a—8(c)(2), the court noted that the counsel's arguments consisted of a "fundamentally irrelevant recitation of some of the political

59. Id. at 676.
60. 17 C.F.R. 240.14a-8(c)(2), n. 4, supra.
61. 17 C.F.R. 240.14a-8(c)(5), n. 4, supra.
62. Id.
63. Chapter 1, Title 8 Delaware Code 242(a)(2), 242(d) (1968).
64. 17 C.F.R. 240.14a-8(c)(2).
protests which had been directed at the company because of its manufacture of napalm,” followed by the conclusion that management was, therefore, entitled to exclude the Medical Committee's proposal. The court did not stop there but indicated that an interpretation of Rule 14a—8(c)(2) which permitted omission of the proposal as one motivated primarily by general political or social concerns might well conflict with the Congressional intent underlying section 14a of the Act. The court implied that the Rule would have to be directed at political or social activity which was beyond the scope of the corporation's control to remain consistent with section 14a of the Securities Exchange Act.

The court concluded that as long as the proposal was consistent with applicable state law, the fact that it related to a more socially responsible, but less profitable, company policy would not render the proposal excludable under Rule 14a—8(c)(2).

However, the court also noted that here the company's own publications proclaimed that the decision to continue to manufacture napalm was made not because of business considerations but in spite of them. Dow indicated that political and moral considerations had influenced its decision to manufacture napalm despite significant business considerations which militated against it. Noting that the control of great corporations by a very few persons was the abuse at which Congress struck in enacting section 14a, the court concluded that it could scarcely be argued “that management is more qualified or more entitled to make these kinds of decisions than the shareholders who are the true beneficial owners of the corporation.” It appears, therefore, that the court is recommending an attack on the Commission's interpretation of Rule 14a—8(c)(2), and thereby supporting political and social action by shareholders where that action is within the corporation's control and not in conflict with applicable state law.

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65. 432 F.2d at 680.
66. Id.
67. This distinction was made by Professor Bayne in his article “The Basic Rationale of Proper Subject” where he stated:

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

34 Univ. of Detroit L.J. 575, 602 (1957).
68. 432 F.2d at 681.
69. Id.