SHAREHOLDER RIGHTS GROUP

Sept. 17, 2018
Hon. Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Staff Roundtable on the Proxy Process – File 4-725

Dear Mr. Clayton,

In response to your July 30 Statement announcing a Staff Roundtable on the Proxy Process, we have developed a page of our website, ShareholderRightsGroup.com, to be a resource for relevant reports, articles, and perspectives. We enclose with this letter a printout of our current Roundtable web page, as well each of the documents referenced, for inclusion in the record of the Roundtable.

Boards of directors have a duty to represent shareholders; that task grows more challenging and complex as time passes. We know, from long experience and academic research, that group decision-making in boardrooms and executive suites benefits from bringing diverse views to the table. The shareholder proposal process has proven a key mechanism to bring such views up for board and management consideration and to channel communication between boards and shareholders.

In addition, at times, boards may fail to fulfill their responsibilities to consider diverse investor concerns and interests. The shareholder proposal process exists as recourse where shareholders have reason to believe that boards are shortsighted on a particular issue or insular in their governance of the company.

Constraining that mechanism, as some have proposed, would deprive boards and management of a process that has, more often than not, resulted in value creation for companies. Among the widespread beneficial changes that arose because of the shareholder proposal process are: increases in the number of independent directors on boards; the independence of the audit, compensation, nominating and corporate governance board committee members; declassifying boards of directors for the purpose of holding annual elections; the adoption of proxy access bylaws; shareholder say on executive pay; and the issuance of corporate social responsibility and sustainability reports. These are ample proof that the shareholder proposal process is an essential ingredient of corporate governance and shareholder rights.

We believe that the Commission would be ill advised to take up time of the Roundtable on potential reforms to the shareholder proposal process. Based on a substantial body of evidence, the shareholder proposal process is functioning effectively today. In the event that the Commission nevertheless decides to place the shareholder proposal process on the agenda of the Roundtable, we trust that you will include appropriate spokespeople from the proponent community.

Thank you for this opportunity to submit comments. We anticipate submitting additional comments subsequent to the Roundtable discussion.

Sincerely,

Sanford Lewis
Director

ShareholderRightsGroup.com

PO Box 231 Amherst, MA 01004-0231 • [redacted] • [redacted]

Membership of the Shareholder Rights Group

- Arjuna Capital
- As You Sow
- Boston Common Asset Management, LLC
- Clean Yield Asset Management
- First Affirmative Financial Network, LLC
- Harrington Investments, Inc.
- Jantz Management, LLC
- John Chevedden
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Shareholder Rights Group

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The Shareholder Rights Group is an association of investors formed in 2016 to defend share owners' rights to engage with public companies on governance and long-term value creation.

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- **Pax World Funds**
- **Sustainability Group of Loring, Wolcott & Coolidge, LLC**
- **Trillium Asset Management, LLC**
- Walden Asset Management

For information on the Shareholder Rights Group
info [at] ShareholderRightsGroup.com
413 549-7333

A Roundtable on Shareholder Proxy Rights: A Resource List

On July 30, 2018, SEC Chairman Jay Clayton announced his intent to hold a SEC Staff Roundtable on the proxy process. The announcement reported that shareholder engagement is up, with 72% of S&P 500 companies reporting engagement with shareholders in 2017 compared to 6% in 2010. The announcement asked the staff to consider various topics for possible inclusion in the Roundtable, including questions related to the voting process, retail shareholder participation, shareholder proposals, technology and innovation and other actions. Among other items discussed in the Chairman's statement, is the idea of potentially putting additional constraints on shareholder proposals, even though there is no evidence of dysfunction that would merit the proposed limits on shareholder rights.

The following references from the investment community respond to many of the issues raised in the Roundtable announcement.

Frequently Asked Questions about Shareholder Proposals

Q. How frequently do public companies receive shareholder proposals?

A. Most public companies do not receive any shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017 according to the ISS database. In other words, the average Russell 3000 company can expect to receive a proposal once every 7.7 years. For companies that receive a proposal, the median number of proposals is one per year.

Q: What type of companies are more likely to receive shareholder proposals?

A: Large companies are far more likely to receive shareholder proposals because these companies represent a greater portion of investors' equity portfolios. According to the ISS database, S&P 500 companies received 659 proposals as of the end of the 2017 third quarter. This equals 77% of the 852 proposals received by Russell 3000 companies, and corresponds to the S&P 500's coverage of the Russell 3000's market capitalization. Small companies rarely receive proposals - only 3.7% of shareholder proposals in the ISS database were filed at companies with a market cap under $1 billion.

Q: How many Rule 14a-8 shareholder proposals are filed per year?

A. According to the ISS Voting Analytics database of Russell 3000 companies, shareholders submitted an average of 836 proposals at 386 companies per year between 2004 and 2017. The number of submitted proposals fluctuated between approximately 800-900

proposals per year, except for a dip to 603 proposals in 2011 and 673 proposals in 2012 after the SEC's adoption of say-on-pay vote requirements.

Q. What percentage of proposals actually go to a vote at annual meetings?

A. Less than half of all submitted proposals actually go to a vote. Out of the 11,706 proposals that the ISS database tracked between 2004 and 2017, only 5,342 of these shareholder proposals (46%) went to a shareholder vote. The SEC permitted companies to omit 1,741 proposals (15%). The remaining proposals were withdrawn after mutually agreeable outcomes with companies or otherwise did not go to a vote.

Q: Are shareholder proposals filed at companies that recently had an IPO?

A: A small proportion are filed at companies with a recent IPO - less than 9% of Russell 3000 companies that have had an IPO since 2004 have received a shareholder proposal.

Q. How many proposals receive less than 10% support? 30% support?

A. The current resubmission thresholds create significant pressure on shareholder proponents and a higher threshold would have dramatic results. The ISS database tracked 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017. Of these proposals, 104 proposals (22.7%) received less than 10% of the For/Against vote. In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.

Q. How often do shareholder proposals with low votes get resubmitted year after year?

A. Resubmissions for a third or fourth time are very rare. Since 2010, shareholders resubmitted environmental and social issue proposals only 35 times after receiving votes under 20% for two or more years. This affected only 26 companies.

Q. How frequently do individual investors use the shareholder proposal rule?

A. According to the ISS database, the Chevedden, Steiner and McRitchie families submitted approximately 1,700 shareholder proposals between 2004 and 2017. Proposals by this group of individual investors represent 14.5% of the 11,706 shareholder proposals contained in the ISS database. On average, 40% of shareholders voted in support of these shareholders' proposals when they went to a vote.

The Business Case

The Business Case for Shareholder Proposals

USSIF/Council of Institutional Investors/Ceres/ICCR

"The shareholder resolution process is important because it allows investors to communicate with boards, management and other shareholders about ways to protect their interests in a proactive, forward-looking way on important corporate governance, risk and policy issues affecting companies, before a crisis arises that erodes shareholder value."

"Small shareholders filing proposals often catalyze beneficial actions and changes in corporate governance and practices that benefit the company and all

shareholders. And many large asset owners and asset managers who rarely file shareholder proposals now vote for ESG proposals filed by smaller shareholders."

[link]

National Association of Manufacturers "Study": Candidate for the Journal of Irreproducible Results
Julie Gorte, Pax World Funds

"A new paper sponsored by the National Association of Manufacturers purports to show that shareholder resolutions do not benefit shareholders. The study alleges that while climate change is real, resolutions related to companies reporting on business management and risks in a world undergoing a low-carbon transition do not improve value for shareholders. The authors then select—perhaps a better term is cherry-pick—ten resolutions filed over a four-year period from 2013 to 2017. They don't say how they picked those ten, which is an early indication that this study may be flawed. According to the Sustainable Investments Institute, 425 climate-related shareholder resolutions were filed during that 4-year period and 142 of those resolutions were filed with companies in the Oil, Gas and Consumable Fuels industry. Of that 142, 36 resolutions specifically addressed company reporting on the 2^0 transition."

"So why pick only ten resolutions? Why those ten? Why are only three of the ten about the subject the authors claim to be examining? Crickets."

"Pax World and other shareholders file shareholder proposals not to get companies to tell us what they think the future of climate change will be—another unfounded assertion in the paper—but to understand how companies are likely to be affected by the world's transition to a lower-carbon economy, and what the company is doing to address the related risks and opportunities. What really would inform investors of how well the company will weather the economic transition isn't the shareholder vote, it's the company's strategic response to how it will manage that transition. Our objectives are to improve how the company performs in the long term, not how it performs in the weeks between the publication of a DEF-14 and the vote on proxy items."

[link]

Retail Investors and the Unmasking of the So-Called Main Street Investors Coalition

New York Times: What's Behind a Pitch for the Little-Guy Investor? Big Money Interests, Andrew Ross Sorkin, July 24, 2018

“It is a Washington organization that purports to represent the little guy — the retail investor that it says has no voice in corporate America…The group is actually funded by big business interests that want to diminish the ability of pension funds and large 401(k) plans — where most little guys keep their money — to influence certain corporate governance issues.”

“Why would the Main Street Investors Coalition want to do this? Because it should probably be called the National Association of Manufacturers — after all, that’s the name of the industry group that helped start it and is among its largest funders...The truth of the Main Street Investors Coalition is that it is an organization aimed at preventing investment firms from raising issues like climate change. Mr. Banks said as much when explaining how he had decided to start the group.”

[link]

So Called "Main Street Investors” Group Actually Aims to Limit Shareholder Rights
CorpGov.net

“In reality, it is a corporate-funded group with no real ties to retail investors, and its advocacy is as fake as its name.”

“MSIC uses inflammatory language, unsupported assertions, and out-and-out falsehoods to try to discredit the institutional investors who file and support non-binding shareholder proposals. While these proposals are filed at a very small fraction of publicly traded companies and even a 100 percent vote does not require the company to comply, somehow, this very foundational aspect of free market checks and balances is so overwhelming a prospect to corporate executives that they are unable to provide a substantive response and instead establish what in Washington is referred to as an “astroturf” (fake grassroots) organization, setting up a false dichotomy between the interests of large and small shareholders.”

“The MSIC perpetuates the myth that incorporating environmental, social and governance (“ESG”) factors inherently conflicts with protecting and advancing shareholder value. However, the 1,200 members of the United Nations-backed Principles for Responsible Investment – including Fidelity, BlackRock, Vanguard and State Street – with over $70 trillion in assets under management, have committed to consider ESG issues in the investment decision-making process since these factors may affect shareholder value.”

[link]

Responses to Corporate Initiatives for Rulemaking to Constrain the Shareholder Proposal Process

Letter to SEC opposing the petition to raise the thresholds to re-file shareholder proposals

Shareholder Rights Group

"It is well known that larger investors, in particular, tend to assess new issues first through engagement processes rather than voting in favor of the proposals… An increase to the resubmission threshold would derail this important process and end discussion of what have frequently become important issues for company management and boards to consider."

"By creating a steeper on-ramp, the effect of the proposed changes to the resubmission thresholds would undermine the ability of shareholders to flag and engage with companies and fellow shareowners on emerging issues, or present innovative ideas. As such, it would reduce the dynamism of shareholder participation and engagement."

[link]

Protecting Shareholder Ownership and Governance Rights

"The lack of a genuine problem should be enough to suggest that [rulemaking on the shareholder proposals process] ought not be a priority for the SEC rulemakers… It is essential to also recognize that screening out new proposals or resubmissions of existing ones would not be harmless, but would mean the loss of crucial services to investors and corporations."

"It is vital to recognize that the current 3%, 6%, and 10% thresholds of Rule 14a-8(i)(12) often prove relevant to the learning curve for companies and investors. The fact that a proposal has achieved the established Rule 14a-8(i)(12) benchmarks, and may appear on the proxy in a subsequent year, often inspires the board or management of companies to engage in dialogue and implement actions responsive to the proposals."

[link]

Shareholder Proposal Reform Rebutted

CorpGov.net

"Aside from serving to increase accountability, proposals often serve as an "early warning" system. Had companies listened, we might have avoided the 2008 financial collapse, since proposals concerning predatory subprime lending and the securitization of such subprime loans were introduced in 2000. Proposals beginning in 2003 asked securitizers to police their loan pools."

[link]

Roster of Comments on Rulemaking Petition: Request for Rulemaking to Amend Rule 14a-8 Under the Securities Exchange Act of 1934 Regarding Resubmission of Shareholder Proposals.

Proxy Advisory Firm Legislation

Letter From Council of Institutional Investors and 45 Investor Organizations on Proxy Advisory Firm Legislation

"H.R. 4015, the "Corporate Governance Reform and Transparency Act of 2017," and similar language which was incorporated in Subtitle Q of Title IV of H.R. 10, "the Financial CHOICE Act," would require, as a matter of federal law, that proxy advisory firms share their research reports and proxy voting recommendations with the companies about whom they are writing before they are shared with the institutional investors who are their clients. In essence, while the stated goal of the proposed legislation is the "protection of investors," as the primary customer of proxy advisory firm research, institutional investors believe that adding the new proposed requirements to the industry is unnecessary, overly burdensome and counter-productive."

"The proposed legislation appears to be based on several false premises, including the erroneous conclusion that proxy advisory firms dictate proxy voting results and that institutional investors do not drive or form their own voting decisions. Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons."

[link]

2018 SEC Decision-making on Shareholder Proposals

Shareholder Rights Group Analysis and Recommendations on the 2018 Proxy Season

"Recently, SEC and external actions have had—or propose to have—a significant impact on this process… the pressure on the SEC from the corporate community to limit shareholder proposals has persisted, and helped to prompt changes in policy during the 2018 proxy season."

"At a time in which shareholder proposals are receiving unprecedented levels of voting support due to recognition of risks to investments, the micromanagement rulings threaten to undermine market-wide investment objectives on an array of issues implicating corporate risk management and financial and ESG performance."

[link]

Lawyers Write to SEC on Why Shareholder Proposals Requesting GHG Goals Are Not Micromanagement

"The recent decision in EOG Resources,Inc. (February 26,2018) involved the exclusion of a form of shareholder proposal that has long been considered by the SEC staff to be acceptable and to not constitute micromanagement for purposes of Rule14a-8(i)(7)."

"For decades, shareholder proponents and corporate counsel have relied upon reasonably consistent decision-making in this area, allowing us to craft our proposals and our arguments to steer clear of micromanagement. It has been our understanding that… a target-setting proposal would generally be appropriate, but a target-setting proposal that specified an unreasonable timeframe for completion, or detailed specific targets with set dates, would arguably constitute micromanagement as these additional details would invite shareholders to delve too deeply into complex matters that should be reserved for management."

[link]

The Business Case for the Current SEC Shareholder Proposal Process

April 2017

About Ceres

Ceres is a sustainability nonprofit organization working with the most influential investors and companies to build leadership and drive solutions throughout the economy. Through our powerful networks and advocacy, we tackle the world's biggest sustainability challenges, including climate change, water scarcity and pollution, and human rights abuses.

The **Ceres Investor Network on Climate Risk and Sustainability** comprises more than 130 institutional investors, collectively managing more than $17 trillion in assets, advancing leading investment practices, corporate engagement strategies and policy solutions to build an equitable, sustainable global economy and planet. For more information, visit www.ceres.org.

About ICCR

The Interfaith Center on Corporate Responsibility (ICCR) is a 46 year-old, pioneer coalition of over 300 organizational investors representing faith-based communities, socially responsible asset managers, labor unions, and others who engage corporations on the environmental and social impacts of their operations.

About US SIF

US SIF: The Forum for Sustainable and Responsible Investment is the leading voice advancing sustainable, responsible and impact investing across all asset classes. Our mission is to rapidly shift investment practices towards sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Our 300+ members collectively represent more than $3 trillion in assets under management or advisement.

Acknowledgements

We wish to thank our colleagues and partners who contributed to this paper: Rob Berridge (Ceres), Chris Davis (Ceres), Dan Mitler (Ceres), as well as numerous members of the Ceres, ICCR, and US SIF investor networks, and the Council of Institutional Investors.

Contact

For more information, contact:
Rob Berridge
Director, Shareholder Engagement, Ceres
berridge@ceres.org

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About this paper

This paper provides an investor perspective on the value to investors and companies of the current shareholder proposal process under SEC Rule 14a-8. It was prepared by Ceres investor program staff with major contributions from numerous investor members of the Ceres, ICCR and US SIF investor networks, who have been active in filing shareholder proposals as part of their corporate engagement and asset stewardship efforts. It is intended as a resource to help inform policy discussions about the content of Rule 14a-8 and the impact of shareholder proposals on corporate issuers, shareholder value and the U.S. economy.

Introduction

In 1942, the U.S. Securities and Exchange Commission (SEC) promulgated its first rule regulating shareholder proposals, and the rule has been adjusted and fine-tuned repeatedly since then.[1] For more than seven decades, the shareholder proposal process has allowed both large and small shareholders to alert corporate boards and the investor community to their concerns and to request timely action on emerging, or neglected, issues. A key element of process allows shareholders who meet certain criteria to submit proposals for inclusion in the company's proxy statement for a vote by all shareholders holding voting shares.

In 2016, shareholders filed approximately 1,000 shareholder proposals with U.S. companies.[2] This includes more than 400 proposals focused on environmental and social issues, and more than 500 focused on pure corporate governance. Voting on these shareholder proposals is an important part of the exercise of institutional investors' fiduciary duty on behalf of their clients and beneficiaries. This paper describes the benefits of the current shareholder proposal process to investors, companies, and society.

The principal benefits of the current shareholder proposal process include the following, as discussed in more detail below:

- It is an essential and cost-effective tool for investors, individually and collectively, to protect and enhance the value of their investments by expressing their views to management, boards and other shareholders on major governance issues, corporate policies, and important risks and opportunities.
- It is a uniquely forward-looking, flexible, and efficient way to raise and resolve issues.
- It can benefit company managers and directors by making them aware of emerging issues that can materially affect the company's performance, without imposing significant costs.
- It helps investors to protect their ownership rights and interests and helps to hold corporate boards accountable to the owners of the corporation.
- It has led to the widespread adoption of numerous beneficial corporate governance and sustainability policies by companies.

[1] http://scholar.valpo.edu/cgi/viewcontent.cgi?article=1500&context=vulr, p. 227

[2] ISS Voting Analytics database.

- It has enabled investors to raise unaddressed systemic risks to the economy caused by companies who also face company-specific risks on the issues.
- The shareholder proposals it facilitates have been shown to improve company financial performance and value.
- It provides access to management and boards by individual and institutional investors who otherwise would not have a voice, and enables owners to aggregate their voices via proxy voting on proposals.

In short, the process as currently structured and administered works well for investors and issuers; it is fair, efficient and effective.

Business groups including The Business Roundtable[3] (BRT) and the U.S. Chamber of Commerce[4] have proposed modifications to the existing shareholder proposal process that would significantly limit shareholders' ability to use this tool to raise issues with corporate boards, who are charged with representing their interests. We believe the proposed modifications would harm the interests of investors, companies, society and the capital markets.

Background

In 1934, Congress passed the Securities Exchange Act. Section 14 of the Act authorized the SEC, as part of its mission "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," to develop proxy regulations "in the public interest" and "for the protection of investors." Over time, the SEC developed a body of regulations that came to be collected in Rule 14a-8, including the thresholds and limitations governing whether and how shareholder proposals are listed in the company's proxy statement.[5]

Under state laws, shareholders have a right to vote by proxy as an alternative to attending a corporate annual meeting in person to cast their vote. Shareholders also have the right to raise issues from the floor of corporate annual meetings. The SEC Proxy Rules, including Rule 14a-8, support these state law rights by ensuring that widely dispersed investors have the opportunity to raise issues and vote their shares as if they were in attendance. The company is required by the SEC to distribute a proxy statement to all shareholders prior to the meeting, which allows them to vote in absentia.

The great majority of shareholder proposals are nonbinding or advisory. Nonbinding proposals give companies the flexibility to address shareholder concerns without displacing the traditional role of the board of directors to oversee the operations of the company. Boards are free to ignore

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[3] https://www.bna.com/business-roundtable-suggests-b57982082135/

[4] https://www.bna.com/us-chamber-calls-n57982063976/

[5] Matsusaka, John G. and Ozbas, Oguzhan and Yi, Irene, Why Do Managers Fight Shareholder Proposals? Evidence from No-Action Letter Decisions (January 9, 2017). USC CLASS Research Paper No. CLASS17-4. Available at SSRN: https://ssrn.com/abstract=2881408 or http://dx.doi.org/10.2139/ssrn.2881408

nonbinding shareholder proposals, although high votes (e.g., above 25-30%) send a strong signal that many investors want the issue addressed.

Majority votes very frequently spur companies to act in part because shareholders – in a sign of respect for the importance of the Rule 14a-8 process – are more likely to withhold their support from directors that ignore shareholder proposals that receive majority levels of shareholder support. This flexibility is an inherent strength of the existing shareholder proposal process, which serves as an important warning mechanism for boards.

The resolution process now operates within the context of the rapid growth of environmental, social and governance (ESG)-related investment practices and increasing materiality to investors of a range of ESG issues. More than 20 percent of assets under professional management in the United States are now associated with various forms of ESG investing according to US SIF Foundation's 2016 *Report on US Sustainable, Responsible and Impact Investing Trends,* a 33 percent increase since 2014.[6] The more than 1,600 signatories to the Principles for Responsible Investment, collectively managing over $60 trillion, are publicly committed to six principles including "active ownership" and to "seek appropriate disclosure on ESG issues by the entities in which we invest."[7] Large investment firms, including Bank of America / Merrill Lynch, Blackrock, Credit Suisse, Goldman Sachs, Morgan Stanley, State Street Global Advisors, UBS, and others provide numerous research and investment products focusing on ESG topics. Many investors view ESG performance as a valuable proxy for the quality of corporate management and a key indicator of long-term financial performance.

Support for shareholder proposals comes from a broad base of investors. The vast majority of proposals are filed by institutional owners with large and long-term holdings or individuals with similarly long-term interests, with the balance coming from smaller institutional investors. Shareholder support for proposals has climbed steadily and represents a significant proportion of investors. In 2016, 61 percent of proposals that came to a vote received at least 25 percent support from shareholders, up from 31 percent with that level of support in 2000.[8] The proportion of proposals that win the support of a majority of shareholders has risen too. In 2016, 21 percent of proposals received a majority of votes cast, up from 15 percent in 2000.

Examples of shareholder proposals that were widely adopted

For over half a century, the shareholder proposal process has served as an effective way for investors to provide corporate management and boards with insights into their priorities and concerns regarding corporate governance, policies and practices. The process has resulted in numerous important changes to corporate governance in the U.S. Examples include:

[6] http://www.ussif.org/files/Trends/US%20SIF%202016%20Trends%20Overview.pdf
[7] https://www.unpri.org/about
[8] ISS Voting Analytics

- Resolutions were the impetus behind the now standard practice – currently mandated by major US stock exchanges' listing standards – that independent directors constitute at least a majority of the board, and that all the members of the following board committees are independent: audit, compensation, nominating and corporate governance.
- In 1987 an average of 16 percent of shareholders voted in favor of shareholder proposals to declassify boards of directors so that directors stand for election each year. In 2012, these proposals enjoyed an 81 percent level of support on average. Ten years ago, fewer than 40 percent of S&P 500 companies held annual director elections compared to more than two-thirds of these companies today.[9]
- Electing directors in uncontested elections by majority (rather than plurality) vote was considered a radical idea a decade ago when shareholders pressed for it in proposals they filed with numerous companies. Today, 90 percent of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority-voting proposals
- A proposal that built momentum even more rapidly and influenced the practices of hundreds of companies in the last few years is the request for proxy access. Resolutions filed by the New York City Comptroller to allow shareholders meeting certain eligibility requirements to nominate directors on the company's proxy ballot achieved majority votes at numerous companies. As a result, since 2015, at least 400 companies have adopted proxy access bylaws.
- "Say-on-pay" vote requirements – now mandated by the Dodd-Frank Act – also resulted from shareholder proposals.
- Shareholder proposals or related engagements played a key role in moving close to 160 large companies (including more than half of S&P 100 companies) to commit to disclosure and board oversight of their political spending with corporate funds.[10]
- Since 2009, 85 companies have agreed to issue sustainability reports as result of shareholder resolutions. According to the G&A Institute, 81 percent of S&P 500 companies published sustainability reports in 2015 compared to just under 20 percent in 2011.[11]
- The first resolution requesting that companies source deforestation-free palm oil went to vote in 2011. By 2016 more than 20 companies had responded to similar resolutions and protected their brands' reputations by committing to source deforestation-free palm oil produced by workers free from human rights abuses.[12]
- Shareholder proposals have led to wide-scale adoption of international human rights principles as part of corporate codes of conduct and supply chain policies, protecting companies from legal and reputational risk.
- A substantial majority of large companies have sexual orientation nondiscrimination policies largely as a result of hundreds of shareholder proposals. A 2016 analysis by Credit Suisse

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[9] AFL-CIO letter to Stanford professors Larcker and Tayan, January 18, 2013

[10] http://politicalaccountability.net/impact

[11] http://www.ga-institute.com/press-releases/article/flash-report-eighty-one-percent-81-of-the-sp-500-index-companies-published-corporate-sustainabi.html

[12] Data compiled by Ceres.

found that 270 companies which provided inclusive LGBTQ work environments outperformed global stock markets by 3 percent annually for the previous six years.

Benefits to investors

The shareholder proposal process helps to protect investor interests

Common stockholders generally have six types of basic rights: the right to file and vote on shareholder proposals and to vote to elect directors (however not all share classes have voting rights); ownership in a portion of the company and a claim on a portion of the assets; transfer of ownership; entitlement to a portion of dividends set by the board of directors; the opportunity to inspect corporate books and records; and the right to sue for wrongful acts, including class action suits. (Corporate bylaws influence these rights, but they are generally applicable as listed.)

These rights are necessary but at times insufficient to protect investor interests. Chief among investor interests is maximizing risk-adjusted, long-term, portfolio-wide returns. And institutional investors generally have a fiduciary duty to act in the interest of their clients and beneficiaries.

As investors seek to protect their interests in accordance with their rights and obligations, they are confronted with a challenge. The tools they have to influence corporate behavior are more easily asserted after things have gone wrong with the company they own, when the issue is widely obvious, and the value of their investment has been impaired.

The shareholder resolution process is important because it allows investors to communicate with boards, management and other shareholders about ways to protect their interests in a proactive, forward-looking way on important corporate governance, risk and policy issues affecting companies, before a crisis arises that erodes shareholder value.

It promotes good corporate governance

The substantial history of corporate scandals clearly demonstrates that the separation of corporate ownership and control allows managers substantial leeway to pursue their own interests, which can at times be at the cost of shareholder wealth.[13] The shareholder resolution process acts as a critical safeguard against these agency problems, and enables all shareholders holding voting stock, including relatively small ones, to encourage management and boards to address ESG issues that they believe are significant to the company and to society.

Examples of managerial strategies that could be classified as "ESG failures" and were disastrous for investors and employees abound: AIG, Bear Stearns, Lehman Brothers, BP, Enron, WorldCom, Fannie Mae and Freddie Mac, Massey Energy, Volkswagen and Wells Fargo. Scandals and disasters are the visible portion of the larger iceberg of incentives that lure corporate managers to manage for the short term and take excessive risk at shareholders' expense.

[13] The Modern Corporation and Private Property. By Adolf A. Berle, Jr. and Gardiner C. Means. New York: The Macmillan Company, 1932.

The world's largest asset managers are acting to address these risks. A letter sent in January 2017 from State Street Global Advisors' CEO Ron O'Hanley to board members of companies in which State Street owns shares says that ESG issues "can have a material impact on a company's ability to generate returns," and that "as stewards we are convinced that addressing ESG issues is a good business practice and must be part of effective board leadership and oversight of long-term strategy."[14] In addition, The Investor Stewardship Group, a coalition of sixteen of the largest institutional investors managing $17 trillion collectively, premiered in January 2017 the Framework for U.S. Stewardship and Governance, outlining a set of six fundamental governance principles for U.S. listed companies.[15]

However, few investors have the clout and access to boards enjoyed by the very largest institutional investors, and shareholder proposals and proxy voting are critical tools to urge companies to adopt the best corporate governance practices and to address material ESG issues.

The proposal process helps enhance board accountability

Boards of directors are charged with ensuring that company management acts in the best interests of the company and its shareholders. In reality, they sometimes fail in this regard for a number of reasons including: use of insufficient or incorrect information; "group think" and lack of diversity; an overly deferential approach to the managers they oversee; or by acting in their own interests. Shareholder proposals can strongly encourage boards and management to address ESG issues that they might otherwise overlook or ignore.

Investors have several tools to communicate with corporate boards tasked with representing shareholder interests. Proxy voting is one. However, without the ability to put items on the proxy, most investors would lack sufficient influence and access to convey their concerns and requests to the board.

Voting against (or withholding votes from) directors is one option for shareholders, but this is a blunt instrument, providing the director no information as to the rationale for the vote, or the underlying issue. And voting against directors due to a specific environmental or social problem is likely to gain momentum only after an adverse event occurs, by which time investors will already have seen the damage to returns. On the other hand, shareholder proposals allow investors to signal their expectations and/or displeasure on individual ESG issues without resorting to withholding their vote from directors.

Successful boards must be knowledgeable about and responsive to a wide range of issues affecting the company. Provided with enough information and a strong enough signal from shareholders, directors and management can often successfully address ESG issues. One of the

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[14] In March of 2017, State Street managed approximately $2.4 trillion. https://www.ssga.com/investment-topics/environmental-social-governance/2017/Letter-and-ESG-Guidelines.pdf

[15] https://corpgov.law.harvard.edu/2017/02/01/promoting-long-term-value-creation-the-launch-of-the-investor-stewardship-group-isg-and-isgs-framework-for-u-s-stewardship-and-governance/

most important ways of sending that signal to companies and their directors is through the shareholder proposal process.

Benefits to small and individual investors

The shareholder proposal regulatory process allows both small institutional investors and individual shareholders to alert boards to management's need to take timely action on emerging and critical ESG issues.

A system that allows shareholders to file proposals is needed in part because individual investors and smaller shareholders nearly always lack large enough holdings to get the board and management's attention in any other way. As Berle and Means argued in the 1930s, "shareholders often are virtually powerless against management, because each individual shareholder owns only a very small percentage of the outstanding shares…"[16]

The voting process allows one investor to raise an issue, make supporting arguments in the company's proxy materials, educate other investors, and then aggregate the votes of other investors who agree the issue needs to be addressed. Small shareholders filing proposals often catalyze beneficial actions and changes in corporate governance and practices that benefit the company and all shareholders. And many large asset owners and asset managers who rarely file shareholder proposals now vote for ESG proposals filed by smaller shareholders.

For example, in 2016, Walden Asset Management, which manages $3 billion for clients focused on sustainable and responsible investment, filed a proposal with CLARCOR, a water filtration company, requesting a sustainability report including disclosure of greenhouse gas reduction goals. The following asset managers are among those that voted for the proposal, which received 61 percent support: Deutsche, Goldman Sachs, John Hancock, Mass Mutual, Northern Trust, ProShares, Schroders, State Street, TIAA-CREF and Wells Fargo.[17]

In 2016, at least 18 large U.S. mutual fund companies voted for more than 50 percent of climate change-related resolutions, including: Alliance Bernstein, GMO, Lazard, Morgan Stanley, MFS, Natixis, Northern Trust, Schroder, and Wells Fargo.[18]

Corporate directors have limited time and resources. As a result, when they do meet with investors, they generally only meet with the company's largest shareholders, who therefore have a reduced need to submit proposals to get a board's attention. The shareholder proposal process ensures that boards can hear from investors of all sizes. Without this process, boards can be largely insulated from the concerns and perspectives of the wider shareholder base.

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[16] The Modern Corporation and Private Property. By Adolf A. Berle, Jr. and Gardiner C. Means. New York: The Macmillan Company, 1932.
[17] According to analysis by Fund Votes
[18] https://www.ceres.org/press/blog-posts/is-your-mutual-fund-company-taking-climate-change-seriously

Benefits to passive and long-term investors

While active investors have the option of selling shares of companies whose management they do not trust to add value, passive investors' options are more limited. BlackRock CEO Larry Fink addresses head-on the benefits of (and need for) shareholder engagement for passive investors:

"BlackRock engages with companies from the perspective of a long-term shareholder. Since many of our clients' holdings result from index-linked investments – which we cannot sell as long as those securities remain in an index – our clients are the definitive long-term investors. As a fiduciary acting on behalf of these clients, BlackRock takes corporate governance particularly seriously and engages with our voice, and with our vote, on matters that can influence the long-term value of firms. With the continued growth of index investing, including the use of ETFs by active managers, *advocacy and engagement have become even more important for protecting the long-term interests of investors.*"[19] [Emphasis added.]

Such engagement includes both private company dialogues by large investors like BlackRock and State Street and shareholder proposals by other smaller investors who often find it difficult to get the attention of management and boards through voluntary engagement.

Investors that utilize active management strategies also have a strong interest in engagement and filing shareholder proposals for the same reasons that these investors value the ability to vote their proxies. Active trading can be costly and is ineffective in addressing long-term governance failures at corporations. Most active investors have an interest in the long-term sustainability of corporations they invest in, regardless of their individual portfolio management strategies. Active investors may wish to continue to hold a stock for financial reasons but still maintain concerns about certain governance, risk management or disclosure practices that a shareholder proposal could effectively address. Similarly, active investors that sell a stock today will generally want to be able to purchase that stock again in the future. Their interest in the long-term value of any particular company can be independent of their trading strategies.

It is also important to recognize that while passive investors are unable to sell shares in order to avoid certain risks, active investors are also exposed to the economy-wide systemic risks that shareholder proposals are uniquely positioned to address. Three University of Cambridge research institutions explain this reasoning in their 2015 paper *Unhedgeable Risk: How Climate Change Sentiment Impacts Investment*. The paper argues that: "Short-term shifts in market sentiment induced by awareness of future, as yet unrealised, climate risks could lead to economic shocks, causing substantial losses in financial portfolio value within timescales that are relevant to all investors."[20]

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[19] https://www.blackrock.com/corporate/en-us/investor-relations/larry-fink-ceo-letter
[20] http://www.cisl.cam.ac.uk/publications/publication-pdfs/unhedgeable-risk.pdf

Benefits and costs to companies

The proposal process is efficient compared to the alternatives

The Business Roundtable states: "As set forth in our 2012 Principles of Corporate Governance, we believe it is the responsibility of the corporation to engage with long-term shareholders in a meaningful way on issues and concerns that are of widespread interest to long-term shareholders, with appropriate involvement from the board of directors and management."[21] For all the reasons described in this paper, the current shareholder proposal process is one of the most effective ways for shareholders to engage the companies in which they invest.

Alternatives to shareholder proposals include voting against directors, lawsuits, books and records requests, and requests for additional regulations. Each of these is more onerous and adversarial than including a 500-word proposal in the proxy statement for the consideration of shareholders. Most importantly, any analysis of costs (discussed below) of the proposal process must be balanced against the benefits. Poor corporate governance and inadequate ESG practices hurt company performance and investor returns, sometimes in catastrophic ways, as described above.

Companies frequently agree to act on the request made in the proposal

Many shareholder proposals result in agreements between the filing shareholder and the company. An average of 37.5 percent of shareholder proposals related to climate change during the 2012-2016 proxy seasons were withdrawn by filers in response to the company agreeing in some form to the request. Withdrawal rates for some other topics is far higher. The New York City Comptroller's Office withdrew 80 percent of the 45 proxy access resolutions it filed during the 2016 and 2017 proxy seasons due to commitments by 36 companies. These examples of high 'agreement rates' suggest that many companies find benefits in committing to act on shareholder proposals before they go to a vote.

The cost to companies is generally low and spending is within their control

The Business Roundtable suggests that companies spend an average of about $87,000 per shareholder proposal.[22] This figure originates from an SEC release in which the SEC attempted to utilize limited and ambiguous data to calculate costs associated with the shareholder proposal process. Prior to its 1998 rulemaking, the SEC surveyed companies regarding the costs of the process. The questionnaire contained ambiguous questions yielding results that do not support the above figure.

First, the SEC asked how much it costs companies per year to determine whether or not to include shareholder proposals, including following the exclusion rules and procedures. Because the question was ambiguously worded, the average figure of $37,000 per year arguably applied to the total cost to companies of considering whether or not to include all proposals. It did not appear to

[21] http://businessroundtable.org/resources/letter-sec-rule-shareholder-proposal-resubmissions

[22] https://www.sec.gov/comments/4-537/smbainbridge7785.pdf; https://www.uschamberfoundation.org/sites/default/files/article/foundation/Analysis%20of%20the%20Wealth%20Effects%20of%20Shareholder%20Proposals_0.pdf

reflect the cost per proposal. The wide range of responses to the question from $10 to $1,200,000 (a median value of $10,000) also reflects the ambiguity of the issue and question, as well as the range of resources expended by companies in their discretion in response to shareholder proposals. Similarly, the SEC reported survey results indicating an average cost of $50,000 to publish proposals, and as with the first question it appeared that this may be the average cost for including all proposals in the proxy, rather than a per proposal expense.[23] These ambiguities in the original questionnaire and responses undermine the conclusion that it costs companies an average of $87,000 per proposal.

Most companies receive few, if any, shareholder proposals. While there are about 4,000 publicly listed companies in the U.S. (excluding over-the-counter stocks)[24], in 2016 approximately 1,000 resolutions were filed[25] – or approximately 1 proposal every 4 years per company on average.[26] Moreover, most proposals tend to be filed with larger (i.e., S&P 500) companies, which have the resources to deal with such shareholder input. The number of shareholder proposals in recent years has not been significantly increasing. Rather the number of proposals has vacillated from a high of 1,126 in 2009 to a low of 691 in 2011.[27]

Finally, the SEC oversees a robust "no-action letter" system that allows companies to exclude proposals from the proxy ballot that do not meet certain procedural and/or substantive hurdles. Requesting an informal no-action letter provides companies with a means of knowing whether the SEC Staff would recommend no enforcement action if the company's excludes the proposal from the proxy. During the 2013-2015 proxy seasons companies challenged nearly one-third of shareholder proposals submitted. About half of those challenged proposals were omitted from the proxy with SEC approval.

Studies show financial performance benefits to companies receiving resolutions and for strong ESG performance

A substantial body of literature shows that companies that have superior sustainability or ESG performance perform at least as well as, and often better than, less sustainable peers. Thus, issues raised in shareholder proposals are often financially material to companies.

- A recent analysis of more than 2,000 empirical studies concluded that approximately 90 percent of those studies found that the relationship between ESG and financial performance was either positive or zero. Only ten percent of the studies showed a negative relationship. Morningstar's research from 2015 shows that large-cap U.S. funds with high Morningstar Sustainability Ratings have lower risk.[28]
- A 2015 study found that successful ESG engagements generate cumulative (1999-2009) excess returns of +7.1 percent. Moreover, unsuccessful engagements (ones that didn't result

[23] https://www.sec.gov/rules/final/34-40018.htm
[24] http://money.cnn.com/2015/07/09/investing/stock-market-shrinking/
[25] Data provided by the Sustainable Investments Institute.
[26] ISS Voting Analytics database.
[27] http://static1.1.sqspcdn.com/static/f/276323/27013100/1462553848273/J+Brown_THE+EVOLVING+ROLE+OF+RULE+14A-8+IN+THE+CORPORATE+GOVERNANCE+PROCESS.pdf?token=eOvll5sXwVYJld48V6JQYXw1OuA%3D P. 181
[28] Higher Sustainability Ratings Can Mean Lower Risk Jon Hale, Morningstar, October 13, 2015

in any corporate action) experienced no change in market value.[29] This suggests that while proposals that lead to corporate action on an ESG issue can be significantly beneficial for companies and shareholders, proposals that don't lead to action cause no harm.

- A 2014 study that tracked two groups of companies (categorized as high / strong or low / weak on sustainability) between 1993 and 2009 found that high sustainability companies significantly outperformed their counterparts over the long-term in terms of stock market and accounting performance.[30]
- A recent study by Wilshire of the effect of CalPERS' corporate governance activism on targeted company share prices shows that, for the three years prior to the engagement, targeted companies significantly underperformed the Russell 1000 index, while for the five years following the engagement, they significantly outperformed the same index.
- An academic study conducted in 2016 found that "[F]irms that adopted shareholder resolutions on long-term [executive] compensation experienced a significant increase in their stock price.... Overall, the findings of this study suggest that long-term incentives improve a firm's governance as well as its impact on society and the natural environment."[31]
- Additional studies are available here.

The current rules and thresholds are appropriate and should be maintained

As mentioned earlier, the current proposal process has been refined and fine tuned since 1943, and works well in its current form. The existing process is flexible, allowing investors to tailor their requests to address company-specific issues as they arise. As a result, the proposals filed each year reflect market conditions and evolving best practices. These benefits are closely related to the specific thresholds and criteria in Rule 14a-8, which we believe should be maintained.

The value of existing filing thresholds

Under the current SEC rule, to submit a proposal, investors most hold at least $2,000 worth of shares continuously for at least one year. The one year holding requirement ensures that the use of the shareholder proposal rule is appropriately limited to longer-term shareholders. For example, the current tax code also uses one year to distinguish short-term capital gains from long-term gains.

Any proposals to significantly increase the filing threshold would exclude many smaller investors from filing. This raises serious fairness and efficacy concerns. For example, religious organizations are long-time leaders in filing constructive shareholder proposals. Some of these filers are very small investors who would be forced out of the system if the filing threshold were raised significantly. Large investors do not have a monopoly on good ideas, and they already have greater access to boards than smaller investors, as previously described. The current shareholder

[29] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
[30] http://pubsonline.informs.org/doi/abs/10.1287/mnsc.2014.1984
[31] https://irrcinstitute.org/wp-content/uploads/2016/12/2016-Academic-Winner-by-Flammer1.pdf

proposal system harnesses the power of a marketplace of ideas, and barring small investors from participating in this marketplace would be as unwise as it is unfair.

Prior to 1983 there was no dollar threshold for submitting a proposal. In 1983 the SEC adopted a $1,000 requirement. In 1998 the SEC raised the threshold to $2,000.[32] They declined to raise the threshold further "out of concern that a more significant increase would restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in maintaining channels of communication with management and fellow shareholders."[33] If the amount were adjusted for inflation since 1998 the current threshold would increase to about $2,946.[34] Therefore, the existing filing threshold is close to what the SEC felt in 1998 was necessary to avoid excluding smaller shareholders.

The value of existing resubmission thresholds:

In order to resubmit a proposal under current rules, it must have received at least 3 percent of the vote on its first submission, 6 percent on the second and 10 percent on the third. The BRT has proposed that at the very least the thresholds should be updated to implement the increases proposed in 1997: 6 percent on the first submission, 15 percent on the second and 30 percent on the third. The percentage of proposals since 2000 that are estimated to fall below those thresholds are 13.32%, 31.5%, and 50.14%, respectively.

As noted above, experience indicates that it often takes several years for a proposal on an emerging issue to gain traction with investors and to achieve double-digit votes. In many instances these proposals eventually receive substantial support, leading to widespread adoption by companies. The current thresholds provide a reasonable amount of time for emerging issues to gain support among investors while ensuring that only those proposals that garner meaningful support remain on the ballot for multiple years.

It is also important to keep in mind the following, which can contribute to low votes on shareholder proposals:

1. Some companies have high insider ownership and insiders can be expected to vote with management;
2. Companies can use multiple share classes that can reduce votes;
3. Broker non-votes and abstentions can be used to reduce vote percentages if they are added to denominator when votes are calculated. The great majority of firms use the simple formula "For / For + Against" when calculating votes, which is the method used by the SEC for assessing whether resubmission thresholds have been met;
4. A few of the very largest asset managers still routinely vote against (or abstain from voting on) all resolutions with environmental and social elements.

[32] https://www.sec.gov/rules/final/34-40018.htm
[33] https://www.sec.gov/rules/proposed/34-39093.htm
[34] https://www.bls.gov/data/inflation_calculator.htm

Existing SEC rules preclude proposals relating to 'ordinary business'

The SEC's current guidance on allowing companies to exclude from the proxy any resolutions pertaining to a company's ordinary business appropriately states that resolutions need to pertain to "significant policy issues" faced by companies.[35] This approach strikes a critical balance between respecting the board's role on corporate governance and management's discretion on routine business decisions, while also recognizing the existence of policy issues significant enough to warrant a shareholder vote.[36]

As Staff Legal Bulletin No. 14E (2009), made clear, a primary benefit of the shareholder resolution process is the ability for investors to help companies address issues that are currently (or may soon become) significant risks that are not widely recognized or appreciated by the company. Resolutions focusing on risks are among the most critical examples of how the private ordering system of the proposal process should work. Investors must be permitted to focus the board and management's attention on unaddressed risks. This system harnesses market forces by allowing shareholders to highlight risks their companies face and ask the companies to act to reduce the risks.

SEC rules to prevent abuse of the system by special interests

Under existing SEC rules, the voting process prevents undue influence from special interests as well as frivolous resolutions. The SEC's "no-action letter" system relies on rules that bar proposals: pertaining to "personal interests;" relating to operations accounting for less than 5 percent of gross sales; "that the company would lack the power or authority to implement;" dealing with "ordinary business operations;" that the company has "already substantially implemented;" or that "relates to specific amounts of cash or stock dividends."[37]

Any resolutions that survive the no-action process but subsequently generate low votes are then excluded by the current resubmission thresholds. Under this part of the system, decisions about what should go on the ballot are primarily in the hands of voting investors. As Matt Orsagh, a corporate governance expert with the CFA Institute, told Bloomberg BNA, "We prefer to let investors decide for themselves whether a proposal is worthy of their time."[38]

Conclusion

It is not surprising that corporate managers and their trade associations may not see the materiality of corporate governance and ESG issues in exactly the same light as investors. The median CEO tenure at S&P 500 companies as of 2014 was six years.[39] Generally speaking, CEOs can be expected to try to maximize share prices and returns during their tenure, a reality partially

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[35] Staff Legal Bulletin No. 14E: https://www.sec.gov/interps/legal/cfslb14e.htm

[36] https://www.sec.gov/interps/legal/cfslb14h.htm and Medical Committee for Human Rights v. SEC, 432 F. 2d. 659, 680-681 (1970), vacated and dismissed as moot, 404 U.S. 402 (1972).

[37] https://www.sec.gov/interps/legal/cfslb14.htm

[38] https://www.bna.com/us-chamber-calls-n57982063976/

[39] http://www.equilar.com/blogs/59-ceo-tenure.html

responsible for the so-called "tyranny of short-termism."[40] But investors saving for retirement and other long-term shareholders have much longer-term interests.

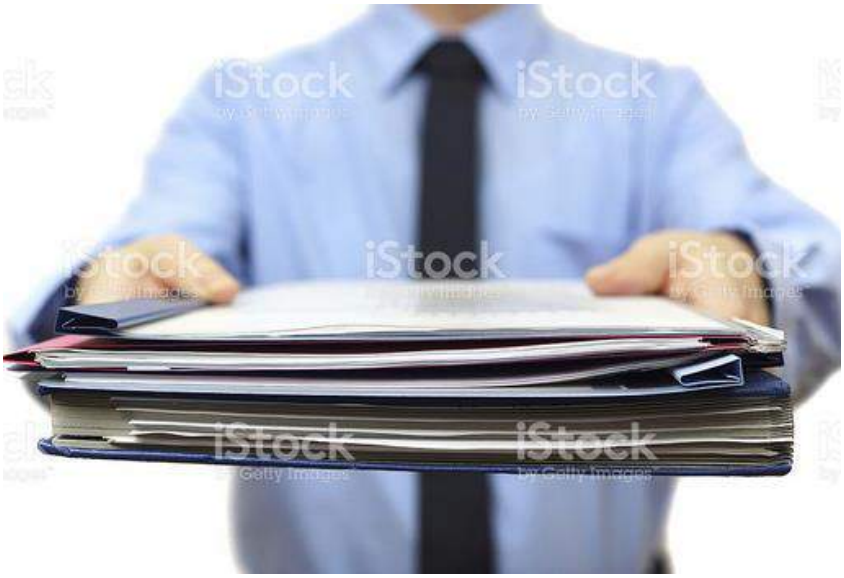
These long-term perspectives can also be helpful to company financial performance. A 2014 study of the effect of long-term investors on corporate decision-making shows that "long-term investors restrain numerous corporate misbehaviors such as earnings mismanagement and financial fraud…" and foster shareholder input into board and management decisions.[41]

The shareholder resolution process allows investors to ask boards and management to address issues that affect the long-term interests of investors. At the same time, the existing process allows companies to exclude frivolous resolutions, those that seek to micro-manage, or that intrude on management's ordinary business judgment. Through use of precedent, the existing no-action letter process sends strong signals to resolution filers to avoid filing resolutions that are likely to be excluded, thereby enhancing the efficiency of the system.

The resolution process provides a needed and effective tool to the growing ranks of passive index investors who often cannot divest shares when they have concerns about corporate governance and other ESG issues. But their fiduciaries can use shareholder proposals to influence the behavior of boards and management and encourage companies to address material corporate issues. And the votes of their fellow investors can send a powerful signal about the importance of these issues to investors. Hence shareholder proposals provide a valuable service to all shareholders, allowing them to signal boards and management in an advisory capacity.

The current U.S. shareholder proposal system provides important benefits for investors and companies. It is a key tool for the assertion of shareholder rights, helps ensure accountability of boards and management, and enables shareholders to focus corporate attention on important issues that may otherwise escape attention. Changing the existing finely tuned SEC rules and practices for overseeing shareholder proposals is likely to do much more harm than good.

[40] https://hbr.org/2011/03/capitalism-for-the-long-term
[41] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2505261



Candidate for the Journal of Irreproducible Results

A new paper sponsored by the National Association of Manufacturers purports to show that shareholder resolutions do not benefit shareholders. The study alleges that while climate change is real, resolutions related to companies reporting on business management and risks in a world undergoing a low-carbon transition do not improve value for shareholders. The authors then select—perhaps a better term is cherry-pick—ten resolutions filed over a four-year period from 2013 and 2017. They don't say how they picked those ten, which is an early indication that this study may be flawed. According to the Sustainable Investments Institute, 425 climate-related shareholder resolutions were filed during that 4-year period and 142 of those resolutions were filed with companies in the Oil, Gas and Consumable Fuels industry. Of that 142, 36 resolutions specifically addressed company reporting on the 2° transition.

So why pick only ten resolutions? Why those ten? Why are only three of the ten about the subject the authors claim to be examining? Crickets.

Despite setting the table by discussing climate-related resolutions at energy companies, six of the ten resolutions chosen by the authors were not climate resolutions; they were sustainability reporting resolutions. And three of the ten were not filed at energy companies; two were pharma companies and one was a chemical company.

The study chose to use a technique known as an event study, a technique that measures whether market prices respond to a specific news event. This technique "is often performed in ways that render it meaningless," according to an economic paper from NERA. In this case, the authors choose to define the event window as beginning with the publication of a shareholder resolution and ending on the date that the shareholder vote is announced, which usually occurs shortly after the annual shareholder meeting. While the latter is sometimes—but certainly not always—newsworthy, the former almost never is. In short, this is an "event" that almost never appears in the news. Proxy statements, which can be found in the SEC's Edgar Database under the label of DEF-14, are rarely covered in the financial or any other media. So, measuring reactions to this very dubious "event" is almost guaranteed to find no impact, because it usually goes unnoticed.

Moreover, defining the "event" as the shareholder resolution and its vote misses the point of the filing altogether. The thing that these climate-related resolutions ask for is that the company publish a plan, at reasonable cost, informing shareholders of how the company's business might change in response to a changing climate. At the close of the study's event period, the company hasn't done anything: the only "event" is the vote, or what proportion of the shareholders who voted on the resolution supported or opposed it, or abstained. And since these resolutions are all nonbinding, even a majority vote doesn't compel the company to publish such a report. Anything that would affect company value, in the eyes of investors, would be in the report.

A final methodological flaw in the report is that the authors chose to report on only nine of the ten resolutions they picked. They don't say why they didn't report on all ten. What did they find? They found that there was no impact on companies' share prices from having one of the resolutions they studied on their proxy ballot for a vote.

Pax World and other shareholders file shareholder proposals not to get companies to tell us what they think the future of climate change will be—another unfounded assertion in the paper—but to understand how companies that are likely to be affected by the world's transition to a lower-carbon economy, and what the company is doing to address the related risks and opportunities. What really would inform investors of how well the company will weather the economic transition isn't the shareholder vote, it's the company's strategic response to how it will manage that transition. Our objectives are to improve how the company performs in the long term, not how it performs in the weeks between the publication of a DEF-14 and the vote on proxy items.

Even the authors of the paper note that climate change is real. Estimates of value at risk from climate change range from over $2 trillion to over $24 trillion, and that is something investors pay close attention to. We ask for this information for the same reason we need financial reporting, which until the 1930s was not required, and companies rarely did. We need information to make reasonable and informed decisions regarding companies' ability to add value, and the risks they face. Without information, investment performance is largely a matter of luck. Shareholders deserve better than a game of chance.

What's Behind a Pitch for the Little-Guy Investor? Big Money Interests

nytimes.com/2018/07/24/business/dealbook/main-street-investors-coalition.html

By Andrew Ross Sorkin July 24, 2018

The group calls itself the Main Street Investors Coalition.

It is a Washington organization that purports to represent the little guy — the retail investor that it says has no voice in corporate America. The group has been not-so-quietly circulating a white paper and various studies in hopes of influencing an examination by the Securities and Exchange Commission of regulations that affect investors. The group has been quoted in the news media and had op-eds published in The Hill, The Washington Examiner and elsewhere.

And yet the Main Street Investors Coalition has nothing to do with mom-and-pop investors.

The group is actually funded by big business interests that want to diminish the ability of pension funds and large 401(k) plans — where most little guys keep their money — to influence certain corporate governance issues.

The coalition popped up in the past two months and is positioning itself against firms like BlackRock and Vanguard, which manage trillions of dollars of Americans' retirement savings and have been using the shareholder votes that come with those investments to take activist positions against corporate boards. The group is incensed that such firms are increasingly promoting environmental, social and governance causes on issues like climate change, gun control and employee diversity. Investors such as BlackRock contend that corporations need to consider such issues for the long-term health of the businesses.

"As the size and influence of these massive institutional holders has grown, so, too, has their power, influence and share of voice — drowning out the voices and interests of Main Street investors who, despite controlling the single largest pool of equity capital in the world, have almost no ability today to influence the decisions these funds make on their behalf, with their money," the Main Street Investors Coalition says on its website.

But the Main Street group knows full well that individual investors rarely mount proxy contests, let alone vote on them. So while empowering individual investors while diminishing the influence of large funds may sound noble, it would simply hand more power back to the managers and boards of directors of the public companies.

Why would the Main Street Investors Coalition want to do this? Because it should probably be called the National Association of Manufacturers — after all, that's the name of the industry group that helped start it and is among its largest funders. (Clearly, "National Association of

Manufacturers" wouldn't sound as good to the man on the street.)

Mindy Lubber, president of Ceres, a sustainability nonprofit organization, described the Main Street Investors Coalition as "a thinly veiled effort to protect those corporations that are unwilling and unprepared to adapt to a changing world — worsening risks for their employees and investors alike."

Among the organization's goals is a way for retail investors to provide voting instructions to the firms that hold their investments. In effect, rather than voting on behalf of all the investors in a given fund, BlackRock would have to parcel out the votes based on each investor's wishes. That sounds good theoretically, but it could erode the ability of the fund's managers to push for big-picture changes on behalf of the many investors who are unlikely to take a position — or, frankly, aren't steeped enough in the issues to make an informed decision.

Nell Minow, a longtime advocate for retail investors and a corporate governance expert who originally brought the group to my attention, wrote in a letter to the Securities and Exchange Commission that the group illustrated how companies were using shareholder money to fight shareholder interests.

"This is yet another reason that we need more transparency on political and lobbying expenditures, especially dark money," wrote Ms. Minow, who is the vice chairwoman of ValueEdge Advisors, a corporate governance consulting firm.

At the moment, there are two important prongs to the coalition's efforts.

The Securities and Exchange Commission is in the middle of examining regulations to protect investors and companies, particularly the role of activist shareholders in proxy battles with companies. The Main Street Investors Coalition has drafted a letter to the commission laying out the group's positions.

And the group supports a piece of legislation winding its way through Congress that would, among other things, require independent proxy advisers to preview their reports on companies with the companies themselves — ostensibly to allow the companies to "fact-check" them, but really providing the companies more power to shape their own narrative.

I asked the organization's executive director, George David Banks, what the connection was between his organization and retail investors. "I'm an individual investor," he said with a laugh.

Mr. Banks said he was aware of the "optics" of his group's backing by the National Association of Manufacturers, whose board includes executives from Exxon Mobil, Goodyear, Dow Chemical, Cargill, Toyota and Pfizer.

"I have gotten that question before. I totally get it," said Mr. Banks, who most recently served as a special assistant to President Trump at the National Economic Council. "We do expect to add a few other groups here that would broaden it out."

Chris Netram, vice president of tax and domestic economic policy for the National Association of Manufacturers, said his organization supported “empowering shareholders.” He also said his organization was the “voice of 12.2 million workers” — although he later acknowledged that its members were the corporations, not their employees.

“We are doing this on behalf on manufacturers and manufacturing workers,” Mr. Netram said. When I pointed out that the group’s positions would most likely benefit companies over their investors, he said, “You’re viewing this as a zero-sum game.”

The truth of the Main Street Investors Coalition is that it is an organization aimed at preventing investment firms from raising issues like climate change. Mr. Banks said as much when explaining how he had decided to start the group.

“It flowed from the shift in institutional investors’ move into the political activism,” he said. He pointed to executives like Larry Fink, the chief executive of BlackRock, who said this year that his firm would hold companies accountable if they didn’t have a way to articulate their contribution to society.

The only goal of investment funds, Mr. Banks said, should be to increase returns. Anything that gets in the way of that is a breach of fiduciary responsibility. His organization said proxy contests over issues like climate change were costly for the companies and didn’t improve their bottom line.

“Such heavy-handed activism creates real burdens for targeted companies, uncertainty for other public companies that may one day be their targets and reduced opportunities for retail investors to invest in the growing number of private companies who avoid or delay going public because of such activism,” Mr. Banks wrote in a white paper for policymakers with Bernard Sharfman, a visiting assistant professor at the University of Maryland law school and the chairman of the group’s advisory council.

The group pointed to a recent study that found among public pensioners, “75 percent of members indicated that the most important issue for fund managers should be to focus on maximizing returns and getting the pension fully funded, while just 14 percent want fund managers to focus first and foremost on advancing social and political causes.”

In Mr. Banks’s view, then, the companies that make up the National Association of Manufacturers aren’t looking out for just themselves.

“The research clearly shows that the overwhelming priority of retail investors is value maximization — the exact same goal of the companies who make up the members of our partners,” he said.

That’s an interesting position to take on investor oversight. It’s almost as if Mr. Banks didn’t think investors needed any say at all.

Shareholder Rights Group

VIA ELECTRONIC DELIVERY

October 5, 2017

The Honorable Walter J. Clayton, III, Chairman
Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Petition regarding resubmission of shareholder proposals
under Rule 14a-8(i)(12) - [File No. 4-675]

Dear Mr. Clayton and Mr. Fields:

The following comments are submitted on behalf of the Shareholder Rights Group to the petition to increase Resubmission Thresholds under Securities and Exchange Commission (SEC) Rule 14a-8(i)(12) [File No. 4-675] and to the July 17, 2017 letter of the petitioners in support of the petition.

The Shareholder Rights Group (the "Group") is an association of investors formed in 2016 to defend shareowners' rights to engage with public companies on issues related to governance and long-term value creation. The members of the Group include:

- Arjuna Capital
- As You Sow
- Boston Common Asset Management, LLC
- Clean Yield Asset Management
- First Affirmative Financial Network, LLC
- Harrington Investments, Inc.
- Jantz Management, LLC
- John Chevedden
- Natural Investments, LLC
- Newground Impact Investment, SPC
- NorthStar Asset Management, Inc.
- Pax World Management, LLC
- Sustainability Group of Loring, Wolcott & Coolidge, LLC
- Trillium Asset Management, LLC
- Zevin Asset Management, LLC

The Petition asserts, without demonstration of need, that the SEC should establish a steeper on-ramp for shareholder proposals under the SEC Rule 14a-8(i)(12) by requiring higher votes to resubmit proposals to a company, the petition would undermine the rights and abilities of investors to participate in dynamic corporate governance through engagement and private ordering. It would discourage investor thought leadership and risk oversight, and undermine the role of the SEC in investor protection, capital formation and the public interest.

The petition wholly lacks merit, and should be rejected by the Commission.

P.O. Box 231 | Amherst, MA 01004 | (413) 549-7333

SYNOPSIS

Every year, shareholder proposals enabled by SEC Rule 14a-8 lead to engagement and dialogue between investors, boards and management at hundreds of companies on issues of governance, risk oversight and long-term value creation. Nearly all shareholder proposals are advisory in nature, but rather than a legal mandate for corporate action. Rule 14a-8 often functions at its best in providing input and advice to boards and management from investors, and encouraging dialogue among subgroups of investors with diverse investment strategies. Individual filers and funds with relatively small holdings are responsible for a high proportion of first time proposals on emerging issues of corporate governance and risk management. These *ahead of the curve* proposals anticipate risks and opportunities facing a company, or offer new models for improving corporate governance. Thus, Rule 14a-8 is an essential tool for investor engagement, governance and private ordering.

1. The Petition does not meet the burden of demonstrating that there is a problem.

The petition to exclude more proposals by imposing steeper thresholds for refiling of proposals provides no evidence that shareholders are abusing the rule or that the existing rule is failing to screen out proposals with low investor support. For example, since 2010, proposals on environmental or social issues have only been resubmitted 35 times after receiving prior votes under 20% for two or more years.

The shareholder proposal process is successful. Over the course of decades, proposals have been drawing increased support from voting shareholders. Perversely, the Petition attempts to justify the idea of imposing steeper thresholds principally based on this growth in support for shareholder proposals. Although the mix of subjects addressed over time has varied, the total number of proposals submitted and appearing on company proxies has **not** grown.

There is no problem in need of a solution.

2. The petition neglects core benefits of the shareholder proposal rule as a tool of engagement which benefits investors and corporations through risk oversight, conflict resolution, governance and private ordering.

The rule provides an appropriate on-ramp for new ideas and concerns.

No attention is given within the petition to the on-ramp established by the Rule 14a-8(i)(12), allowing an educational and engagement process to ensue in the first three years of a proposal's introduction. It is well known that larger investors, in particular, tend to assess new issues first through engagement processes rather than voting in favor of the proposals. The identified emerging issues may be integrated to larger firms' engagement processes for a number of years before resulting in favorable votes by those firms. An increase to the resubmission threshold would derail this important process and end discussion of what have frequently become important issues for company management and boards to consider.

Resubmission thresholds affect engagement and private ordering.

Far more shareholder proposals are filed each year than appear on the proxy. Many proposals are withdrawn after companies agree to address the issues raised by the proposal. The current 3%, 6%, and 10% thresholds of Rule 14a-8(i)(12) often prove relevant to the negotiation and withdrawal process. The fact that a proposal has achieved the Rule 14a-8(i)(12) benchmarks, and may appear on the proxy in a subsequent year, often inspires the board or management of companies to engage in dialogue and implement actions responsive to the proposals. This is particularly germane to engagements by smaller and institutional investors that are attentive to early warning signs and enhanced corporate risk management by bringing management and board attention to prevent disruptive trends from becoming destructive. Contrary to the Petition's assertion that shareholder proposals address trivial matters, the proposal process allows companies to seize opportunities to lead or drive the market, and to head off crushing liabilities, reputation damage, or consumer revolts.

Although private ordering through shareholder proposals is no substitute for a general SEC rule on ESG disclosures, proposals focused on specific environmental and social concerns at a given company provide a targeted means to ensure better disclosure for the large segment of investors who currently use ESG data in their investment strategies. The proposals help to fulfill the SEC's mission of ensuring the availability of information to investors.

Our comments demonstrate that the economic and public benefits of the existing Rule 14a-8(i)(12) far exceed the costs associated with inclusion of resubmitted proposals on the proxy. From a rulemaking perspective, failure to consider such economic and public interest consequences can render any SEC rulemaking arbitrary and capricious. *Business Roundtable and Chamber of Commerce v. Securities and Exchange Commission,* 647 F.3d 1144 (D.C. Cir. 2011).

3. The petition neglects the role of insider and passive votes in diluting the significance of support numbers by investors actively considering proposals.

Since the purpose of the resubmissions rule is to assess the level of interest and support among shareholders to an idea that management is opposing, there is no utility in counting votes controlled by management. Given the growth in dual class ownership, as well as the role of controlled companies, passive investing strategies, and management affiliated or controlled voting blocs, such as ESOPs, it may actually be more appropriate to <u>lower</u> the current resubmission thresholds, rather than raising them.

Elevating the resubmission thresholds would undermine the private ordering, risk oversight and governance services of the shareholder proposal rule, would be harmful to investor, corporate and public interests, and would be arbitrary and capricious as well as poor public policy. The Petition threatens to waste valuable government and shareholder resources on an issue previously considered and rejected by the Commission. We believe the same outcome would result today after the proposed reconsideration, involving an unnecessary diversion of Securities and Exchange Commission resources.

BACKGROUND: THE CRUCIAL ROLE OF SHAREHOLDER PROPOSALS IN THE ECOSYSTEM OF INVESTING STRATEGIES

The Petition's perspective misrepresents shareholder proposals and proponents as existing in a majority rules, win/lose environment where homogenous investors decide which issues are worthy of board and management attention. In contrast, our Group believes that the proposal process is correctly understood as an important means to harmonize disparate investment strategies and respond to an ecosystem of diverse investors. Shareholder proposals enable open discussion and deliberation among subgroups of investors, particularly on the issue of short and longer-term value creation. As such, they are an essential tool for shareholder engagement and private ordering.

While some subgroups in the investment ecosystem – such as activist hedge funds and short-term traders – may place pressure on companies to achieve short-term stock price increases, they do so largely without availing themselves of Rule 14a-8.[1] In contrast, the typical proponents of shareholder proposals under Rule 14a-8, are often seeking disclosure of metrics or governance changes that bring a longer-term value creation perspective to corporate deliberations.

As a self-executing mechanism for enabling shareholders to raise and resolve conflicting interests among themselves,[2] the SEC shareholder proposal rule, Rule 14a-8, imposes minimal

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[1] Activist hedge funds typically deploy more costly forms of engagement through Rule 14a (directly soliciting proxies) rather than Rule 14a-8.

[2] While corporate governance literature and debate typically focuses on conflicts between board or management and a company's shareholders, governance systems also manage conflicts ***among*** rival stakeholders. "Intra-stakeholder tensions" addressed through governance include:

> those between minority and controlling investors, equity investors and creditors, knowledge workers and routine workers, senior and new employees, owner-managers and professional managers, and insider and arm's-length buyer/suppliers. **Different governance systems privilege distinct classes of shareholders in terms of their capacity for achieving their investment goals, monitoring performance, and enforcing their claims[2]**. Michael Carney, Eric Gedajlovic, Sujit Sur, "Corporate governance and stakeholder conflict", *Journal of Management & Governance*, August 2011, Volume 15, Issue 3, pp 483-507. https://link.springer.com/article/10.1007/s10997-010-9135-4

The conflicts between subgroups of *shareholders* was characterized in an American Bar Association publication which noted that:

> Shareholders in a corporation generally have the same ultimate goal: to maximize shareholder value. However, this is not always the case and sometimes the shareholders do not agree on how to achieve this goal.

Richard C. Reuben, American Bar Association, *Corporate Governance: A Practical Guide For Dispute Resolution Professionals*, Section of Dispute Resolution, 2005. https://shop.americanbar.org/ebus/store/productdetails.aspx?productid=213630 Shareholders, management, employees and other stakeholder groups are all part of a 'team' contributing to the success of the firm, but among which conflicts may need to be resolved and harmonized. Lynn Stout and Margaret Blair, "A Team Production Theory of Corporate Law," *Virginia Law Review,* Vol. 85, No. 2, pp. 248-328, March 1999. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=425500 Harmonizing conflicting stakeholder interests, including different subgroups of shareholders is a necessity to keep the team working together for the success of the firm.

costs on corporations and society and brings major issues to the attention of investors, who can deliberate on those matters while considering both their own interests and the best interests of the corporation.

1. Short-Term Pressures are not Driven by Rule 14a-8 or Rule 14a-8(i)(12)

The conflict over long-term versus short-term value creation is in part a fight to bring balance to the numbers that matter—between the quarterly returns and current stock prices and metrics that are relevant to longer-term value. For many investors, the shareholder proposal process serves as a modest corrective to the gaps in existing SEC rules for ensuring disclosure of long-term corporate strategy, accountability to diverse investors and disclosure of longer-term and socially relevant metrics.

Despite the proliferation of policy reports and missives encouraging companies and investors to take a longer-term view, company managers perceive pressures for short-term performance as pervasive. A recent study commissioned by the think-tank ***Focusing Capital on the Long Term*** suggested 87 per cent of executives feel pressure to deliver results within two years or less. The think tank notes:

> Too many investors continue to seek returns on their strategies as quickly as possible. Companies are missing out on profitable investments for fear of missing quarterly earnings guidance. Corporate management significantly undervalues and underinvests in longer-term prospects. Savers are missing out on potential returns because stock markets are penalizing companies that make long-term investments. Society is missing out on long-term growth and innovation because of underinvestment.[3]

These pressures derive both from the volume of market responses to metrics in company quarterly reports and to the dominance of short-term trading in setting stock prices:

> And short-termers have been taking over the stock market. In the 1950s the average holding period for an equity traded on the New York Stock Exchange was about seven years. Now it's six months. Similar trends can be seen in other markets around the world. In a more recent development, high-frequency traders whose holding periods can sometimes be measured in milliseconds now account for as much as 70% of daily volume on the NYSE.[4]

Hedge fund activists also may affect pressures for short-termism:

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[3] Focusing Capital on the Long Term, "A roadmap for focusing capital on the long term," March 2015, pp 2. http://www.fcltglobal.org/docs/default-source/default-document-library/a-roadmap-for-fclt.pdf?sfvrsn=7b2e258c_0

[4] Fox, Justin, Jay W. Lorsch, "What Good Are Shareholders?", Harvard Business Review, July-August 2012.

> In recent years, companies have found it even more challenging to focus on long-term value creation due to the rise of hedge fund activist investors. These activist investors are looking to maximize stock price before they sell their shares, and they have been very effective at influencing boards, changing CEOs and management, and driving mergers and acquisitions.

Around 550 hedge fund activist investors globally control more than $180 billion in capital.[5] These "activists" often aggressively seek to alter how a company is managed, overriding board and management judgments regarding changes, such as splitting up the company, selling assets or other measures, including such measures as layoffs and firings or reduced R&D expenditure. Such measures may allow the activist to sell out at a profit and leave the company in a weaker position for long-term value creation. [6]

The controlling investors and insiders also (board members and executives) may also drive short-sighted decisions through self-dealing. As one corporate governance expert has noted:

> Given human nature, it would be surprising indeed if the board of directors (or some members thereof) did not occasionally use its control of the corporation to increase their own wealth rather than that of the shareholders. Consequently, much of corporate law is best understood as a mechanism for constraining agency costs.[7]

In the absence of accountability, self-dealing by board and management may easily contravene the interests of many of the firm's capital providers, including institutional investors. This clash of insiders versus outsiders plays out in many instances in decisions to sell a company, for which extensive rules and litigation have sought to ensure a review of fairness as between insiders and outsiders.[8] This insider/outsider clash also plays out in considerations of executive pay. The annual "say on pay" established by the Dodd-Frank Act and SEC rules allows all shareholders to vote on an advisory basis to approve executive compensation packages. For the insiders, however, this "Say on Pay" vote may be a short-sighted decision on whether to approve

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[5] Activist Investors and the Rise of Short-Termism 2.0, Laura Gitman, Senior Vice President, BSR, June 21, 2017.

[6] Huffington Post, Alex Edmans, "How Short-Term Activists Create Long-Term Value, August 24, 2016. http://www.huffingtonpost.com/alex-edmans/how-shortterm-activists-c_b_11675538.html However, note that there is a lively debate about the *overall* effect of hedge fund activism on long term value, with some studies showing that overly activist hedge funds create value in both the short and long run. One study, for instance found that activism leads to firm value increasing by 7%, with no long-term reversal. Some possible reasons for this include reallocation of investment to better growth opportunities, top executive salaries are cut, and restructurings increase productivity and investment efficiency.

[7] Bainbridge, Stephen, "Shareholder Activism in the Obama Era," *UCLA School of Law, Law-Econ Research Paper No. 09-14,* July 23, 2009. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1437791

[8] Control carries with it the potential for oppression. Approval even by disinterested board members is not viewed as a substitute for close judicial scrutiny of the merits of the transaction. *Kahn v. Lynch Communication Systems, Inc.,* 638 A.2d 1110, 1116-17 (Del. 1994).

their own salaries rather than an assessment of whether executive compensation appears excessive relative to performance.[9]

Notably, neither controlling shareholders nor activist hedge fund shareholders need to avail themselves of Rule 14a-8 to effectuate their goals.[10]

2. Longer-term Value Creation and Rule 14a-8 Proposals

Contrary to the Petition's assertion that shareholder proposals address trivial matters, investors rely on Rule 14a-8 as a crucial tool for engagement on longer timeline issues, in part by seeking new metrics through proposals focused on value creation in the long term.

About a fifth of assets under professional management in the US ($8.72 trillion as of 2016) are engaged in sustainable, responsible or impact investing in the United States.[11] These investors and advisors bear responsibility, through contract and client expectations, to ensure that investments are managed consistent with a client's or trustee's strategy/investment mission, and include in many cases a commitment to directly engage with portfolio companies on long-term risks and opportunities. As an example, the pension funds of religious institutions, which are driven by obligations to invest consistent with their faith values, rely on the rights of the shareholder proposal process to open doors for engagement with corporate boards and managers. The Interfaith Center on Corporate Responsibility (ICCR), a coalition of more than 300 faith- and values-driven institutional investors, collectively represents over $200 billion in invested capital.[12]

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[9] According to As You Sow: "Say on Pay votes *can* have a powerful effect. After the majority of shareholders failed to support the company's pay packages in 2012 and 2013, Abercrombie and Fitch separated the chairman and CEO positions, increased its emphasis on performance-based equity, redesigned both short-term and long-term incentive programs, and signed a new employment agreement with CEO Michael Jeffries. In 2014 shareholders approved the advisory vote on compensation." http://www.asyousow.org/our-work/power-of-the-proxy/executive-compensation/faqs/

[10] The hedge funds tend to use Rule 14A rather than Rule 14a-8. Rule 14A requires far more costly procedures associated with direct communication with other shareholders and solicitation of proxies. The insiders typically effectuate their goals by company proposals or board action without involving other shareholders.

[11] US SIF, *Report on US Sustainable, Responsible and Impact Investing Trends 2016,* pp 5. Worldwide, the assets committed to responsible, long-term investment includes over 1,400 signatories managing more than US$59 trillion that have endorsed the global Principles of Responsible Investment. United Nations Environmental Programme – Financial Initiative, *Principles for Responsible Investment: An investor initiative in partnership with UNEP Finance initiative and the UN Global Compact*, 2016, p. 4.

[12] Zinner, Josh, Interfaith Center on Corporate Responsibility, letter to Senators regarding the Financial CHOICE Act of July 10, 2017:

> "For over four decades ICCR members have used the proxy process to engage hundreds of multinational corporations on a host of environmental, social and governance topics…. As a direct result of shareholder resolutions brought by ICCR members and other responsible investors, longer-term emerging risks with the potential to negatively impact the world's most vulnerable have been identified early and proactively managed -- to the financial benefit of hundreds of companies, as well as the health of the environment, and the welfare of communities across the globe."

Also in the longer-term category are union members' pension funds, that manage retirement assets on behalf of employees covered by collective bargaining agreements. Collectively, union-sponsored and Taft-Hartley pension funds oversee approximately $667 billion in investment assets in the United States.[13] Because union members have extensive information on the weaknesses of governance at the companies where they are employed, they can be exceptionally astute and effective at identifying the need for reforms at particular companies.

Finally, it should be noted that individual investors typically file 25% of Rule 14a-8 shareholder proposals each year. The individual filers and funds with relatively small holdings are responsible for a high proportion of first-time, groundbreaking proposals on emerging issues of corporate governance and risk management.[14] These *ahead of the curve* proposals anticipate risks and opportunities facing a company, or offer new models for improving corporate governance. These proposals would face the greatest risk of exclusion in elevated resubmission thresholds.

The academic and business literature often talk about the power of "disruptive" developments. A key business goal is to use *disruption*, but to manage it to avoid business *destruction*. Disruptive developments include quickly changing consumer concerns, emerging understanding of environmental or product hazards, shifting human rights concerns, and rapidly changing technologies. The shareholder proposal process brings an opportunity – through thoughtful engagement and shareholder deliberation – to address disruptive developments in a manner that is decidedly not destructive to the firm or its long-term value creation. The effectiveness of these engagements is not dependent on whether the proponents are on track to win majority support among other share owners, but it may be very much dependent on the ability of these shareholders to sustain their engagement over the course of years.

Decades of shareholder proposals have effectively persuaded hundreds of companies to produce annual sustainability reports and other key environmental and social metrics of that investors value. Existing rules allow this to happen and helped to bring these practices to leading companies. Investor support for seeing this kind of disclosure and management generalized to all companies has grown – and jumped particularly in the 2017 proxy season when dominant mutual fund players including BlackRock, State Street and Vanguard supported resolutions for more climate risk reporting at leading energy companies.

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[13] 2017 S&P Money Market Directory.

[14] Public pension funds such as CalPERS, CalSTRS, NY State Common Retirement Fund and NYCERS also file many of the important risk oversight and governance proposals.

ANALYSIS OF PETITION

SEC Rule 14a-8(i)(12) provides for exclusion of shareholder proposals submitted to a company in prior years based on the level of voting support for the proposal. The Rule provides:

> (12) Resubmissions: If the proposal deals with substantially the same subject matter as another proposal or proposals that has or have been previously included in the company's proxy materials within the preceding 5 calendar years, a company may exclude it from its proxy materials for any meeting held within 3 calendar years of the last time it was included if the proposal received:
> (i) Less than 3% of the vote if proposed once within the preceding 5 calendar years;
> (ii) Less than 6% of the vote on its last submission to shareholders if proposed twice previously within the preceding 5 calendar years; or
> (iii) Less than 10% of the vote on its last submission to shareholders if proposed three times or more previously within the preceding 5 calendar years…

The US Chamber of Commerce with other business trade associations submitted petition 4-675 to the SEC in 2014, seeking to upwardly revise the shareholder proposal resubmission thresholds of Rule 14a-8(i)(12).

The petition asking the SEC to undertake a rulemaking on this issue threatens to waste valuable government and shareholder resources on an issue previously considered and rejected by the Commission. The Securities and Exchange Commission in 1997 proposed to increase these thresholds to 6 percent, 15 percent and 30 percent. However, after receiving public comments, the Commission rejected the proposed changes. We believe the same outcome would result today, but after an unnecessary diversion of Securities and Exchange Commission resources.

1. The petitioners have not met the burden of demonstrating that there is a problem in need of a solution.

(a) Greater investor support for proposals is <u>not</u> a basis for more restrictive rules.

The Petition attempts to justify the idea of steeper thresholds principally based on the growth in support for shareholder proposals. The Petition notes that the number of proposals excludable under the threshold has been declining due to increasing support for proposals:

Out of 618 proposals in 2013 for which voting data was available, only eleven, or 1.8%, failed to achieve the initial minimal 3% support threshold, and only 98, or 15.8%, failed to achieve the *most stringent* 10% threshold.[15]

The decline in the portion of excludable proposals is directly attributable to an increased portion of shareholders voting in favor of the proposals. The shareholder proposal process is working, as evidenced by increased support from voting shareholders.

In telling contrast to the growth in voting support for proposals, the total number of proposals submitted and appearing on company proxies has **not** grown. The Institutional Shareholder Services (ISS) Voting Analytics Shareholder Proposals Database tracks shareholder proposals that were submitted between 2004 and 2017 at Russell 3000 companies. Although the total number of proposals varies from year to year, viewing the number proposals submitted on average, there is no growth in the number of proposals submitted. For instance, an average of roughly 800 proposals were submitted to companies annually between 2004 and 2009, and about the same level of 800 proposals per year averaging from 2013 – 2017.[16]

The Petition references the prior effort of the SEC to increase the resubmission thresholds from the current 3, 6, 10% votes in the first, second and third years of voting to 6, 15 and 30%, respectively. There is no justification for these numbers. Changes such as these would steepen the on-ramp for proposals, making it significantly more difficult for a proposal to survive the three-year introductory period. Many potential engagements would be derailed, heading off discussion of what often become important issues for company management and boards to consider from the perspective of risk management, leadership, or identifying opportunities.

(b) The petitioners have provided no evidence of abuse.

The Petition provides no evidence that shareholders are abusing the Rule, that the existing Rule is failing to screen out proposals with low investor support, or that proxy statements are cluttered with proposals which appear year after year on the proxy despite support near the 10% threshold of Rule 14a-8(i)(12). Resubmissions a third or fourth time with supporting votes near 10% are very rare. Even considering votes approaching 20%, there are few continuing resubmissions. For example, since 2010, proposals on environmental or social issues in particular have only been resubmitted 35 times after receiving prior votes under 20% for two or more years.[17]

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[15] Petition 4-674, p. 14.

[16] Less than half of the 11,706 proposals submitted to companies went to a shareholder vote. The SEC permitted companies to omit 1741 proposals. The remainder of the proposals were either withdrawn by the proponent or otherwise did not go to a vote. Analysis of Institutional Shareholder Services, Voting Analytics Shareholder Proposals Database, a database of Russell 3000 Companies.

[17] Based on data analysis by Jonas Kron, Trillium Asset Management, analysis of Sustainable Investments Institute Database, courtesy of Heidi Welsh.

John Chevedden is an individual share owner who files various proposals on corporate governance with colleagues including James McRitchie, Myra K. Young, William Steiner and Kenneth Steiner. Mr. Chevedden notes:

> We do not file the same proposal at companies for 3 or more years, if the vote count hovers in the low teens. In some cases we have filed the same proposal at companies for 3 years when support hovered around 40%.[18]

Shareholders already recognize the purpose of the rule and exercise their rights responsibly.

In short, the Petition identifies an ostensible solution to a nonexistent problem. The purpose of the Petition seems to be, quite simply, to limit the voice shareholders successfully raising issues of risk oversight and governance. The success of the shareholder proposal process provides no justification for restricting proposals. The number of proposals appearing on corporate proxies is not increasing. Nor has the petitioner demonstrated that the proposals are disconnected from long-term value creation and corporate governance concerns. **Simply stated: there is no problem in need of a solution.**

2. The Petition neglects core benefits of the shareholder proposal Rule as a tool of engagement which benefits investors and corporations through risk oversight, conflict resolution, governance and private ordering.

The Petition is misguided in its assumption that only proposals calculated to be on a pathway to obtain majority support merit continued appearance on the proxy under Rule 14a-8(i)(12). Proposals receiving far less than majority support play a very significant role in private ordering and dynamic corporate governance, to the benefit of corporations, investors and society. Any consideration of changes to the Rule would be arbitrary and capricious if it failed to assess the loss of these benefits. Such consideration is notably absent from the Petition.

The Petition exaggerates costs of the no-action letter process[19] and, at the same time, fails to recognize and account for these core benefits. It is important to recognize the economic, corporate, investor, and societal benefits generated by the current Rule, and the potential losses posed were those benefits to be curtailed. This includes the services to corporations and to investors of risk oversight and management, conflict resolution and governance.

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[18] Correspondence with John Chevedden. As the most prolific individual filers, despite relatively small holdings, Chevedden and his small group of colleagues have had an outsized impact, reforming corporate governance at public companies on proposals, such as simple majority voting, independent board chairman, allowing shareholders to call meetings, confidential voting, cumulative voting, and limited accelerated pay in the case of a merger or buyout.

[19] See, e.g., Adam Kanzer, The Dangerous "Promise of Market Reform": No Shareholder Proposals," Domini Impact Investments. https://corpgov.law.harvard.edu/2017/06/15/the-dangerous-promise-of-market-reform-no-shareholder-proposals/

In addition, one would expect the Commission to consider and calculate the loss in private ordering benefits to society of resolving issues of risk governance and corporate social responsibility via investors, who also have the best interests of the corporation foremost in mind.

(a) The Rule provides an appropriate on-ramp for new ideas and concerns.

No attention is given within the petition, or other corporate advocacy or criticisms of the resubmission rule, to the on-ramp established by the Rule 14a-8(i)(12) allowing an educational and engagement process to ensue in the first three years of a proposal's introduction. It is well-known that larger investors, in particular, tend to assess new issues first through engagement processes rather than voting in favor of the proposals. Emerging issues are often integrated into larger firms' engagement processes for a number of years, after which there are favorable votes by those firms on relevant proposals at companies that do not respond to the engagements.[20] Thus, the resubmission thresholds of Rule 14a-8 reflect an ongoing process among subgroups of investors expressed through deliberation, education, policy development, engagement and persistence.

By creating a steeper on-ramp, the effect of the proposed changes to the resubmission thresholds would undermine the ability of shareholders to flag and engage with companies and fellow shareowners on emerging issues, or present innovative ideas. As such, it would reduce the dynamism of shareholder participation and engagement.

The resubmission process often entails a gradual process of educating and enlisting broader investment community support – in some instances, both a short-term and longer-term educational arc. The short arc is the first three years of submission and resubmission. The resubmission thresholds of Rule 14a-8(i)(12) are directed in part to these first three years, which might be termed the *initial introduction* or *education* period. Those thresholds require that a proponent earn at least 10% of share owner support by the third year of submission to keep a proposal on the proxy. We believe this three-year introduction period is an integral part of the shareholder proposal process and that the thresholds are appropriate and functional. For instance, an *innovative* proposal might initially receive only 3% or 4% support of shareowners.

Support sometimes takes decades to build – such as on proposals seeking better risk management on climate change, amending equal employment opportunity policies to include LGBT people, or seeking governance changes such as board declassification. Proposals on these topics that have hovered around 10% support for a decade or more in the 2000s and eventually moved into widespread adoption and majority support.

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[20] Jerilyn Klein Bier, "Passive Investing Giants Drive Stewardship Efforts," Financial Advisor, September 26, 2017:

> The Big Three haven't filed any shareholder resolutions. "I almost think they're willing to leave that to the other participants in the market that have already established a long-term willingness to do that…"

Maintaining proposals on the proxy that have modest support is relevant, within the investing ecosystem, to the needs and rights of larger and institutional investors. These firms tend to monitor the response to a proposal generally in the investing community as part of their broader assessment process. Does the issue have sufficient staying power that it is appropriate for the large firm or institution and its analysts and advisors to dedicate significant organizational resources? In a number of instances, while proposals are introduced by smaller firms and holders, larger shareholding institutions have attempted to address the same issues through engagement with companies, and only after those engagements have failed to yield sufficient results have the firms developed voting policies to support these proposals. We have seen this in particular in the last year with some of the larger investment firms, such as BlackRock and Vanguard, who supported climate proposals after what they saw as a failure or breakdown of progress in their own engagement processes.

Proposals at ExxonMobil asking the company to assess the impact of climate change on its business model tended to get 10% support for many years. But shareholder support rose to 30% support in 2016 and then 62.3% support at the company's most recent annual meeting in 2017. This only happened after winning eventual "Yes" votes from some of the largest firms.

The shift in attention to these issues, particularly on climate change, is reflected in communications and strategy by the big investment firms. For example, Glenn Booraem, Vanguard's Investment Stewardship Officer, said in the Vanguard Investment Stewardship Report:

> First, companies should expect that we're going to focus on their public disclosures, both about the risk itself and about their board's and management's oversight of that risk. Thorough disclosure is the foundation for the market's understanding of the issue. Second, companies should expect that we'll evaluate their disclosures in the context of both their leading peers and evolving market standards, such as those articulated by the Sustainability Accounting Standards Board (SASB). Third, they should expect that we'll listen to their perspective on these and other matters. And finally, they should see our funds' proxy voting as an extension of our engagement. When we consider a shareholder resolution on climate risk, we give companies a fair hearing on the merits of the proposal and consider their past commitments and the strength of their governance structure.[21]

(b) Resubmission thresholds affect engagement and private ordering.

Far more shareholder proposals are filed each year than appear on proxy statements. In addition to proposals that are excluded by the SEC, investors withdraw many proposals after the proposal prompts engagement and companies agree to address the expressed issues of concern. Thus, it is notable that while over the last five years the total number of proposals filed with

[21] Vanguard, *Investment Stewardship, 2017 Annual Report*, p. 11.

companies on environmental and social issues has grown, the number appearing on the proxy has held steady because many of these proposals are withdrawn after companies and investors developed collaborative solutions. These withdrawn proposals represent private ordering of great value that is inherent in the shareholder proposal process.

The current 3%, 6% and 10% thresholds of Rule 14a-8(i)(12) often prove relevant to the negotiation and withdrawal process. The fact that a proposal has achieved the Rule 14a-8(i)(12) benchmarks, and may appear on the proxy in a subsequent year, often inspires the board or management of companies to engage in dialogue and implement actions responsive to the proposals. This is particularly germane to engagements by smaller and institutional investors that are attentive to early warning signs to enhance corporate risk management and often can spur management and board attention to prevent disruptive trends from becoming destructive – to seize opportunities to lead or drive the market, and to head off crushing liabilities, reputation damage or consumer revolts. If the resubmission thresholds were to ramp up more quickly as the petition proposes, the value of this process would be significantly curtailed.

The ability of some relatively small shareholders to persist and to prompt action by companies through the shareholder proposal process, even before adding up large supportive votes, can be critical to the success of companies. For example, consider the 2000 and 2003 proposals filed by religious investors at banks regarding subprime lending and securitization. The responsive companies—those that took action on the issues raised by the proposals—reportedly avoided being part of the financial crisis.[22]

(c) Relevance of private ordering and education to SEC mission.

The benefits of the private ordering enabled by the shareholder proposal rule have been frequently acknowledged by SEC officials. For example, SEC chair Mary Jo White stated in a 2016 keynote address to the International Corporate Governance Network Annual Conference:

> Direct engagement with shareholders of U.S. companies, particularly with institutional shareholders, has increased significantly in recent years – a development that I have strongly encouraged. This engagement has been buttressed with rights shareholders have

[22] As Attorney Paul Neuhauser has noted:

> The first shareholder proposals concerning predatory subprime lending were submitted in 2000 and the first asking securitizers to police the loan pool were submitted in 2003, in each case years before subprime lending became recognized as a major problem. The shareholder proposals constituted an early warning system for those who heeded them. Although these proposals were submitted to a number of companies and survived company challenges at the SEC, they never appeared on any proxy statement because the recipients in each case agreed to a change of policy with regard to predatory lending to subprime borrowers (in one case the securitizer called the proponent the day after it lost its no-action request at the SEC to request a meeting and dialogue on the matter and at the meeting agreed to alter its due diligence process with respect to loans purchased for securitization). Notably, the securitizers that received the precatory proposals and changed their practices have not been among those who have suffered during the recent unpleasantness.

Paul Neuhauser, comment letter to SEC, Oct. 2, 2007, https://www.sec.gov/comments/s7-16-07/s71607-476.pdf

> under SEC rules, specifically Rule 14a-8, to have their own proposals included in a company's proxy statement to be voted on by all shareholders. These proposals can cover a wide range of issues, including environmental, social and corporate governance ones. This is an avenue that shareholders increasingly use to get traction and initiate meaningful dialogue with boards and executives for changes on issues of importance to them.
>
> There are significant success stories resulting from these efforts and the private ordering by companies responding to shareholder views. Prominent examples include the near disappearance of staggered boards, majority vote standards becoming the norm across the S&P 1500, and the recent successes of proxy access proposals resulting in 35% of the S&P 500 adopting proxy access, compared to 1% two years ago. [23]

Furthermore, an analysis published on the SEC website in 2015 demonstrated that the private ordering enabled by shareholder proposals on Proxy Access resulted in significant positive response from the marketplace. The study identified a 53 basis point increase in shareholder value for firms targeted with such proposals.[24]

(d) The marketplace is seeking better disclosure on environmental and social issues.

In 2016, hundreds of investors wrote to the SEC urging the establishment of mandatory disclosure metrics on environmental and social issues.[25] The Sustainability Accounting Standards Board (SASB) analyzed the comment letters received by the SEC in response to the 2016 Concept Release.[26] Two-thirds of the 276 non-form comment letters discussed ESG disclosures in SEC filings. Most of the letters supported ESG disclosures, and for many commenters, this was the only issue they addressed. A full 80% of ESG-related comment letters called for improved disclosure of sustainability information in SEC filings. Of the ESG-related comment letters submitted, 37% were submitted by asset owners and asset managers. SASB concluded its analysis by stating that the comments on the Concept Release "have sent a strong signal to the SEC that times have changed" and that investors are asking for better disclosure of material ESG information in SEC filings.

In its comment letter responding to the SEC's Concept Release, the SASB (an independent standard-setting body) pointed out that "today's reasonable investors use sustainability disclosures." SASB cited a 2015 CFA Institute survey, in which 73% of institutional investors stated that they take ESG issues into account in their investment analysis

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[23] Mary Jo White, Focusing the Lens of Disclosure to Set the Path Forward on Board Diversity, Non-GAAP, and Sustainability, June 27, 2016, https://www.sec.gov/news/speech/chair-white-icgn-speech.html

[24] Tara Bhandari, Peter Iliev, Jonathan Kalodimos, Public versus Private Provision of Governance: The Case of Proxy Access, July 24, 2015 https://www.sec.gov/files/public-vs-private-provision-of-governance.pdf

[25] SASB, Blog, August 16, 2016, https://www.sasb.org/investors-sec-sustainability-disclosure/

[26] https://www.sasb.org/wp-content/uploads/2016/09/Reg-SK-Comment-Bulletin-091416.pdf

and decisions. SASB also commented that while Regulation S-K already requires disclosure of material sustainability information, current disclosures are of poor quality. In fact, 40% of 10-K disclosure on ESG issues consists of "boilerplate" language and does not help investors "understand or price risk or to evaluate performance…"

The role of such ESG metrics in bringing attention to the issue of long-term management is currently widely understood, even by investors that are not sponsors of proposals. Although larger investors in the market have greater capacity to engage directly with companies on the relevant issues, and, therefore, tend not to utilize Rule 14a-8 to file proposals, the largest investing institutions have come to recognize the importance of the kinds of environmental and social metrics sought in shareholder proposals as indicators of potential long-term value creation. For instance, Larry Fink, the chief executive of BlackRock, the world's largest investor, has noted in his annual letter to investors that "ESG factors relevant to a company's business can provide essential insights into management effectiveness and thus a company's long-term prospects." A growing portion of investors are also focused on issues with potential to pose *economy-wide and cross-portfolio impacts* by externalities. This includes the growing portion of investors and advisors who, through investing strategy, contracts and client expectations, bear responsibility to ensure that investments are consistent with their clients' or trustees investing missions and values. These investors' sensitivity to long-term risk and "low road" business strategies leads to differing top concerns.

Institutional investors are strengthening, not diminishing, their focus on long-term value creation and systemic risk. A recent state of the industry report, "Tipping Points 2016,"[27] collected data from a group of 50 institutions, including 28 asset owners and 22 asset managers. These institutions were selected because of their diversity, including size, geographical locations, institutional missions, and clients. The report sought to assess whether and to what extent institutional investors consider and manage their impacts on environmental, societal, and financial systems, and to what extent they consider those systems' impacts on their portfolios. The report found that financial returns and risk reduction appear to be two primary motivators for approaching investment decisions on a systemic basis. Asset owners and managers frequently cite the financial risks they perceive from environmental, social, and governance risk at the level of specific securities and industries. Institutional investors are concerned with measuring and managing non-financial returns of their investments.

Although private ordering accomplished through shareholder proposals is no substitute for a general SEC rule on ESG disclosures, at a minimum the proposals focused on specific environmental and social concerns at a given company provide a targeted means of ensuring better disclosure for the large segment of investors who currently use ESG data in their investment strategies. The proposals clearly help to fulfill the SEC's mission of ensuring that relevant information is available to investors. The proposal process is a self-help remedy for

[27] http://tiiproject.com/tiiping-points-2016

investors to flag issues, and to seek management response on issues of concern at particular companies.

(e) Proposed SEC rulemaking on Rule 14a-8(i)(12) would fail both public interest and economic consequences tests.

As demonstrated above, the economic benefits of the existing functional Rule 14a-8(i)(12) far exceed the costs associated with inclusion of resubmitted proposals on the proxy. Failure to consider the economic consequences as well as the impact on the public interest of a rulemaking can render any SEC rule arbitrary and capricious. *Business Roundtable and Chamber of Commerce v. Securities and Exchange Commission*, 647 F.3d 1144 (D.C. Cir. 2011).

In summary, altering the resubmission rule in a manner that undermines the private ordering, risk oversight, and governance services of the shareholder proposal rule in addressing emerging issues and concerns would harm investor, corporate, and public interests, be arbitrary and capricious, and result in poor public policy.

3. The Petition neglects the role that insider and passive votes play in diluting assessment of support by independent investors actively considering proposals.

Share ownership configurations and voting rights complicate interpretation of the percentage of support under Rule 14a-8(i)(12). When one considers dual class share ownership, insider ownership and the non-involvement of passive investors, the percent of support for a proposal reflected by the Rule's counting methods may reflect a sharp underestimate of the support by those investors known to actively consider shareholder proposals.

Where a majority or significant minority of share ownership is held by insiders and passive investors that reflexively vote with management, the current Rule 14-8a(i)(12) thresholds allow a margin of error reflecting the understanding that at some companies, the active support of 3%, 6%, and 10% of shareholders under the current counting methods may signify a very substantial portion of those shareowners who are realistically and actively focused on a proposal.[28]

Responsible Investor published an article in 2015 that reviewed the implications of insider shareholding on vote outcomes.[29]

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[28] The failure of retail investors to vote on proposals is relevant to this question of active consideration. When the lengthy proxy has buried the shareholder proposals 95 pages deep in the proxy book, the decision to leave shareholder proposals blank while voting only on management's proposals cannot realistically be weighed as a vote against the proposal. Yet some companies' current methods of counting will allow management to treat submitted proxies with non-votes on shareholder proposals as votes against the proposals. This further skews the voting. These non-votes on submitted ballots should not be considered in calculating whether or not a proposal can be resubmitted.

[29] Paul Hodgson, "Insider and controlled shares are keeping out public shareholders: Why one shareholder, one vote should be the rule," *Responsible Investor*, November 10, 2015.

So what does this control mean in practice? At Facebook, for example, the controlled shares owned largely by founder Mark Zuckerberg outgun the publicly held shares by about 3.5:1. The vast majority of the controlled shares are "B" shares that have 10 votes per share. So, in 2014, when shareholder resolutions were on the ballot at Facebook to support: a change to shareholder voting; a corporate lobbying disclosure report; and a sustainability report, all of these were easily defeated, with 80-90 per cent of "votes" cast against them. Labour union AFSCME's John Keenan tracks the issue closely and regularly analyses what would have happened to shareholder resolutions and other proxy voting items if controlling and insider shares were excluded. I asked him for his findings on a group of around 10 companies that met these criteria in both 2014 and 2015. He calculated, for example, that if only outside votes were counted at Facebook in 2014, the shareholder vote resolution (which calls for one vote per share) and the lobbying disclosure report resolution would both have passed. And the sustainability report resolution would have received over a third of outstanding outsider votes. The shareholder vote was up again this year, and received the support of almost all the public shareholders…

This story is repeated over and over at other US controlled companies. Take Google: in 2014, for example, an equal voting resolution failed at the "polls" despite receiving the support of 81% of public shareholders. And a resolution calling for an independent chairman, that would have dislodged former CEO Eric Schmidt from the job, almost received majority support from public shareholders but barely made a showing in the final vote tally. Similarly, in 2015, the vast majority of Google's public shareholders again supported resolutions for one share one vote and a simple majority voting standard. In addition, a fifth of them even opposed Google's new stock incentive plan, and almost half objected to the re-election of director John Doerr, a partner at Kleiner Perkins Caufield & Byers, one of the venture capitalists that initially backed Google, as well as Zynga, Intuit, Twitter.... But he was re-elected, the stock plan approved and neither of the two shareholder resolutions were even considered.

* * *

At T-Mobile, significant minority protest votes against 6 directors, including CEO John Legere, were noted among outside shareholders in 2014, with the number of protest votes increasing in 2015, and over a larger number of directors – nine. Even more significant, had Deutsche Telekom's massive stockholding not voted against it, a proxy access resolution would have passed with two-thirds of outside shareholder support.

At Urban Outfitters, a human rights risk assessment resolution in 2014 received the support of a third of outside voters compared to only a quarter of total outstanding shares, and in 2015, a clear majority of outside shareholders supported a proxy access resolution and voted against two directors associated with private equity firms. The founder and his wife, the "chief creative officer", also received substantial minority protest votes, but because of their voting power were comfortably re-elected.

> At Walmart, in 2014, resolutions on lobbying disclosure, the implementation of a pay clawback policy and for an independent chair received between a third and two-fifths of support from public shareholders…

Since the purpose of the resubmissions rule is to assess the level of interest and support among shareholders to an idea that management usually opposes, there is no utility or rationale in counting votes controlled by management. Considering the proliferation of dual class ownership, controlled companies, passive investing, and management affiliated or controlled voting blocs, such as ESOPs, the current 3, 6 and 10% resubmission thresholds may in many instances be higher than appropriate, rather than too low.[30]

CONCLUSION

Modifying the shareholder proposal rule in a manner that would exclude more proposals — as the Petition to elevate resubmission thresholds would do —– will benefit neither investors, nor companies, nor the public interest.

To the extent that changes to resubmission thresholds create a steeper on-ramp for proposals, they will weaken a dynamic and effective system that provides risk oversight, governance, and conflict resolution.

Investors who engage in the shareholder proposal process to bring their time, talent and treasure to the table to provide early warnings or emerging risks, and early opportunities for innovation, accountability, and leadership. Viewed from the perspective of services to the corporation, the process enabled by SEC rules is not costly, but actually quite a bargain for both the corporation and society. Eliminating rights of smaller investors to sustain proposals on the proxy would mean privileging larger and often short-term focused investors.

The rights and responsibilities set forth in the SEC's shareholder proposal rules, including the resubmission rule, empower investors while preventing abuses. These rules reflect a balance refined over the course of decades by the SEC. Any rulemaking that undermines the rights of groups of investors to persist in the shareholder proposal process would likely backfire by increasing long-term costs to corporations, taxpayers and society.

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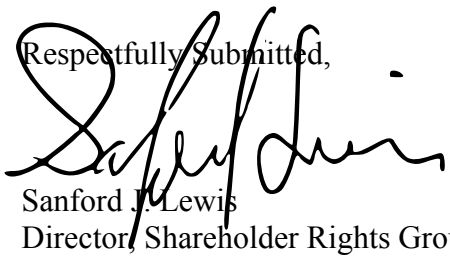
[30] The significance of 3%, 6% and 10% thresholds is consistent with other corporate governance triggers. For instance, in the proxy access rule making, the 3% threshold was effectively endorsed by the SEC as the appropriate portion of shareholders to nominate board members through proxy access. In contrast to the advisory proposals of Rule 14a-8, the ability to nominate board members is arguably even more consequential and yet a 3% threshold of shareholding is considered significant by the SEC and by the corporate and share owner communities. Similarly, shareholders who own more than 5% of a company or hold a seat on its board are exempt from Reg FD—they are considered corporate insiders and are subject to different restrictions and disclosure requirements.

Therefore, we urge the Commission to reject the Petition. We also respectfully request a meeting with Chairman Clayton to discuss this matter further, prior to initiating a rulemaking. In addition, we would be pleased to provide further information, and to participate in forums for discussion of this matter prior to any determination to embark on a new rulemaking.

Respectfully Submitted,



Sanford J. Lewis
Director, Shareholder Rights Group

Shareholder Rights Group:

- Arjuna Capital
- As You Sow
- Boston Common Asset Management, LLC
- Clean Yield Asset Management
- First Affirmative Financial Network, LLC
- Harrington Investments, Inc.
- Jantz Management, LLC
- John Chevedden
- Natural Investments, LLC
- Newground Impact Investment, SPC
- NorthStar Asset Management, Inc.
- Pax World Management, LLC
- Sustainability Group of Loring, Wolcott & Coolidge, LLC
- Trillium Asset Management, LLC
- Zevin Asset Management

The Main Street Investors Coalition is an Industry-Funded Effort to Cut Off Shareholder Oversight

corpgov.law.harvard.edu/2018/06/14/the-main-street-investors-coalition-is-an-industry-funded-effort-to-cut-off-shareholder-oversight/

Disclosure, Environmental disclosure, ESG, Index funds, Institutional Investors, Long-Term value, Oversight, Proxy voting, Retail investors, Shareholder proposals, Shareholder voting
More from: Nell Minow, ValueEdge Advisors
Nell Minow is Vice Chair of ValueEdge Advisors.

Here's a tip from a long-time Washington DC lawyer: the more folksy or patriotic the name of the group, the more likely that it is funded by people who are promoting exactly the opposite of what it is trying to pretend to be. And thus we have the Main Street Investors Coalition, which bills itself as "bring[ing] together groups and individuals who have an interest in amplifying the voice of America's retail investor community."

In reality, it is a corporate-funded group with no real ties to retail investors, and its advocacy is as fake as its name. MSIC uses inflammatory language, unsupported assertions, and out-and-out falsehoods to try to discredit the institutional investors who file and support non-binding shareholder proposals. While these proposals are filed at a very small fraction of publicly traded companies and even a 100 percent vote does not require the company to comply, somehow, this very foundational aspect of free market checks and balances is so overwhelming a prospect to corporate executives that they are unable to provide a substantive response and instead establish what in Washington is referred to as an "astroturf" (fake grassroots) organization, setting up a false dichotomy between the interests of large and small shareholders.

MSIC says:

> *[A]s the size and influence of these massive institutional holders has grown, so too has their power, influence and share of voice—drowning out the voices and interests of Main Street investors who, despite controlling the single largest pool of equity capital in the world, have almost no ability today to influence the decisions these funds make on their behalf, with their money.*

Of course this completely overlooks the fact that institutional investors are fiduciaries representing everyday working people like teachers, firefighters, and employees of publicly traded companies. What the folksy-sounding, corporate-front Main Street Investors want to do is divide and conquer. They know they can no longer rely on the support of investors smart and focused enough to tell when corporate management has gone off the track and big enough to make their views meaningful. So, they pretend to be concerned about some mythic, stock-picking investors who will read through the proxy statements and decide to vote for management's recommendation. If MSIC really cared about the power of individual

shareholders, and if in fact they controlled the single largest pool of equity capital in the world, it would help them to vote their proxies more effectively. It would help them provide oversight to the institutions who manage their money, perhaps circulating reports on the annual disclosures of how the funds vote. After all, index funds have the same fees and returns, but there are differences in how they vote their proxies. Then the investors could decide whether, for example, Vanguard's votes on CEO pay were more appealing than Fidelity's.

MSIC's faux populism about the "real" investor being mom and pop and their little basket of stocks ignores the reality that most working people invest through intermediaries like mutual funds because they perform better. The whole idea of institutional investors is based on the reality that they do better than individuals who do not have the time, resources, or expertise. And it makes sense that the same people who make the buy, hold, and sell decisions should make the decisions about how to vote on proxies as well.

Capitalism, after all, is named for the investors who provide capital, not the executives. And it is founded on the idea of accountability to ensure confidence that the capital they provide will be used honorably. But now that investors are pushing back on issues like excessive CEO pay, ineffective boards, and failure to consider climate risk via advisory shareholder proposals, corporate executives are trying to kill the messenger. Corporate executives love to talk about the free market until it delivers a response they do not like.

MSIC is not a membership organization. Its board does not include representatives of the groups that actually do work with small investors, like, for example, the American Association of Individual Investors, which has excellent educational materials for its members, or Motley Fool and FolioInvesting, which provide services for individual investors. Instead, MSIC has "partners" like the powerful corporate lobbying group the National Association of Manufacturers and the anti-public pension fund American Council for Capital Formation, which says on its website that its purpose is "exposing the politicization of corporate governance."

So we should be skeptical about their assertion that investors do not care about issues like the environment. PWC's annual report on boards found, to the contrary, that investors are much more concerned about incorporating environmental risk into corporate strategy than boards are. This is exactly why we have a system allowing for shareholder proposals: to send a message when there is a disconnect between investor and director priorities.

The Main Street Investors Coalition has been tweeting about a new academic study that purports to show that shareholder resolutions have an adverse impact on share price. And where do we find that study? On the website of the NAM, which paid for it. That subsidy alone should make anyone skeptical about its findings.

There are further flaws as well. One is MSIC's constant use of the term "political" to describe shareholder resolutions to indicate that their purpose is counter to shareholder value. On the contrary. These proposals, filed by fiduciaries who represent large, sophisticated financial institutions acting on behalf of millions of small pension plan participants in most cases, are explicitly grounded in the promotion of long-term shareholder value. SEC rules strictly limit the

subject matter of these non-binding shareholder proposals to matters directly relating to legitimate areas for investor feedback. Every one of the proposals is explicitly tied to investor concerns about long-term, sustainable growth.

If corporate management would like to explain on the merits why their positions are incorrect, they have as much room in the proxy statement as they like to rebut it (while shareholders are limited to 500 words). But so far, they have not been persuasive, which is why shareholder resolutions on better disclosure of climate risk, for example, have had support from almost two-thirds of investors. No wonder—78 percent of directors at the largest companies have said that climate change was never or seldom discussed in their board meetings. If corporate executives want to explain why that is appropriate, they will have to do better than they have so far.

Even with strong support for a few advisory resolutions, there is no evidence that financial institutions managing billions of dollars have all of a sudden turned into the Sierra Club. Approximately half of top asset managers opposed more than 50 percent of key climate-related proposals in 2017, and several top managers voted against more than 85 percent of key climate proposals. Eight of the top ten asset managers failed to support key climate votes more than 50 percent of the time. At the very least, this shows that the institutions MSIC is so shrill about are reviewing the proposals carefully and making distinctions between those they do and do not want to support. And that means that the votes are not in any way “political.”

The study MSIC is promoting uses highly suspect metrics to purport to prove that these proposals do not help and can hurt shareholder value. The study looks at the reaction of companies’ stock prices to both increased disclosure of climate-change-related information and shareholder proposals calling for such disclosure.

In what way is that a relevant measure? There are innumerable factors that go into the pricing of stock on a given day, and no one is suggesting that the adoption of particular policies urged by shareholders will have the immediate positive stock price impact that, say, a generous tender offer would. These are complex, multi-layered issues and, more important, these are essentially permanent shareholders. They are not trying to time or manipulate the market. As corporate governance expert Beth Young points out, “The yardstick should not be whether a company’s stock price goes up upon disclosure of climate-related risk/opportunity disclosure; investors might see the disclosure and think that the company has more risk than previously understood, or decide that the risks are being poorly managed, in which case the right direction for the stock price is down.” It is not in investors’ interests to have the stock price inflated due to inadequate disclosure. If more information results in a more accurate stock price, that will help managers and directors make better decisions going forward.

And then there is the study’s “finding” that these proposals can impose millions of dollars of cost onto the corporations. We reiterate that these proposals are not binding, so there is no obligation to spend any money at all. And we fully expect that corporate executives, as a matter of professional responsibility and fiduciary obligation, would never authorize

expenditures unless they were supported by cost-benefit analysis. Yet we do not see benefits from complying included in these calculations. More important, we suspect that self-reported, unsubstantiated reports of costs may be inflated to a considerable degree.

Perhaps the next step should be a shareholder proposal to stop wasting money on fake public interest groups and poorly designed studies.

And yet, they are trying to undermine shareholder votes here. What is especially outrageous is their argument that mutual funds are “uninformed,” because what they are suggesting here is that individual investors are somehow more informed. On the contrary, individual investors entrust their money to managers who have the expertise, resources, and fiduciary obligation to buy, sell, hold, and vote their shares.

In a post on this blog, MSIC asserts without any substantiation that retail investors don’t know and don’t approve of the way fund managers vote. They assert contrary to documented data that fund managers outsource their votes to proxy advisors. In reality, the data show that while institutional investors appreciate the analysis they receive from proxy advisors, they vote according to their own proxy voting policies, and the more complex or controversial the issue, the less likely they are to follow the proxy advisors’ recommendations. Proxy advisors are like securities analysts. No one has to buy their products. No one has to follow their recommendations. But their clients find them a valuable resource. It is also not true that proxy advisors are unregulated. We often see corporations object to any regulation except that which protects them from competition or other market tests, so we note that proxy advisors are subject to stringent restrictions when they register as investment advisors.

MSIC engages in the slimiest possible rhetorical trick by assuming without evidence and contrary to the record that fund managers are somehow voting against the economic interests of their customers. They assert without any evidence that the people who manage money do not know what their customers want but they do.

We do agree with one point made by MSIC: the best decisions about proxy voting are made by those with the most significant economic interest. MSIC has none; indeed its interests are entirely the other way. So until they fully disclose all of their sources of funding and put some actual retail investors on their board they should leave it to those who have not only economic interest but fiduciary obligation, and are thus in the best position to provide what even they acknowledge is “an important component of efficient corporate governance.” The only way to make that vital component effective is to respond to votes against management’s recommendations by engaging with shareholders, not creating fake advocacy groups to try to undermine them.

[NOTE: In the interest of providing the transparency I am urging on MSIC, I am co-founder of four companies focused on corporate governance that provided services to institutional investors, including proxy advisory services at ISS, which I left in 1990. I have no ownership interest in any of those companies. I do not currently receive any income from institutional

investors or expect to receive any in the future. I also serve on the board of a non-profit called the 5050 Climate Project that advises large shareholders on climate change-related matters, but accepts no payment from them.]

The Main Street Investors Coalition is an Industry-Funded Effort to Cut Off Shareholder Oversight 2018-06-14T09:28:49-04:00 2018-06-15T09:28:50-04:00 Harvard Law School Forum on Corporate Governance and Financial Regulation

Protecting Shareholder Ownership and Governance Rights

corpgov.law.harvard.edu/2017/10/20/protecting-shareholder-ownership-and-governance-rights/

CHOICE Act, Disclosure, Engagement, Hedge funds, Institutional Investors, Rule 14a-8, SEC, SEC rulemaking, Securities regulation, Shareholder activism, Shareholder proposals, Shareholder voting

More from: Sanford Lewis, Shareholder Rights Group

Sanford Lewis is Director at the Shareholder Rights Group. This post is based on a Shareholder Rights Group publication by Mr. Lewis, and was adapted from comments submitted by the Shareholder Rights Group to the Securities and Exchange Commission regarding the petition to alter resubmission thresholds for shareholder proposals.

Various efforts to reform the shareholder proposal process, SEC Rule 14a-8, ask the Securities and Exchange Commission to formally curb the ability of share owners to file proposals. The proposed reforms, including a 2014 petition by a consortium of corporate interest groups and a recent proposal by the US Department of Treasury [1], take a bigger-is-better approach. They seek both to require higher votes than currently required to resubmit proposals for the proxy subsequent to a vote, and to raise the filing threshold so that only larger share owners could file proposals.

These reform efforts fail to recognize and account for the high value of the services that the proposal process provides to corporations and investors in risk oversight, conflict resolution and governance. These services require that investors of all sizes, with diverse investment strategies, are able to bring forth issues relevant to the success of the corporation through the shareholder proposal process.

The so-called “reforms” are also grounded in a mistaken underlying assumption that proposals have merit solely when more than a 50% majority of votes are cast “for” them. For instance, the petition filed in 2014, that seeks to elevate thresholds for refiling previously voted proposal, asserts that the existing Rule creates a “tyranny of the minority” by requiring repeat consideration of proposals that fall short of majority votes. [2] Similarly, proposed legislation to raise the threshold for filing proposals [3] could be understood to imply that only wealthy investors have valid ideas that are worthy of shareholder consideration. [4] While cast in terms of democracy, the reform proposals seem downright authoritarian—assuming that only the largest and wealthiest investors should have access to the shareholder proposal process.

Shareholder Proposal Process Success Merits Reward, not Punishment

Over the course of decades, shareholder proposals have drawn increased support from voting share owners. Perversely, the reforms would justify imposing steeper resubmission thresholds based entirely on the success of the process. For instance, the Chamber’s petition on

resubmission thresholds notes that the number of proposals excludable under the Rule's current threshold has declined due to increasing support for proposals [5]—which is because the portion of "Yes" votes on these proposals has increased. In America, isn't success typically rewarded, not punished, as the reformers propose?

There is also no added burden on corporations. While the mix of subjects addressed over the years has evolved, and the absolute number of proposals filed does vary in individual years, observed objectively the average number of proposals submitted to companies has not grown, but rather has held steady at about 830 proposals per year. [6] Nor is there an abundance of shareholder proposals appearing on the proxy year-after-year despite non-majority support. For example, since 2010, of the roughly 2,000 proposals that appeared on proxies, proposals on environmental or social issues that have received prior votes under 20% for two or more years have only been resubmitted 35 times. [7]

The lack of a genuine problem should be enough to suggest that this ought not be a priority for the SEC rulemakers. While lack of need is enough of a reason to reject the proposed reforms, this evaluation leaves more than half of the story untold. It is essential to also recognize that screening out new proposals or resubmissions of existing ones would not be harmless, but would mean the loss of crucial services to investors and corporations.

Shareholder Proposals As Catalyst for Engagement

While proposals published in the proxy inform shareholder voting, they are also an effective catalyst for engagement and private ordering. Nearly all shareholder proposals are advisory in nature, i.e., not providing a legal mandate for corporate action. That is why Rule 14a-8 often functions at its best in providing input and advice to boards and management from investors, and encouraging dialogue among subgroups of investors with diverse investment strategies. Every year, shareholder proposals enabled by SEC Rule 14a-8 lead to engagement and dialogue among investors, boards and management at hundreds of companies on issues of governance, risk oversight, and long-term value creation.

While the origins of the shareholder proposal rule may be in ensuring informed voting, as used by investors and issuers today, the process arguably offers its greatest value in harmonizing disparate investment strategies among an ecosystem of diverse investors, and in inviting open dialogue that allows investors of all sizes to contribute to the success of the corporation. Some subgroups in the investment ecosystem—such as activist hedge funds and short-term traders—may pressure companies for short-term stock price increases, but they do so largely without availing themselves of Rule 14a-8. [8] In contrast, the typical proponents of shareholder proposals under Rule 14a-8 are often providing early warnings of long-term risk issues, or seeking disclosure of metrics or governance changes that bring a longer-term value creation perspective to corporate deliberations.

The Size of Stock Holdings does not Constrain Investor Insight or Foresight

Individual filers and institutional funds with relatively small holdings are responsible for a high proportion of first-time proposals on emerging issues of corporate governance and risk management. These ahead-of-the-curve proposals often encapsulate an investor's insight or foresight on risks and opportunities. They can bring management and board attention needed to prevent disruptive trends from becoming destructive. The proposal process allows companies to seize opportunities to lead or drive the market, and to head off crushing liabilities, reputational damage, or consumer revolts.

Many shareholder proposal filed each year do not appear on the proxy. While some proposals are allowed to be excluded by the SEC under the no action letter process, many are withdrawn voluntarily by investors after the board or management agrees to take measures to address the issues raised.

Even before adding up large supportive votes, these shareholder initiatives can be critical to the success of companies, if they cause management and board to pay attention to investors' concerns. For example, consider the 2000 and 2003 proposals filed by religious investors at banks regarding subprime lending and securitization. The responsive companies—those that took action on the issues raised by the proposals—reportedly avoided being part of the financial crisis. [9] The proposal process serves as a self-help remedy for investors to seek management response on issues of concern.

Resubmission Thresholds Define Learning Curve for Companies and Investors

It is vital to recognize that the current 3%, 6%, and 10% thresholds of Rule 14a-8(i)(12) often prove relevant to the learning curve for companies and investors. The fact that a proposal has achieved the established Rule 14a-8(i)(12) benchmarks, and may appear on the proxy in a subsequent year, often inspires the board or management of companies to engage in dialogue and implement actions responsive to the proposals.

A typical example involves a company that is ignoring an issue when it receives a shareholder proposal on the topic, such as addressing its risks associated with subprime lending or reputation endangering use of child labor in its supply chain. While the management may initially view the issue raised in the proposal as irrelevant to their effective stewardship of the company, if at least 3% of the shareholders vote in favor so that the proposal may be resubmitted, this is a plain signal to the management that the issue may not go away. Often this is enough of a gentle nudge to spur them to at least do some analysis as to how the issue may affect the company. If the proposal is submitted again in the subsequent year, management is more prepared to engage with the concerned shareholder about the issue. Thus, the thresholds for resubmission often trigger a learning process for board and management.

Similarly, the resubmission process enables a gradual process of educating and enlisting broader investment community support sufficient to sustain a proposal on the proxy.

Building further support beyond the on-ramp of the first three years also triggers company engagement—when proposals continues to grow to 20%, 30%, or 40% of levels. [10] Crossing the 50% vote threshold to achieve majority support certainly is another trigger for board and management action, but reality of practice in this field is that any level of shareholder support for a proposal can be a trigger for this private ordering process, beginning with the resubmission threshold levels.

Support for shareholder resolutions sometimes takes decades to build—such as on proposals seeking better risk management on climate change, amending equal employment opportunity policies to include LGBT people, or seeking governance changes such as board declassification. Proposals on these topics hovered around 10% support for a decade or more in the 2000s and eventually moved into widespread adoption and majority support.

A gradual growth trend in voting support during the early years of a proposal's consideration mirrors the trend of many of what today are established societal norms. Seen in proper context, a gradual trend does not imply that proposals are irrelevant to larger investing institutions (or investors, or society at large). In a number of instances, while withholding supportive votes, larger shareholding institutions have attempted to address the same issues raised in proposals through engagement with companies, and only after those engagements have failed to yield sufficient results have the firms developed voting policies to support these proposals.

For instance, in the last year some of the country's largest investment firms, including BlackRock and Vanguard, supported climate proposals after what they saw as a failure or breakdown of progress in their own engagement processes.

Proposals at ExxonMobil asking the company to assess the impact of climate change on its business model tended to get 10% support for many years. But shareholder support rose to 30% support in 2016 and then 62.3% support at the company's most recent annual meeting in 2017. This only happened after winning eventual "Yes" votes from some of the largest firms. [11]

The evolution and success of shareholder proposals as a central tool of corporate governance, risk management, and conflict resolution does not merit rollback rulemakings. The proposed reforms seem more geared toward insulating boards and management than to ensuring the success of the corporate enterprise, benefitting investors, or serving society. If anything, the demonstrated trends of investor support for shareholder proposals invites policy enhancements that truly serve investors and corporate governance and that reinforce the best of the 14a-8 process, not the proposed curbs on the governance and ownership rights of shareholders.

Special thanks to Bruce Herbert, Richard Liroff, and Julie Gorte for essential editorial feedback.

Endnotes

1https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf pages 31-32 Treasury recommends that the $2,000 holding requirement for shareholder proposals be substantially revised and that the resubmission thresholds for repeat proposals be substantially revised from the current thresholds of 3%, 6%, and 10%.(go back)

2The petition under consideration at the SEC would seek to raise the thresholds for resubmitting proposals after they are voted on at a company. SEC Rule 14a-8(i)(12) provides for exclusion of shareholder proposals submitted to a company in prior years based on the level of voting support for the proposal. In essence, the rule provides that shareholders need to obtain at least 3%, 6% and 10% of shareholder support in the first three years of filing in order to be able to resubmit a proposal. The US Chamber of Commerce and the Financial CHOICE Act sought to upwardly revise those thresholds in line with the previously considered and rejected proposal to increase these thresholds to 6 percent, 15 percent and 30 percent. These thresholds were considered by the SEC in 1997 and rejected after public comments.(go back)

3The so-called Financial CHOICE Act.(go back)

4The House of Representatives passed the Financial CHOICE Act, in which would screen out not just small investors, but all but the largest shareholders from filing proposals. It would require shareholder proponents to hold one percent of the issuer's voting securities for three years, instead of the current requirements to hold $2000 worth of shares for one year.(go back)

5Petition 4-674, p. 14.(go back)

6Less than half of the 11,706 proposals submitted to companies went to a shareholder vote. The SEC permitted companies to omit 1741 proposals. The remainder of the proposals were either withdrawn by the proponent or otherwise did not go to a vote. Analysis of Institutional Shareholder Services, Voting Analytics Shareholder Proposals Database, a database of Russell 3000 Companies.(go back)

7Based on data analysis by Jonas Kron, Trillium Asset Management, analysis of Sustainable Investments Institute Database, courtesy of Heidi Welsh.(go back)

8Activist hedge funds typically deploy more costly forms of engagement through Rule 14a (directly soliciting proxies) rather than Rule 14a-8.(go back)

9As Attorney Paul Neuhauser has noted:

> The first shareholder proposals concerning predatory subprime lending were submitted in 2000 and the first asking securitizers to police the loan pool were submitted in 2003, in each case years before subprime lending became recognized as a major problem. The shareholder proposals constituted an early warning system for those who heeded them. Although these proposals were submitted to a number of companies and survived company challenges at the SEC, they never appeared on any proxy statement because the recipients in each case agreed to a change of policy with regard to predatory lending to subprime borrowers (in one case the securitizer called the proponent the day after it lost its no-action request at the SEC to request a meeting and dialogue on the matter and at the meeting agreed to alter its due diligence process with respect to loans purchased for securitization). Notably, the securitizers that received the precatory proposals and changed their practices have not been among those who have suffered during the recent unpleasantness.

Paul Neuhauser, comment letter to SEC, Oct. 2, 2007,https://www.sec.gov/comments/s7-16-07/s71607-476.pdf(go back)

10Although the reform proposals act as if these percentages are a consistent indicator across companies, in practice they are not. As a means of assessing the level of interest and support among shareholders to an idea that management is opposing, there is no practical merit in counting votes controlled by management. Given the growth in dual class ownership, as well as the role of controlled companies, passive investing strategies, and management affiliated or controlled voting blocs, such as ESOPs, it may actually be more appropriate to *lower* the current resubmission thresholds, rather than raising them.(go back)

11This evolving approach is captured in the comments of Glenn Booraem, Vanguard's Investment Stewardship Officer, in the Vanguard Investment Stewardship Report:

> First, companies should expect that we're going to focus on their public disclosures, both about the risk itself and about their board's and management's oversight of that risk. Thorough disclosure is the foundation for the market's understanding of the issue. Second, companies should expect that we'll evaluate their disclosures in the context of both their leading peers and evolving market standards, such as those articulated by the Sustainability Accounting Standards Board (SASB). Third, they should expect that we'll listen to their perspective on these and other matters. And finally, they should see our funds' proxy voting as an extension of our engagement. When we consider a shareholder resolution on climate risk, we give companies a fair hearing on the merits of the proposal and consider their past commitments and the strength of their governance structure.

Vanguard, *Investment Stewardship, 2017 Annual Report*, p. 11.(go back)

Protecting Shareholder Ownership and Governance Rights 2017-10-20T09:09:00-04:00 2017-10-20T10:20:58-04:00 Harvard Law School Forum on Corporate Governance and Financial Regulation

Shareholder Proposal Reform Rebutted

corpgov.net/2017/08/chamber-releases-shareholder-proposal-reform/

James McRitchie August 2, 2017

Shareholder Proposal Reform or Fat-Cat Entrenchment?

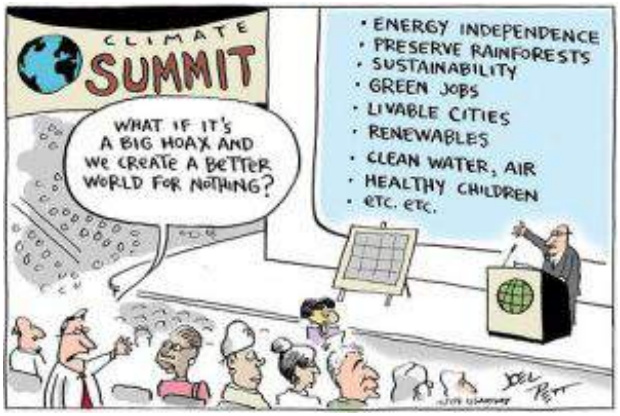
The U.S. Chamber of Commerce Center for Capital Markets Competitiveness (CCMC) released a **paper** on shareholder proposal reform, which contains a "set of recommendations for the SEC on fixing the broken Rule 14a-8 system in order to protect investors and make the public company model more attractive." See also the Chamber's **press release**, U.S. Chamber Offers Recommendations to SEC on Shareholder Proposal Reform.

Rule 14-8 is not broken, many of the Chamber's attestations are **alternative facts** and its recommendations are more likely to hurt our economy than help it. The paper is very similar to their previously released **Responsible Shareholder Engagement And Long-Term Value Creation: Modernizing the Shareholder Proposal Process**. As I wrote in my rebuttal last year (**Business Roundtable to SEC: Muzzle Shareholders**),

> 'modernization' for the Business Roundtable means moving the SEC further and further from its primary mandate of 'investor protection' by creating a democracy-free zone for entrenched managers.

Chamber's Shareholder Proposal Reform Grounded in Alternative Facts and False Premises

The paper reminds readers that Rule 14a-8 provides 13 exemptions allowing companies to exclude shareholder proposals. It then takes a leap into alternative facts with "the SEC has never allowed unfettered access to a company's proxy statement" (with regard to shareholder proposals). From that alternative fact, the paper then argues,



> The long-standing guardrails that were put in place to protect investors have steadily weakened, and the shareholder proposal system today has unnecessarily devolved into a mechanism that a minority of interests use to advance idiosyncratic agendas that come at the expense of other shareholders.

The true facts have seen the erosion of shareholder rights, with regard to the inclusion of proposals in corporate proxies. After it's founding, the SEC was largely a champion of shareholder rights, requiring companies to include proposals on any 'proper subject' in the proxy. The idea was to "approximate the conditions of the old-fashioned meeting." SEC v. Transamerica Corp. (3d Cir. 1947) was the first and only case in which the SEC brought suit to compel an issuer to include a shareholder proposal. As Jill E. Fisch notes in **The Transamerica Case**.

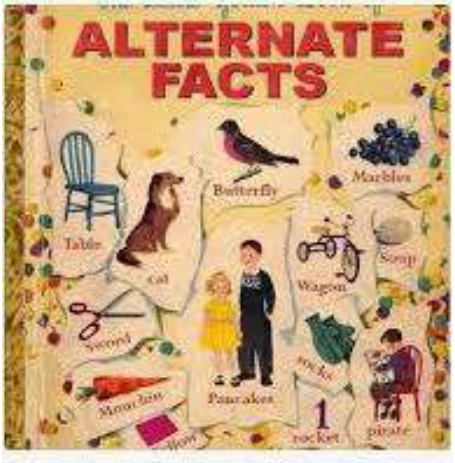
> The Transamerica decision represented the high point in SEC protection of shareholder voting. Rule X-14A-7 afforded shareholders the broadest power with respect to the introduction of shareholder proposals; **it imposed *no qualification requirements, limits on the number of proposals allowed or subject matter limits.*** (my emphasis)

The court concluded issuer-specific limitations interfered with the intent of Congress that shareholder voting rights operate as a check on the abuse of power by corporate management and that Rule X-14A-7 was consistent with that intention.

From that high-point, the SEC began chipping away at shareholder rights with regard to the proxy. The rules were amended so that shareholder proposals could only target issues *directly related* to the corporation. When grey areas arose, such as a 1951 proposal to consider the advisability of abolishing Greyhound's segregated seating system in the South, the SEC insulated management from proposals *motivated* by a 'general' cause, even if the proposal concerned issues directly related to the corporation, by granting no-action letters.

Then came the 'ordinary business rule,' allowing exclusion of proposals concerned with day-to-day business decisions, followed by other exclusions. The proxy was transformed from the equivalent of a face-to-face meeting where any issue could be raised to a right limiting proposals to profit-oriented general strategies. President Reagan's SEC excluded shareholder

proposals that concerned “operations which account for less than five percent of the issuer’s gross assets” and by disqualifying proposals from shareholders unless they owned at least $1,000 of common stock for at least a year. Proposals must stem from economic motives; that became the clear philosophy that was adopted within fairly recent history.



However, the **post-Cracker Barrel** SEC accepted the untenability of enforcing a bright line between the market and society. The bright line was removed in 1998 when the SEC announced it would return to a case-by-case approach regarding when social policy issues fall within the scope of the ‘ordinary business’ exclusion.

Yes, “guardrails” have been put in place over the years but not to protect investors, as the Chamber claims in the *Shareholder Proposal Reform* paper. Instead, those barriers have created a maze with so many false passageways to inclusion in the proxy that it takes an expert to navigate the process, especially when companies hire outside counsel to prepare legal briefs arguing, not the merits of the proposal but the many technical traps that can result in a proposals exclusion.

Shareholder Proposal Reform: Materiality

According to the Chamber’s *Shareholder Proposal Reform* paper, “half of all proposals submitted to Fortune 250 companies during the 2016 proxy season dealt with some type of social or policy-related matter,” which it infers are immaterial. Shareholders are not just economic robots, demanding the highest profits possible without regard to harm to society or the environment. Additionally, determining what is material is a problematic task. As I noted in my **letter** opposing the Financial Choice Act,

> Aside from serving to increase accountability, proposals often serve as an “early warning” system. Had companies listened, we might have avoided the 2008 financial collapse, since proposals concerning predatory subprime lending and the securitization of such subprime loans were introduced in 2000. Proposals beginning in 2003 asked securitizers to police their loan pools. See **letter to the SEC from Paul M. Neuhauser dated 10/2/2007**.

Seeking to buttress their argument that social and policy proposals have little relevance, the Chamber’s paper notes that between 2006 and 2016, “Fortune 250 companies received 445 proposals dealing with corporate political disclosures — a perennial favorite topic of activists. Only 1 of these proposals during that time frame received majority backing.” However, that does not mean such proposals are having no impact. As a result of the efforts of the **Center for Political Accountability (CPA)** its and its partners, 153 leading public companies, including 53 in the S&P 100, have adopted political disclosure and oversight.

Justice Anthony Kennedy’s majority opinion in the 2010 Supreme Court case of **Citizens United v FEC**, which limited the government’s ability to constrain corporate expenditures for

political purposes, included the following ideal of internal democracy within corporate governance as a partial justification for the Court's opinion:

> With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits, and citizens can see whether elected officials are 'in the pocket' of so-called moneyed interests.

I strongly disagree with the decision but Justice Kennedy's opinion does reinforce my own long-standing belief that real democracy depends on more than just a democratic government. It depends on democratic structures and mindsets throughout society, especially in the operation of corporations, which have so much influence on other social institutions, including governments at all levels.

Yet, corporations are not required to make the disclosures Justice Kennedy referenced. Certainly, it is not in the interest of some CEOs and entrenched boards to make such disclosures, since doing so would make it more difficult for them to have politicians in their "pockets."

Shareholder Proposal Reform Paper Blames Shareholder Proposals for a Litany of Unrelated Problems

The Chamber's *Shareholder Proposal Reform* goes on to argue

> a very small subset of investors have come to dominate the shareholder proposal system, while the vast majority of investors— including those that routinely vote against social and political proposals—bear the costs. Fully one-third of all shareholder proposals in 2016 at Fortune 250 companies were sponsored by six individual investors, while 38% of proposals were sponsored by institutions with an explicit social, religious, or policy purpose. Including a proposal on a proxy or seeking "no-action" relief from the SEC staff creates significant costs for all shareholders.

My wife and I are among the "six individual investors" mentioned, so I take personal offense at the implication that our proposals create a burden on "the vast majority of investors." The paper implies our proposals have little or no merit or support. During the last five years, 132 of our proposals have been voted on. Most received substantial support in the 30-50% range. Well over 20% received a majority vote. See Exhibit 1 (Download in Excel **Exhibit1,** included in my letter to Congress on the Financial CHOICE Act). My figures do not count the many proposals we file and withdraw because of negotiated agreements or the equivalent. See **WD-40 Win Win – Majority Vote Standard** and **Broadridge Amends Proxy Access: Allows 50** for two cases in July of this year alone.

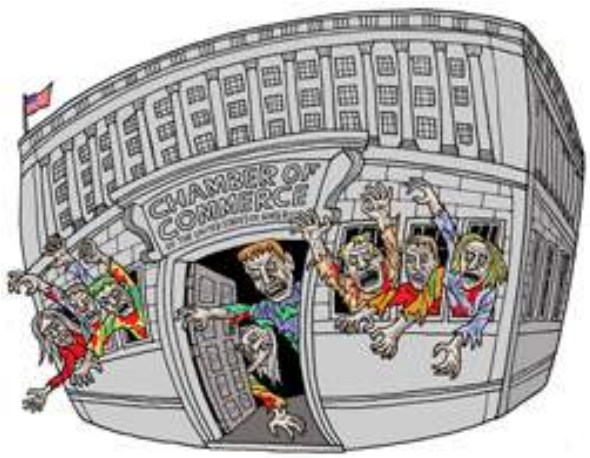
Shareholder Proposal Reform then goes on with an apparent effort to blame proxy proposals for the reduction in the number of public companies during the last two decades, our failing struggle to achieve even 2% GDP growth and the "ability of American households to build wealth." This is all because of the "substantial 'tax' on companies" imposed by the cost of

shareholder proposals. None of these claims have any basis in fact nor is any substantive evidence provided. I addressed the GDP issue last week toward the end of **Proxy Access Battlefront Shifts: HRB No-Action Rejected**. I argued that companies and employees in other developed countries do not have to worry about healthcare and other modern essentials, which are considered rights elsewhere. That contributes more to our slow growth than the small costs companies must bear for shareholder proposals.

Regarding the cost of shareholder proposals, which appears to be at the heart of the paper's argument for shareholder proposal reform, I agree that companies are often spending too much, although it is a much smaller amount than the Chamber presumes. Instead of **filing expensive slap suits** or even requesting no-action letters, why not pick up the phone and talk with the proponent? When companies have contacted me, we have usually been able to reach an agreement. However, the cost of including proposals in the proxy or even of requesting a no-action letter from the SEC is minimal. For fact-based analyses, see **The Dangerous "Promise of Market Reform": No Shareholder Proposals** and **The Value of the Shareholder Proposal Process**.

Shareholder Proposal Reform #1: Raise Thresholds

The Chamber recommends resubmission requirements be raised from support of 3% to 6%; 6% to 15%; and from 10% to 30%.



US Chamber of Horrors

How many years did it take to end legalized slavery, segregation, the ban on gay marriage? Although now widely recognized by corporations as an important risk issue, climate change was widely dismissed for years. Good ideas usually take time to be recognized.

Even ideas like the majority vote standard to elect directors took many years to achieve a 30% support level after first being proposed. Because that standard has been adopted by more than 90% of the S&P 500, many at the Chamber probably believe the standard is nearly universal. It is not. Most companies still use a plurality standard for uncontested elections. The vote of one share gets directors in such companies elected. It can still take years to get such resolutions adopted at small-cap companies, although support grows gradually almost every year.

Shareholder Proposal Reform #2: Withdraw Staff Legal Bulletin 14H (CF)

The Chamber argues the former interpretation of (i)(9) was "relied on for years." However, the exemption started out as the equivaltent of a rabbit path and ended up more like a freeway.

At the time of adoption, proposals could be excluded under subsection (i)(9) only in very narrow circumstances and only where adoption of competing proposals could be harmful to shareholders. As *General Electric* (Jan. 28, 1997) and *Northern States* ((July 25, 1995) demonstrated, proposals could be excluded where adoption resulted in confusion or uncertainty in actual implementation or where, as a result of incompatibility, implementation of both proposals was impossible.

By the time I appealed the no-action letter granted to Whole Foods Market, a competing proposal merely needed to address the same subject. It was a rule change over time without going through the rulemaking process. See **Appeal of No-Action on Proxy Access at Whole Foods Markets (WFM)**.

Staff Legal Bulletin No. 14H (CF) does not adhere completely to original intent, which staff determined was "to prevent shareholders from using Rule 14a-8 to circumvent the proxy rules governing solicitations." However, it gets us where we need to be in defining the meaning of "directly conflicts" with regard to Rule 14a-8 exclusions.

The guidance still provides some wiggle room for companies to game the system by proposing the opposite. For example, if a shareholder proposes proxy access a company could invoke (i)(9) by countering with a proposal to deny *any* form of proxy access. However, in most cases that tactic will backfire. Whole Foods became something of a pariah when they put up a counter proxy access proposal to mine with thresholds that could never be met. Taking a "**do the opposite**" stand might be funny in comedy but not when carrying out the fiduciary duties of a board.

Yes, as the *Shareholder Proposal Reform* paper notes, staff relied on another interpretation for years, but they did so illegally, just as they had previously denied the right of shareholders to proxy access until *AFSCME v AIG* (2006). That case involved a 2004 bylaw proposal submitted by AFSCME to the American International Group (AIG) requiring that specified nominees be included in the proxy. AIG excluded the proposal after receiving a no action letter from the SEC and AFSCME filed suit.

The court ruled the prohibition on shareowner elections contained in Rule 14a-8 applied only to proposals "used to oppose solicitations dealing with an identified board seat in an upcoming election" (also known as contested elections). SEC Staff had reinterpreted the rule without providing an opportunity for public comment, as required by the Administrative Procedure Act. The SEC subsequently adopted a formal rule banning proposals aimed at prospective elections and later adopted a more restrictive proxy access rule.

Shareholder Proposal Reform #3: Requiring Proponents to Disclose Economic Interest Objectives

The Chamber complains a 500 word proposal costs companies a substantial amount of money to include in the proxy. Now they want what appears to be an even longer explanation of the proponents motives and particulars, as well as from anyone acting on behalf of the proponent. Proponents are already required to submit evidence of the required ownership from a broker or

bank. Proponents already state the need for the proposal in their 500 word statements.

For years, many companies have complained that shareholders should not be able to seek expert advice when submitting proposals or responding to company inquiries. Yet, those same companies employee legal counsel, both internally and outside, to craft their arguments as to why proposals should be kept of the proxy. Under *Shareholder Proposal Reform*, will companies be required to make the same disclosures the Chamber requests be added for proponents and their agents?

I have been submitting proposals for almost twenty years and have never hired counsel to assist me in crafting or defending a proposal before SEC staff or the courts. However, I routinely get help from others in the submission process, to ensure all the details are correct, and at other stages if needed. Many people hire financial advisors to help them invest, why should barriers be erected to discourage them from getting assistance in filing shareholder proposals? The Chamber's recommendation is especially disconcerting, given that researchers have found that proposals are excluded "mainly due to sponsors' lack of experience and knowledge." (**An Analysis of Omitted Shareholder Proposals**)

It also seems odd to have the Chamber advocating for mandatory inclusion of the proponent's name and other particulars, given past history.Exchange Act Release No. 4950 (Oct. 9, 1953) included the following (**The Evolving Role of Rule 14a-8 in the Corporate Governance Process**):

> In order to discourage the use of this rule by persons who are motivated by a desire for publicity rather than the interests of the company and its security holders, it is proposed to provide that the managements' proxy material need not contain the name and address of the security holder if it contains, in lieu thereof, a statement that the name and address of the security holder will be furnished upon request.

It there is one good recommendation in *Shareholder Proposal Reform*, perhaps it is the change to require publishing the proponent's name in the proxy. That might save me time in voting my proxy, since I can see if the name is a trusted one and move with an expedited review from there.

Shareholder Proposal Reform #4: The 5% Solution

In 1982, the Commission amended Rule 14a-8 to include a provision that a matter failing the 5% test would still have to be included in the company's proxy materials if it was "otherwise signicantly related to the issuer's business." The Chamber argues the Commission should reassert the original intent of the 14a-8(i)(5) exclusion by allowing proposals to be excluded that do not meet the 5% asset and net earnings threshold, regardless of the underlying subject matter.

Apparently, the Chamber wants to return to the good old days of Peck v. Greyhound Corp., 97 F. Supp. 679 (S.D. NY 1951) when a civil rights activist submitted a proposal recommending that "management consider the advisability of abolishing the segregated seating system in the

South" to the Greyhound Corporation. The SEC also approved the exclusion of shareholder proposals that an investment firm divest from liquor stocks, and that another company extend to women the same pension benefits as it offered to men. (**Protecting Markets from Society: Non-Pecuniary Claims in American Corporate Democracy**)

More recently, we might have avoided the 2008 financial collapse if banks had heeded the warnings of shareholder proposals also failing the 5% threshold concerning predatory subprime lending and the securitization of such subprime loans. Proposals beginning in 2003 asked securitizers to police their loan pools. See **letter to the SEC from Paul M. Neuhauser dated 10/2/2007**.

Had the board of Wells Fargo's not opposed such a proposal, they could have escaped both losses due to subprime loan practices but also their more recent scandal involving opening unwanted accounts.

> In 2004, Northstar Asset Management raised issues related to Wells' loan sales and asked the bank's board to "conduct a special executive compensation review" because, according to banking regulators at the time, Wells Fargo had "not adjusted compensation policies to discourage abusive sales practices" and did not have adequate audit procedures in place. The board dismissed the request, saying that Wells Fargo's "compensation and commission policies are designed to encourage appropriate sales practices" and that the bank had "comprehensive monitoring and audit procedures." (***Here's How Wells Fargo's Board Of Directors Just Failed Customers***, by **Eleanor Bloxham**, Fortune, 4/14/2017.

Proposala addressing social issues that do not appear to meet the 5% economic threshold can easily spiral to much higher impacts, depending on social reputation and **black swan risks**. Companies seeking a no-action letter under 14a-8(i)(5) usually try to do so under the ordinary business exclusion as well [Rule 14a-8(i)(7)] Since the ordinary business exclusion applies irrespective of the actual impact on earnings or assets, companies using it can forgo the need to assess the economic significance of the proposal to the company. The SEC should eliminate the 5% rule as essentially redundant.

Shareholder Proposal Reform #5: Prohibit Images, Photos or Graphic in Proposals

In anticipation of a problem that does not yet exist, the Chamber recommends

> The SEC should prohibit the use of images, photographs, charts, or graphs with shareholder proposals to avoid situations where investors could be provided with false or misleading information. However, the SEC should maintain the ability of proposals to include hyperlinks to websites that the proponent wishes to include.

So far, this is a solution in search of a problem, since few proposals have been submitted making use of images. Rushing to ban graphics before we have more than a handful of cases is like banning proxy access proposals before a consensus began to form around what those

would look like. We could have saved many years in three separate rulemaking processes by allowing a few years of experimentation. I recommending waiting a few years and assessing the issue based on real submissions.

Shareholder Proposal Reform #6: Clarify Prohibition of Personal Grievance Proposals

The Chamber provides no evidence or examples of abuse. We have seen a few cases related to proposals filed by former employees, who may use the proposal process as a platform to state their case for a grievance. If there is any abuse, it is probably denying shareholders the right to file a proposal that any other shareholder could file but is granted no-action just because of a past dispute with the company. Shareholders should not lose their rights simply because they once had a dispute with the company.

Shareholder Proposal Reform #7: Crack Down on Misleading Statements

The report contends, "the SEC staff has eroded the viability of this exemption by placing the burden on issuers to prove that a statement made by a proponent is materially false or misleading" **Rule 14a-9** clearly prohibits the use of false or misleading statements with regard to any material fact. To my knowledge, this is being enforced.

The Chamber's real objection appears to the following provision in Rule 14a-8(g):

> Who has the burden of persuading the Commission or its staff that my proposal can be excluded? Except as otherwise noted, the burden is on the company to demonstrate that it is entitled to exclude a proposal.

Rule 14a-8(g) applies to the entire filing, not just Rule 14a-9 standards regarding misleading statements. It certainly would not make sense to put the burden of proof on shareholders for Rule 14a-9 but keep the burden of proof on the company with regard to all other provisions.

The burden of proof assumption has been in place since the outset when the only exclusion allowed was the right to delete proposals not deemed to be "a proper subject for action" by shareholders. The exclusion mostly turned on state law. It was up to management to provide affirmative evidence. See Exchange Act Release No. 4979, 1954 WL 5772 (Jan. 6, 1954) quoted in **The Politicization of Corporate Governance: Bureaucratic Discretion, the SEC, and Shareholder Ratification of Auditors**:

> The rule places the burden of proof upon the management to show that a particular security holder's proposal is not a proper one for inclusion in management's proxy material. Where management contends that a proposal may be omitted because it is not proper under state law, it will be incumbent upon management to refer to the applicable statute or case law and furnish a supporting opinion of counsel.

Conclusion

I do not mean to imply the proxy proposal process is perfect. I would love to see it go back to

empowering shareholders as it did in 1947. However, I think the likelihood of repealing all those regulations and guidance documents are slim.

Many things are broken in America – healthcare, educational systems, infrastructure, our tax system, the criminal justice system (especially as it pertains to white collar corporate crime), even our election system is subject to foreign interference – Rule 14a-8 is not broken. The Chamber would do well to focus its attention elsewhere. What and I missing? Comments welcome.

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Council of Institutional Investors®
The voice of corporate governance

Via Hand Delivery

November 9, 2017

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: Proposed Legislation Relating to Proxy Advisory Firms

Dear Mr. Chairman and Ranking Member Waters:

On behalf of the Council of Institutional Investors (CII or the Council) and the undersigned 45 investors and investor organizations, we are writing to express our opposition to legislation that has recently been introduced and is pending in the Committee on Financial Services related to proxy advisory firms.

CII is a nonpartisan, nonprofit association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management exceeding $3 trillion.[1] CII's member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families.

H.R. 4015, the "Corporate Governance Reform and Transparency Act of 2017,"[2] and similar language which was incorporated in Subtitle Q of Title IV of H.R. 10, "the Financial CHOICE Act,"[3] would require, as a matter of federal law, that proxy advisory firms share their research reports and proxy voting recommendations with the companies about whom they are writing before they are shared with the institutional investors who are their clients. In essence, while the stated goal

[1] For more information about the Council of Institutional Investors (Council or CII) and our members, please visit the Council's website at http://www.cii.org/about_us. We note that the two largest U.S. proxy advisory firms, Glass Lewis & Co. and Institutional Shareholder Services Inc. (ISS), are non-voting associate members of CII, paying an aggregate of $24,000 in annual dues—less than 1.0 percent of CII's membership revenues. In addition, CII is a client of ISS, paying approximately $19,600 annually to ISS for its proxy research.
[2] H.R. 4015, 115th Cong. (2017), https://www.congress.gov/115/bills/hr4015/BILLS-115hr4015ih.pdf.
[3] H.R. 10, 115th Cong. (2017), https://www.congress.gov/115/bills/hr10/BILLS-115hr10rfs.pdf.

of the proposed legislation is the "protection of investors,"[4] as the primary customer of proxy advisory firm research, institutional investors believe that adding the new proposed requirements to the industry is unnecessary, overly burdensome and counter-productive.[5]

The proposed legislation appears to be based on several false premises, including the erroneous conclusion that proxy advisory firms dictate proxy voting results and that institutional investors do not drive or form their own voting decisions. Indeed, many pension funds and other institutional investors contract with proxy advisory firms to review their research, but most large holders have adopted their own policies and employ the proxy advisory firms to help administer the voting of proxies during challenging proxy seasons.

In short, most large institutional investors vote their proxies according to their own guidelines. While large institutional investors rely on proxy advisors to manage the analysis of issues presented in the proxy statements accompanying over 38,000 meetings annually, and to help administer proxy voting, this does not mean that they abdicate their responsibility for their own voting decisions.

The independence that shareowners exercise when voting their proxies is evident in the statistics related to "say on pay" proposals and director elections. Although Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm, recommended against say on pay proposals at 11.92 percent of Russell 3000 companies in 2017, only 1.28 percent of those proposals received less than majority support from shareowners.[6] Similarly, although ISS recommended votes in opposition to the election of 10.43 percent of director-nominees during the most recent proxy season, just 0.185 percent failed to obtain majority support.[7]

We believe the pending legislation (both Subtitle Q of Title IV of H.R. 10 and H.R. 4015, which was introduced last month) would weaken corporate governance in the United States; undercut proxy advisory firms' ability to uphold their fiduciary obligation to their investor clients; and reorient any

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[4] H.R. 4015.

[5] *See* Letter from Jack Ehnes, Chief Executive Officer, California State Teachers' Retirement System (CalSTRS) to The Honorable Maxine Waters, Ranking Member, Committee on Financial Services 2 (June 5, 2017) ("CalSTRS believes Sections 482 of the CHOICE Act that imposes new regulatory burdens and restrictions on proxy advisory firms is wholly unnecessary, could weaken the governance of public companies in the U.S. and does not reflect the needs of the customers of proxy advisory firms who are primarily institutional investors, such as CalSTRS"), https://www.calstrs.com/sites/main/files/file-attachments/06-05-2017_maxine_financial_choice_act.pdf; Letter from Gregory W. Smith, Executive Director, Colorado Public Employees' Retirement Association (PERA) to The Honorable Ken Buck, United States House of Representatives 1 (May 8, 2017) ("We believe this new regulatory superstructure is overly burdensome, unnecessarily driving up costs, and gives corporations the ability to hinder and delay the independent proxy analysis process."), http://www.peraontheissues.com/wp-content/uploads/2017/06/POTI_CHOICE-Act-letter.pdf; Letter from Karen Carraher, Executive Director, Ohio Public Employees Retirement System (OPERS) to The Honorable Joyce Beatty, United States House of Representatives 1 (May 1, 2017) (on file with CII) ("OPERS opposes Section 482 of the Act because it would negatively impact the independence, timeliness, and affordability of the proxy advisory research and reports that we use to assist in fulfilling our fiduciary duty of ensuring that each of our proxies is voted in the best long-term interests of our members."); *see also* Financial CHOICE Act of 2017, Hearing Before the H. Comm. on Fin. Servs., 115th Cong. 13 (Apr. 26, 2017) (Testimony of Michael S. Barr, The Roy F. and Jean Humphrey Proffitt Professor of Law, University of Michigan Law School) ("The proposed legislation would . . . burden proxy advisory firms."), https://financialservices.house.gov/uploadedfiles/hhrg-115-ba00-wstate-mbarr- 20170426.pdf.

[6] ISS Voting Analytics Database (last viewed on Oct. 23, 2017 & on file with CII).

[7] *Id.*

surviving firms to serve companies rather than investors. The system of corporate governance that has evolved in the United States relies on the accountability of boards of directors to shareowners, and proxy voting is a critical means by which shareowners hold boards to account.[8] Currently, proxy advisors provide equity holders of U.S. corporations with independent advice. The proposed bills threaten to abrogate that very independence, which is a hallmark of ownership and accountability.

Proxy advisory firms, while imperfect, play an important and useful role in enabling effective and cost-efficient independent research, analysis and informed proxy voting advice for large institutional shareholders, particularly since many funds hold thousands of companies in their investment portfolio.[9] In our view, the proposed legislation would undermine proxy advisory firms' ability to provide a valuable service to pension funds and other institutional investors.

We are particularly concerned that, if enacted, H.R. 10 and H.R. 4015 would:

- **Require that proxy advisory firms: 1) provide companies early review of their recommendations and most elements of the research informing their reports; 2) give companies an opportunity to review and lobby the firms to change their independent recommendations; 3) mandate a heavy-handed "ombudsman" construct to address issues that companies raise.[10]**

- **Under H.R. 10, the company could essentially veto the proxy advisor's report and prevent its publication,[11] while H.R. 4015 would require proxy advisors to publish a company's statement "detailing its complaints" in the proxy advisory firms' final reports to their clients, if the ombudsman is unable to resolve these complaints and if the companies make the request in writing.[12]**

Giving corporate issuers the "right to review" the proxy advisors' work product BEFORE the reports go to the paying customers would not only give corporate management substantial undue influence over proxy advisory firms' reports, but could compromise the very fiduciary duties that large institutional investors have to their own clients, beneficiaries and shareowners. We believe the objective of the bills is to bias proxy advisory firm recommendations in favor of corporate management, creating a dynamic that would encourage the firms to view management as their clients, rather than the investors who contract for this research. This approach would award a privileged position

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[8] "The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests," wrote the Delaware Chancery Court in the seminal 1988 decision, Blasius Indus. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988). "If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out," wrote the Delaware Supreme Court in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 959 (Del 1985).

[9] *See* Letter from Jack Ehnes at 2 ("Proxy advisory firms provide useful research regarding the governance and finance at these companies to supplement our own due diligence and research, and they play an important and helpful role in enabling cost-effective proxy voting with respect to the 7,000 companies in our investment portfolio."); Letter from Karen Carraher at 2 ("With holdings in more than 9,300 public companies, it would be more difficult for OPERS to fulfill its fiduciary duty without the research and recommendations of proxy advisors").

[10] H.R. 4015, § 3(a), § 15H(g)(1); H.R. 10, § 482(a), § 15H(g)(1).

[11] H.R. 10, § 482(a), § 15H(g)(1).

[12] H.R. 4015, § 3(a), § 15H(g)(1).

to high-powered CEOs and other executives to talk proxy advisory firms out of criticizing management on subjects such as CEO pay, without providing the same pre-publication right to others.
Another concern is that such forced pre-publication review may not be consistent with First Amendment rights to freedom of speech. Regardless, the attempt by government fiat to interpose corporate management between investors and those investors hire to provide them with independent research is highly questionable as a matter of public policy.

Further, the additional regulatory hurdles imposed would surely: increase the complexity of the challenges faced by the proxy advisory firms; impose even more severe time constraints on the production of reports; and, without doubt, add significant resource burdens that would increase the cost of their services. In short, H.R. 4015 would add no value but would add an unnecessary drag to institutional investors' portfolios. This is not constructive regulatory "reform," and is not supported by institutional investors.

Under both bills, pension funds and other institutional investors would have less time to analyze the advisor's reports and recommendations in the context of their own adopted proxy voting guidelines to arrive at informed voting decisions. Time is already tight, particularly in the highly concentrated spring "proxy season," due to the limited period between a company's publication of the annual meeting proxy materials and annual meeting dates.

Moreover, the proposed legislation does not appear to contemplate a parallel requirement that dissidents in a proxy fight or proponents of shareowner proposals also receive the recommendations and research in advance. This would violate an underlying tenet of U.S. corporate governance that where matters are contested in corporate elections, management and shareowner advocates should operate on a level playing field.

- **Require the Securities and Exchange Commission (SEC) to assess the ability of proxy advisory firms to perform their duties and to assess the adequacy of proxy advisory firms' "financial and managerial resources**."[13]

The entities that are in the best position to make assessments about the ability of proxy advisory firms to perform their contractual duties are the pension funds and other institutional investors that choose to purchase and use the proxy advisory firms' reports and recommendations. These are sophisticated consumers who make choices based on free-market principles.

In 2014, the SEC staff issued guidance reaffirming that investment advisors have a duty to maintain sufficient oversight of proxy advisory firms and other third-party voting agents.[14] We publicly supported that guidance.[15] We are unaware of any compelling empirical evidence indicating that the

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[13] H.R. 4015, § 3(a), § 15H(d)(6); H.R. 10, § 482(a), § 15H(b)(1)(B)(i).
[14] U.S. Securities and Exchange Commission, Staff Legal Bulletin No. 20 at 3 (June 13, 2014) ("it is the staff's position that an investment adviser that receives voting recommendations from a proxy advisory firm should ascertain that the proxy advisory firm has the capacity and competency to adequately analyze proxy issues, which includes the ability to make voting recommendations based on materially accurate information"), https://www.sec.gov/interps/legal/cfslb20.htm.
[15] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, CII to The Honorable Scott Garrett, Chairman, Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services et al. 5 (July 23, 2014),

guidance is not being followed or that the burdensome federal regulatory scheme contemplated by the proposed legislation is needed.

- **Increase costs for institutional investors with no clear benefits.**

If enacted, the proposed legislation is likely to result in higher costs for pension plans and other institutional investors – potentially much higher costs if investors seek to maintain current levels of scrutiny and due diligence around proxy voting amid the exit of some or all proxy advisory firms from the business. The proposed legislation is highly likely to limit competition, by reducing the current number of proxy advisory firms in the U.S. market and imposing serious barriers to entry for potential new firms.[16]

We believe that the cost estimate provided by the Congressional Budget Office to the House Financial Services Committee in September 2016 on substantially similar legislation in the 114th Congress (that is, that private sector costs would be less than $154 million) underestimates the costs that this bill would impose through private-sector mandates.[17] The CBO should analyze the probable effects of the proposal on competition, and the costs to investors if (a) competition is reduced and the pricing power of a surviving proxy advisory firm is enhanced, and (b) if all present firms exit the market and the services they provided are no longer available, forcing individual investors to use internal resources not subject to the new regulatory mandate.

Finally, we note that in recent months the United States Department of Treasury (Treasury) performed outreach to identify views on proxy advisory firms in connection with its recently issued report to the President on "A Financial System that Creates Economic Opportunities, Capital Markets."[18] In that report, the Treasury found that "institutional investors, who pay for proxy advice and are responsible for voting decisions, find the services valuable, especially in sorting through the lengthy and significant disclosures contained in proxy statements."[19] More importantly, the Treasury *did not* recommend any legislative changes governing the proxy advisory firm industry.[20]

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http://www.cii.org/files/issues_and_advocacy/correspondence/2014/07_23_14_letter_Subcommittee_Capital_Markets.pdf.

[16] *See, e.g.,* Keith F. Higgins, "Keynote Address at the Practicing Law Institute, Corporate Governance – A Master Class" 2 (Mar. 9, 2017) (on file with CII) (commenting on proposed proxy advisory firm legislation noting that "[i]t is unclear how added regulatory burden will help promote competition").

[17] Congressional Budget Office, Cost Estimate, H.R. 5311, Corporate Governance Reform and Transparency Act of 2016 ("Aug. 30, 2016) ("CBO estimates that implementing H.R. 5311 would cost $5 million over the 2017-2021 period to hire about 4 additional staff to create and maintain the registry and to prepare annual reports"), https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr5311.pdf.

[18] U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities, Capital Markets" 31 (Oct. 7, 2017), https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[19] *Id.*

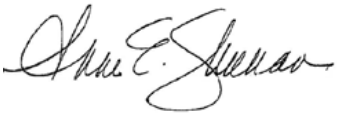
[20] *Id.* ("Treasury recommends further study and evaluation of proxy advisory firms, including regulatory responses to promote free market principles if appropriate.").

Thank you for considering these views. CII would be very happy to discuss its perspective in more detail. Jeff Mahoney can be reached at jeff@cii.org, or by telephone at (202) 822-0800.

Sincerely,

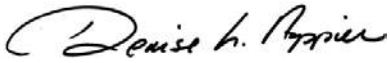
Jeff Mahoney
General Counsel
Council of Institutional Investors

/s/ Marcie Frost
Chief Executive Officer
CalPERS



Anne Sheehan
Director of Corporate Governance
California State Teachers' Retirement System

Gregory W. Smith
Executive Director/CEO
Colorado Public Employees' Retirement Association



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Connecticut State Treasurer
Trustee
Connecticut Retirement Plans and Trust Funds

Michael McCauley
Senior Officer
Investment Programs & Governance
Florida State Board of Administration

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Karen Carraher
Executive Director
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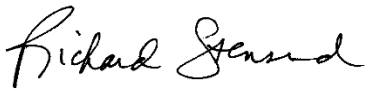

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School Employees Retirement System of Ohio

Jeffrey S. Davis
Executive Director
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State of Oregon

Michael J. Nehf
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AFL-CIO

Dieter Waizenegger
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CtW Investment Group

Timothy J. Driscoll
Secretary-Treasurer
International Union of Bricklayers & Allied Craftworkers

Janice J. Fueser
Research Coordinator, Corporate Governance
UNITE HERE

Euan Stirling
Global Head of Stewardship & ESG Investing
Aberdeen Standard Investments

Blaine Townsend
Senior Vice President, Director, Sustainable, Responsible and Impact Investing Group
Bailard, Inc.

Jennifer Coulson
Senior Manager, ESG Integration
British Columbia Investment Management Corporation (bcIMC)

Julie Cays
Chair
Canadian Coalition for Good Governance

Mike Lubrano
Managing Director, Corporate Governance and Sustainability
Cartica Management, LLC

/s/ Carole Nugent
CCRIM Coordinator
Conference for Corporate Responsibility
Indiana and Michigan

Karen Watson, CFA
Chief Investment Officer
Congregation of St. Joseph

Sister Teresa George, D.C.
Provincial Treasurer
Daughters of Charity, Province of St. Louise

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Susan S. Makos
Vice President of Social Responsibility
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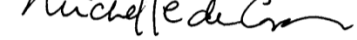
Luan Jenifer
Chief Operating Officer
Miller/Howard Investments, Inc.



Michelle de Cordova
Director, Corporate Engagement & Public Policy
NEI Investments

Judy Byron, OP
Director
Northwest Coalition for Responsible Investment

Amy O'Brien

Amy O'Brien
Global Head of Responsible Investing
Nuveen, the investment manager of TIAA

Julie Fox Gorte, Ph.D
Senior Vice President for Sustainable Investing
Pax World Management, LLC

Kathleen Woods

Kathleen Woods
Corporate Responsibility Chair
Portfolio Advisory Board, Adrian Dominican Sisters

Judy Cotte
VP & Head, Corporate Governance & Responsible Investment
RBC Global Asset Management

/s/ Maria Egan
Portfolio Manager and Shareholder Engagement Manager
Reynders, McVeigh Capital Management, LLC

Maureen O'Brien
Vice President and Corporate Governance Director
Segal Marco Advisors

Kevin Thomas
Director of Shareholder Engagement
Shareholder Association for Research & Education

Jonas D. Kron
Senior Vice President
Director of Shareholder Advocacy
Trillium Asset Management, LLC

Tim Smith
Director of ESG, Shareowner Engagement
Walden Asset Management

Sonia Kowal
President
Zevin Asset Management, LLC

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The Honorable Andy Barr, Committee on Financial Services, United States House of Representatives
The Honorable Joyce Birdson Beatty, Committee on Financial Services, United States House of Representatives
The Honorable Ted Budd, Committee on Financial Services, United States House of Representatives

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Proxy Season 2018

Shareholder Proposal Decision-Making of the Securities and Exchange Commission

Analysis and Recommendations of the Shareholder Rights Group

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SUSTAINABILITY GROUP OF LORING, WOLCOTT & COOLIDGE

TRILLIUM ASSET MANAGEMENT

WALDEN ASSET MANAGEMENT

July 2, 2018

ABOUT THE AUTHOR:

Sanford Lewis is the Director of the Shareholder Rights Group and an attorney whose clients include institutional investors and investment firms. His practice is focused on shareholder rights and environmental and social disclosure requirements of the Securities and Exchange Commission. He was co-author of *Fooling Investors and Fooling Themselves: How Aggressive Corporate Accounting and Asset Management Tactics Can Lead to Environmental Accounting Fraud.*

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- Adam Kanzer: Domini Impact Investments
- Jonas Kron: Trillium Asset Management
- Tim Smith: Walden Asset Management
- Holly Testa: First Affirmative Financial Network
- John Chevedden, individual investor
- Rob Berridge, Ceres
- Andrew Toritto, intern

SUMMARY

In the 2018 proxy season decision-making, the Securities and Exchange Commission (SEC) applied new guidelines on whether to allow companies to exclude shareholder proposals from the annual proxy statement. The invitation under Staff Legal Bulletin 14I (November 1, 2017) for Board of Directors "findings" regarding the significance of proposals to companies led to a cogent outcome: **most boards of directors proved unable to demonstrate to the SEC Staff that topics of shareholder proposals were insignificant to their companies**. Instead, the new process had the counterproductive effect of **increasing legal costs for both investors and companies**.

While the Bulletin itself did not increase the exclusion of proposals, other changes in SEC practice did. Changes to interpretation of **micromanagement** interfered with the long-standing work of investors and fiduciaries to encourage improve performance on companies' climate change responses. At a time in which shareholder proposals are receiving unprecedented levels of voting support due to recognition of risks to investments, the micromanagement rulings **threaten to undermine market-wide investment objectives on an array of issues implicating corporate risk management and financial and ESG performance.**

Further, other decisions under Rule 14a-8(i)(9) excluded shareholder proposals as a result of management introducing "conflicting" proposals that merely ratified the status quo. This had the effect of **allowing corporate gamesmanship to override shareholder rights.**

To rectify these problems we respectfully recommend that the Staff issue additional guidance:

1. **Confirm that proposals requesting that a company set targets or improve its performance on significant policy issues are not considered micromanagement** unless they attempt to direct minutiae of operations.

2. **Prevent the abuse of the conflicting proposals rule**, Rule 14a-8(i)(9). Establish a rebuttable presumption against a "conflict" when a management seeks ratification of an existing policy.

3. **Provide additional detail in no-action decisions**, applying the decision-making rule to the facts and language of the proposal to clarify the decisive issues.

4. **Identify categories of proposals where Board "findings" tend to be less relevant:**

    - Where the company's externalities can impose portfolio-wide impacts for investors;
    - Where the company's activities may pose systemic risks;
    - Where the company has material gaps in its ESG disclosure.

5. **Identify categories of proposals that the Staff views as "governance" proposals** exempt from relevance and significance challenges.

6. **Clarify the need for the board section of a no-action request to include analysis of the substance and significance of the proposal**, as well as documentation regarding the content of the board process.

(1)

THE SHAREHOLDER PROPOSAL PROCESS

Rule 14a-8 administered by the Securities and Exchange Commission authorizes investors who have held more than $2000 in shares for more than a year to file proposals to be considered by fellow investors through public companies' annual corporate proxy statements.[1] This crucial right of shareholder democracy has long been a core vehicle for shareholders to engage with one another and with their companies – to monitor and assess risks, reform corporate governance and provide feedback to companies on critical issues.

Shareholder proposals are typically non-binding. They offer a flexible mechanism for investors with diverse goals and objectives to request enhanced disclosures and increased accountability of corporate boards and managers regarding emerging, neglected, or systemic long-term risks and opportunities. Many current corporate practices, such as the issuance of sustainability reports, and effective attention to long-term environmental and social risks such as climate change, have been substantially initiated and shaped by shareholder proposals.

Securities and Exchange Commission Rule 14a-8 sets forth the process for determining whether or not a shareholder proposal may appear on a corporation's annual proxy statement. Decision-making under the rule is overseen by SEC Staff through an informal process of correspondence between companies, Staff and proponents. If a company's management believe that a proposal does not meet the criteria articulated in the rule for acceptable proposals, it can write to the Staff and request that the Staff confirm that it will "take no action" if the Company omits the proposal from the proxy statement. This *no-action letter process* is determinative of the fate of many proposals each year.

Recently, SEC and external actions have had – or propose to have – a significant impact on this process. Portions of the corporate community have long resisted the proposal process. Efforts by corporate lobby groups, such as the US Chamber of Commerce, to roll back the shareholder proposal process have reached a fever pitch since the 2016 election. In 2017, the US House of Representatives passed the Financial Choice Act. Section 844 of the bill would have eviscerated the shareholder proposal process by confining the filing of shareholder proposals to only the largest institutional investors, and by making it more difficult to resubmit proposals at a company. While the prospects are dim for that bill becoming law, the pressure on the SEC from the corporate community to limit shareholder proposals has persisted, and may have helped to prompt changes in policy at the SEC during the 2018 proxy season.

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[1] 17 CFR 240.14a-8, https://www.gpo.gov/fdsys/pkg/CFR-2013-title17-vol3/pdf/CFR-2013-title17-vol3-sec240-14a-8.pdf

On November 1, 2017, the Staff issued guidance regarding the process on (Staff Legal Bulletin 14I), for the first time inviting boards of directors to weigh in on whether proposals received are "relevant" or address "significant issues for the company" pursuant to Rule 14a-8(i)(7) (ordinary business) and Rule 14a-8(i)(5) (relevance).[2]

While the invitation for board findings under SLB 14I increased expenses and uncertainties for investors and companies without changing decision outcomes, important deviations from prior practice related to *micromanagement* and *conflicting proposals*.

(2)

MICROMANAGEMENT

A. Background

The *ordinary business* doctrine under SEC Rule 14a-8(i)(7) is intended to draw a boundary against investors intruding too far into decision-making that is reserved to the board and management. The rule allows exclusion of proposals on:

> Management functions: If the proposal deals with a matter relating to the company's ordinary business operations

There is a balance between everyday operations overseen by board and management, and big strategic questions, on which shareholders are entitled to have a voice. Under Delaware law[3], shareholders have the ability to hire and fire the Board of Directors by voting directors on or off the board. In addition, federal securities law has enshrined the right of investors to advise the management and board through shareholder proposals. The shareholder proposal rule excluding "ordinary business" (Rule 14a-8(i)(7)) preserves board and management discretion on day-to-day management of the company and confines shareholder proposals to big questions.

When a proposal might be considered to address day-to-day "ordinary business," the SEC determination rests on whether the issue addresses policy questions and significant public debates. Such big questions are appropriate for shareholder deliberation**,** while the day-to-day decisions of running a company are reserved to board and management since it

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[2] https://www.sec.gov/interps/legal/cfslb14i.htm

[3] The concept of reserving oversight of ordinary business to the board and management results from state law, including Delaware law, where most companies are incorporated:

> The central idea of Delaware's approach to corporate law is the social utility of an active, engaged central management. That idea is expressed by our statute, which states the fundamental principle that the "business and affairs of the corporation are managed by or under the direction of a board of directors." It is managerial ingenuity that creates stockholder wealth through the invention and exploitation of new products, the development and more efficient provision of services, and sound financial management. Delaware corporate law recognizes that reality by investing central management with wide discretion to make business decisions and a wide choice of means to effect those decisions. Those investments facilitate creativity and risk-taking.

Leo E. Strine, Jr., Delaware Court of Chancery, The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face, European Policy Forum London, England Salisbury Square, July 5, 2005.

would be "impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting." Concisely speaking, the rules on ordinary business state that a "significant policy issue" "transcends" "ordinary business."

Thus, if a proposal appears to address matters that are part of the day-to-day conduct of the business, then in order to survive an ordinary business challenge the proposal must address a significant policy issue that bears a connection (nexus) to the company. Examples of significant policy issues recognized by the Commission and the Staff include such topics as environmental impact, human rights, climate change, discrimination, as well as virtually all issues of corporate governance.

In addition, the proposal must not be written in a form that *micromanages* the company's business. According to SEC pronouncements, a proposal may micromanage the company's business "by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."

The Staff has had a long tradition of preserving the right of shareholders to file proposals that make specific requests to companies, determining if a proposal micromanages by evaluating how the request is framed. Staff has generally allowed proposals addressing issues at a ***broad policy level,*** while overly prescriptive proposals in which a proponent sought to dictate the minutiae of a firm's operations were allowed to be omitted.[4] In general, the Staff's traditional *application* of micromanagement exclusions has been sensitive to protecting the rights of investors to encourage improved corporate performance on significant policy issues.[5]

Accordingly, proposals directed toward large business strategy questions related to a significant policy issue have not been excluded as micromanagement. For instance, numerous proposals have asked companies to set greenhouse gas (GHG) emission reduction targets and timelines to respond to the challenges of climate change. These proposals have not been considered by the Staff to micromanage; instead, once the GHG reduction model proposal was treated by Staff as *not* micromanaging, companies and shareholders understood that similar outcomes would be likely at other companies.

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[4] For instance, in *Marriott International Inc*. (March 17, 2010) the proposal addressed minutia of operations – prescribing the flow limits on showerheads. In *Duke Energy Corporation* (February 16, 2001) the proposal attempted to set what were essentially regulatory limits on the company – 80 percent reduction in nitrogen oxide emissions from the company's coal-fired plant and limit of 0.15 lbs of nitrogen oxide per million British Thermal Units of heat input for each boiler excludable despite proposal's objective of addressing significant environmental policy issues.

[5] In discussing its deliberations on ordinary business, the Commission explained this tolerance for allowing proposals to address questions of business strategy in the 1998 release:

> …. in the Proposing Release we explained that one of the considerations in making the ordinary business determination was the degree to which the proposal seeks to micro-manage the company. We cited examples such as where the proposal seeks intricate detail, or seeks to impose specific time-frames or to impose specific methods for implementing complex policies. Some commenters thought that the examples cited seemed to imply that all proposals seeking detail, or seeking to promote time-frames or methods, necessarily amount to ordinary business.
>
> We did not intend such an implication. **Timing questions, for instance, could involve significant policy where large differences are at stake, and proposals may seek a reasonable level of detail without running afoul of these considerations**. [emphasis added]
> https://www.sec.gov/rules/final/34-40018.htm

B. Breaking with Prior Practice

Implementation of micromanagement during the 2018 season seems to have diverged from this approach. Of greatest concern to many in the proponent community is the Staff decision in ***EOG Resources, Inc.*** (February 26, 2018), which allowed *exclusion as micromanagement* of a proposal asking the company to set company-wide, quantitative, time-bound targets for reducing greenhouse gas (GHG) emissions and issue a report discussing its plans and progress towards achieving these targets.

Numerous companies have made commitments to science-based greenhouse gas reduction targets after receiving shareholder proposals.

This decision runs contrary to long-standing precedent, as the Staff had long found identical proposals, including at oil and gas companies, to be not excludable and to not constitute micromanagement. For instance, in *ONEOK, Inc.* (February 25, 2008) the proposal requested that the board of this oil and gas company prepare a report concerning the feasibility of adopting quantitative goals, based on current and emerging technologies, for reducing total GHG emissions from the company's operations.

The company argued the proposal related to the Company's ordinary business operations, adding that ordinary business problems should be confined to management and the board of directors, "since it is it is impracticable for shareholders to decide how to solve such problems at an annual shareholder meeting." The company's no-action request noted that its greenhouse gas emissions are related to control of "line loss" of natural gas in its pipelines, which is a complex policy issue managed on a day-to-day basis and directly related to its profitability and therefore ordinary business and micromanagement. The proponent had argued in response:

> …the mere fact that the subject matter of the Proposal is "complex" is not dispositive. In fact, the Staff repeatedly has rejected arguments that the alleged complexity of a proposal's subject matter renders it an attempt to micromanage… As the Proposal does not seek shareholder input on the analysis or resolution of complex issues – but, rather, asks nothing more than that the Board determine what is possible – the alleged complexity of its subject matter is beside the point.
>
> Finally, that the Company evaluates pipeline integrity and formulates policies relating to GHG emissions in the ordinary course of its business is of no moment. Again, the Proposal does not purport to tell the Company how to perform these – or any other – functions. It merely asks for an assessment of whether a given course of action (*i.e.,* the adoption of quantitative goals for the reduction of GHG emissions) is possible.

The Staff rejected the company's micromanagement argument and did not allow the company to omit the proposal. The same result occurred at other companies, including those in other sectors. In *Great Plains Energy Incorporated* (February 5, 2015) the proposal directed toward a utility requested that the company adopt quantitative, time bound, carbon dioxide reduction goals to reduce corporate carbon emissions, and issue a report to shareholders on its plans to achieve the carbon reduction goals it sets. As with ONEOK, Great Plains asserted that the proposal was micromanaging by potentially affecting the company's mix of energy sources.

In rejecting exclusion and following the ONEOK precedent, the Staff stated: "In our view, the proposal focuses on reducing greenhouse gas emissions and does not seek to micromanage the company to such a degree that exclusion of the proposal would be appropriate."

In the recent season, companies' assertions of micromanagement, and successful exclusions, swelled. At least eight shareholder proposals were excluded for micromanagement.[6]

Most notable was EOG Resources. The company and its board of directors asserted that the proposal micromanaged, because if it implemented the proposal's advisory request, it could require the company to alter its priorities by giving greater focus on to reducing GHG emissions. They claimed that debating such a change in company priorities is impractical for shareholders to do in an annual meeting.[7] In a break with prior practice, the Staff allowed the proposal to be excluded as micromanaging. The decision stated: "In our view, the Proposal seeks to micromanage the Company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment. Accordingly, we will not recommend enforcement action to the Commission if the Company omits the Proposal from its proxy materials in reliance on rule 14a-8(i)(7)."

Undermining the right to file these proposals threatens to interrupt this long-standing and productive interchange between shareholders and their companies.

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[6] *Apple Inc.,* (December 21, 2017), *Deere & Company* (December 27, 2017), *JPMorgan Chase & Co.* (March 30, 2018) (two decisions), *PayPal Holdings, Inc.* (March 6, 2018), *Amazon.com, Inc.,* (January 18, 2018), *Verizon Communications Inc.,* (March 6, 2018), *EOG Resources, Inc.,* (February 26, 2018).

[7] The company clarified its argument for micromanagement in a supplemental letter:

> Implementing the Proposal **would require EOG's management to potentially prioritize quantitative emissions reduction targets over a wide variety of factors involved in oil and gas exploration and production operations** (such as geologic formation characteristics, operational considerations, rate-of-return economics and the then-current commodity price environment), **in each case at the expense of management's own judgment,** at least if such quantitative targets are to be meaningful at all.
>
> Likewise… the requested quantitative targets would potentially displace or disrupt management's judgment regarding, energy opportunity growth among other operational factors, the location, timing, and mix of production, which are at the core of EOG's daily business decisions as an exploration and production company. This is the very definition of micro-management.

The proponents replied:

> … the Proposal does not specify the target to be set by EOG. The Proposal simply asks the Company to set GHG emissions reduction targets that would align with the Company's approach to this significant social policy issue.
>
> * * *
>
> It is evident that the Proposal does not infringe on management's ability to select an appropriate mix of production methods, production regions, or production mix. Nor does the Proposal mandate what the quantitative targets could or should be, or how they should be set. The Company is free to set and accomplish these goals in whatever manner it chooses to reduce GHG emissions and protect shareholder value. The simple question of whether or not a company should adopt and report on greenhouse gas emissions reduction targets is easily understood by shareholders and does not delve to deeply into the Company's operations.

C. Undermining Clear Investor Support for Monitoring and Elevating Performance

Proposals that request companies to set and disclose targets allow investors to more clearly understand and compare companies' ambitions and performance. At the same time, setting targets on material issues like greenhouse gas emissions "provide companies with a clearly defined pathway to future-proof growth by specifying how much and how quickly they need to reduce their greenhouse gas emissions."[8] Many companies have already set science-based targets (SBTs) in order to combat climate change by reducing their GHG emissions. Currently 412 companies are making science-based climate commitments, and 106 companies have approved SBTs.[9] A significant portion of these companies have made these commitments to science-based targets after receiving shareholder proposals, and either having seen the proposals go to a vote, or having proponents withdraw the proposals in exchange for company commitments. Undermining the right to file such proposals would interrupt this productive interchange between shareholders and their companies.

The support for these proposals is clear and continues to grow. In 2017 and 2018, various companies either agreed to set SBTs or received a significant amount of shareholder support on these proposals. In 2017, proposals won 33.98 percent of the vote at Emerson Electric,[10] 33.9 percent at Nucor,[11] and 30.06 percent at Danaher.[12] In 2018, shareholder support was 41.6 percent at Fluor, 57.2 percent at Genesee & Wyoming Inc., 39.0 percent at Emerson Electric, 37.8 percent at CH Robinson, 24.6 percent at Illinois Tool,[13] and 21.44 percent at J.B. Hunt.[14] Minerals Technology shareholders withdrew their proposal asking for SBTs after the company formalized a new process to review its environmental impacts and set reduction targets.[15]

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[8] http://sciencebasedtargets.org/what-is-a-science-based-target/

[9] http://sciencebasedtargets.org/companies-taking-action/

[10] https://www.sec.gov/Archives/edgar/data/32604/000162828017001100/a2017votingresults8-kbody.htm

[11] 8-K: https://www.sec.gov/Archives/edgar/data/73309/000119312517172145/d397199d8k.htm Proxy: https://www.sec.gov/Archives/edgar/data/73309/000119312517092987/d309622ddef14a.htm#toc309622_23

[12] https://www.sec.gov/Archives/edgar/data/313616/000119312517167384/d385458d8k.htm

[13] http://www.trilliuminvest.com/shareholder-proposal/illinois-tool-works-greenhouse-gas-emissions-reduction-targets-2018/

[14] http://www.trilliuminvest.com/shareholder-proposal/j-b-hunt-greenhouse-gas-emissions-2018/

[15] http://www.trilliuminvest.com/shareholder-proposal/minerals-technologies-greenhouse-gas-emissions-reduction-2018/. Similarly, in 2018 various companies agreed to, or received significant votes from shareholders, to disclose any targets on GHG emissions. In this regard, proposals for sustainability reporting that also requested disclosure of goals received 57.2 percent of shareholder support at Middleby Corporation (http://www.trilliuminvest.com/shareholder-proposal/middleby-corporation-sustainability-report-2018/) and 49.8 percent support Acuity Brands (http://www.trilliuminvest.com/shareholder-proposal/acuity-brands-sustainability-ghg-reporting-2018). See also https://corpgov.law.harvard.edu/2018/06/27/surprises-from-the-2018-proxy-season/ for a summary of recent support for environmental, governance and social proposals.

Investor demand for climate disclosures in general and science-based targets specifically has increased substantially as the risks have become more apparent. For instance:

- Anne Simpson, Investment Director, Sustainability, at California Public Employees' Retirement System: "Mapping a company's carbon footprint, or the emissions it produces, and measuring its progress in this area is an important and growing part of our portfolio analysis. Over the long-term investors are saying to these companies that we want them to align their business strategy with the Paris Agreement."
- Ingrid Dyott, Portfolio Manager of $2.5 billion Neuberger Berman Socially Responsive Fund: "If [companies] can't show that they've got systems in place to manage their environmental challenges then it suggests that management may not be up to standard in other areas too."
- Jeanett Bergan, Head of Responsible Investment at KLP states the potential of better long term returns from setting SBTs: "If we as active owners improve the performance of CO2 intensive companies, that will help us secure better returns in the future."[16]

The support for better disclosure and target setting by individual investment firms and experts has been accompanied by increasing recognition of the need for investor disclosure on climate change, including through the recommendations of the global Task Force on Climate-Related Financial Disclosures.[17] Moreover, when it comes to the concerns raised at EOG Resources, there even more compelling evidence has emerged in recent months to demonstrate that omitting a proposal regarding failure to engage in GHG reduction goal-setting is likely to be a material issue for an oil and gas company.[18]

Thus, despite long-standing and widespread utilization by shareholders of proposals asking companies to set GHG targets, clear justification from an investment standpoint, and increasing support from a wide range of investors, the Staff decision in EOG Resources offers the prospect that each company presented with such a proposal can challenge the proposal *de novo*, and that shareholders cannot be assured that the company will not be able to claim an exception to the precedents finding this proposal appropriate for corporate proxy statements.

D. Errors of Omission are Far More Harmful to Investors Than Errors of Over-Inclusion

In deciding whether to allow exclusion of shareholder proposals, the Securities and Exchange Commission must consider its clearly stated investor protection mission. History has shown it can be far more detrimental to that mission to make errors of omission (wrongly omitting proposals) than to make errors of inclusion. Recent history contains numerous examples of proposals that were excluded only to later prove to have been early warnings of highly material risks.

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[16] http://sciencebasedtargets.org/what-investors-are-saying/

[17] https://www.fsb-tcfd.org/

[18] See the recent New York Times article: The Natural Gas Industry Has a Leak Problem http://nyti.ms/2lqOsHm?

As early as 2000, shareholders recognized the risk posed by subprime lending, a practice which contributed to the mortgage crisis of the mid-2000s. The risks taken by individual financial institutions generated concern amongst shareholders, who filed some on-target resolutions that were excluded by the SEC as pertaining to ordinary business.

In 2000, Household International was one of the largest subprime lenders in the United States. Predatory lending in the subprime market was of growing concern to some investors as it became clear that borrowers were unable to repay these loans and were losing their homes. Subprime lending was already beginning to indicate the financial risks that would ultimately produce the housing bubble, the mortgage meltdown, and the financial crisis. There had already been bankruptcies of several large subprime lenders over the course of 1998-99.

Shareholders of Household International brought a resolution in 2000 citing interest in predatory lending amongst policy makers on the national and state level, and large settlements with lenders already being required by the FTC. The shareholder resolution filed in 2000 requested the establishment of a committee of outside directors to develop and enforce policies to ensure "that accounting methods and financial statements adequately reflect the risks of subprime lending and … employees do not engage in predatory lending practices" and issue a report to shareholders. In *Household International,* (March 13, 2000) the Staff determined that this proposal could be excluded as ordinary business. These shareholders who had the foresight to sound the alarm were rebuffed, and by 2002 Household International subsequently settled a groundbreaking case with 20 state attorneys general over predatory lending (Iowa DOJ News Release, October 11, 2002). A significant opportunity to alert shareholders and boards of directors to the problems and risks posed was barred by the SEC decision.

By 2007 it became clear that subprime lending posed systemic risk, and as subprime lending burst the housing bubble, several proposals at *Washington Mutua*l (February 5, 2008), M*errill Lynch* (February 19, 2008; February 20, 2008), KB Home (January 11, 2008), and *Lehman Brothers* (February 5, 2008) were excluded. Even as the market was in early signs of collapse, these proposals were considered by the SEC to be excludable, regardless of the fact that these risky practices were at the time clearly causing systemic risk. In fact, the collapse of Lehman Brothers, one of the hedge funds whose shareholders submitted a proposal, was a uniquely catastrophic event in the crisis. Lehman's shareholders were denied their opportunity to engage with the company in 2007 *Lehman Brothers* (February 5, 2008). Lehman collapsed in September 2008.

Experience shows that errors in omission of shareholder proposals are far more harmful to investor protection and company interests than errors of over-inclusion. The no-action process should be guided by this.

In contrast, when the SEC allows shareholders to do their work through the shareholder proposal process, many smaller and institutional investors attentive to early warning signs can spur management and board attention where due. To cite one example, some religious pension fund shareholders that were in some instances able to flag subprime lending issues in 2000 through the shareholder proposal process, assisted some companies that cooperated to avoid the disastrous fate met by numerous big banks. As Attorney Paul Neuhauser has noted although a number of other proposals on subprime lending:

> survived company challenges at the SEC, [but] they never appeared on any proxy statement because the recipients in each case agreed to a change of policy with regard to predatory lending to subprime borrowers (in one case the securitizer called the proponent the day after it lost its no-action request at the SEC to request a meeting and dialogue on the matter and at the meeting agreed to alter its due diligence process with respect to loans purchased for securitization). Notably, the securitizers that received the precatory proposals and changed their practices have not been among those who have suffered during the recent unpleasantness.[19]

To cite one of many other errors of omission in Staff decisions, ordinary business exclusions were allowed for a proposal at Wells Fargo inquiring about whether the employee compensation system was exposing the bank or economy to excess risk. *Wells Fargo* (February 14, 2014) These proposals were early warnings of what later proved a scandalous and costly crisis due to fraudulent cross selling spurred by employee incentives. To date, Wells Fargo has paid at least over a $1 billion in fines and penalties for its reckless risk management and employee incentives, including penalties for opening 3.5 million accounts for customers without their consent, abusive auto loan practices, and in related suits by customers and investors.

Are the Staff decisions today allowing exclusion of proposals that seek improved performance and risk management destined to be viewed in hindsight as further "errors of omission"? The strong market sentiment in favor of vigilance and engagement on multiple, high risk policy issues seems to point in that direction.

E. The New "Specific Methods" Doctrine for Micromanagement Raises Additional Concerns

Later in the proxy season, decisions explicitly excluded proposals as micromanaging by ***"seeking to impose specific methods for implementing complex policies*."** Our research indicates that this specific phrase, drawn from the 1998 Release,[20] has never been expressly applied or quoted as a rationale of prior Staff decisions.

The SEC invoked the specific methods language first at J.P. Morgan Chase for two different proposals excluded as micromanaging. *JPMorgan Chase* (March 30, 2018). One proposal related to financing of tar sands production of oil and gas, with its related climate and financial risks.[21] The second proposal requested that the Company establish

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[19] Paul Neuhauser, comment letter to SEC, Oct. 2, 2007, https://www.sec.gov/comments/s7-16-07/s71607-476.pdf

[20] The 1998 Release involved the recasting of the shareholder proposal rule into the current Q&A format, and also considered and rejected amendment to the resubmission threshold.

[21] The proposal sought a report on the reputational, financial and climate risks associated with project and corporate lending, underwriting, advising and investing for tar sands production and transportation, and specified that the report should include assessments of:

- Short- and medium-term risk of portfolio devaluation due to stranding of high-cost tar sand assets.
- Whether the Company's tar sands financing is consistent with the Paris Agreement's goal of limiting global temperature increase to "well below 2 degrees Celsius."
- How tar sands financing aligns with the Company's support for Indigenous Peoples' rights.
- Reducing risk by establishing a specific policy, similar to that of other banks, restricting financing for tar sands projects and companies.

a human and indigenous peoples rights committee.[22]

In both no-action requests, JPMorgan Chase summarized its micromanagement theory:

> The Company is a global financial services firm… As such, the Company's decisions with respect to the origination and management of specific financial products and services are central to its ability to run the business on a day-to-day basis. The Company's management invests a significant amount of time, energy and effort on a daily basis in determining how the Company will offer its products and services, while generating an attractive return to the Company's shareholders… ***Management focuses extensively on establishing appropriate standards for making products and services decisions***, which are then considered on a day-to-day basis by management and employees who are making the products and services decisions. [Emphasis added]

At issue in both proposals was whether the standards being set by the company for its product and service decisions were adequate to the task of addressing what are clearly significant policy issues – human rights and environmental impacts. While there may be room for disagreement as to whether the wording of those proposals could have been less directive, the proponents in both instances made a compelling argument that the existing standards of the company are inadequate and leave the company exposed to significant financial, reputational and operational risks. For example, JPMorgan Chase is the largest financer of tar sands operations, ($8.4 billion in financing from 2014 to 2017), assets which many analysts believe are at high risk of becoming stranded due to climate change.

Investors often urge their companies to set targets on various issues – and thus the urgency and importance of questions about the scope of Staff's new interpretation of micromanagement.

Moreover, the proposals at JPMorgan Chase were preceded by similar successful investor engagement that led *other* companies to reform their policies. For instance, the Presbyterian Church's engagement with Phillips 66 – which has a significant investment in the Dakota Access Pipeline (DAPL) project – help to encourage the company to strengthen its human rights and Indigenous rights policies, a necessary part of respecting the Standing Rock Sioux tribe's human right to water. Similarly, As You Sow engaged with Morgan Stanley and Goldman Sachs – which provide capital to the oil, gas and mining sectors and provided financing for the DAPL project – encouraging them to review their due diligence processes for financing projects with potential community impacts. Enbridge was asked to report on the due diligence processes it uses when reviewing potential acquisitions to identify and address social and environmental risks. The resolution at Enbridge received 30 percent support.

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[22] The proposal asked that, at a minimum, the committee would adopt policies and procedures to require the Company and its fiduciaries in all relevant instances at the corporate level, project or consortium financing, ensure consideration of finance recipients' policies and practices for potential impacts on human and indigenous peoples' rights, and ensure respect for the free, prior and informed consent of indigenous communities affected by all Company financing.

Despite the market wide implications, and the presence of an issue of obvious significance to the company and society, in both instances, the decision stated that the proposals could be excluded under Rule 14a-8(i)(7):

> In our view, the Proposal **micromanages the Company by seeking to impose specific methods for implementing complex policies**. [emphasis added]

In the absence of articulated limits, this new "specific methods" doctrine applied for the first time in these JPMorgan Chase decisions will inevitably invite new challenges from companies in many of their no-action requests.

F. Proposals Seeking Company Performance Targets Apply to an Array of Significant Policy Topics

The EOG Resources decision raises obvious concern for proponents filing proposals asking companies to set performance targets related to climate change. However, efforts by shareholders to encourage companies to set targets extends to many other issue areas, therefore raising urgent and important questions about the scope of the new approach to micromanagement.

One example is the surge of investor efforts to encourage companies to improve diversity. In 2017 and 2018, numerous proposals urged companies to adopt time-bound, measurable, benchmarks for improving diversity among their boards of directors and workforces. In a similar vein, shareholders also requested that companies amend their policies towards lesbian, gay, bisexual and transgender (LGBT) workers to ensure equal treatment, hiring opportunities, and protections for the LGBT community. Many of these proposals to improve corporate diversity either request *specific methods* for addressing company policies, or request that companies set targets to improve their performance.

In the absence of articulated limits by the Staff, the new *specific methods for implementing complex policies* doctrine will inevitably invite more efforts to undermine shareholder rights to engage with companies on improved financial and ESG performance.

As with the GHG reduction target examples, the benefits of the actions requested in these proposals are well-founded in investment rationales and evidence in the financial literature. Numerous studies have shown the many benefits diversity and nondiscriminatory policies brings to companies – not just in terms of inclusivity and fairness, but the sharp increases in profitability and productivity. For instance, McKinsey and Company have conducted studies on diversity in the work place for the past few years and have found results suggesting diversity positively affects businesses:

> More diverse companies, we believe, are better able to win top talent and improve their customer orientation, employee satisfaction, and decision making, and all that leads to a virtuous cycle of increasing returns. This in turn suggests that other kinds of diversity – for example, in age, sexual orientation, and experience (such as a global mind-set and cultural fluency) – are also likely to bring some level of competitive advantage for companies that can attract and retain such diverse talent.[23]

[23] The 2018 report notes that "Companies in the top quartile for racial and ethnic diversity are 35 percent

The successful filing of these diversity and nondiscrimination proposals has been pivotal in improving company performance on these issues 2017 and 2018. In 2018, Nike agreed to evaluate the shareholder request and meet quarterly to discuss progress. Priceline Group, Stifel Financial, KeyCorp, CVS Health Corp, Sealed Air, Ansys Corp, PNC Financial and Cigna Corp pledged to improve their diversity data and reporting. LogMeIn agreed to implement the "Rooney Rule" which states that one candidate from each applicant pool must be of a diverse gender, race, or sexual orientation. Alphabet shareholders withdrew their proposal after the appointment of Sundar Pichai to the Executive Committee of the Board. Citigroup also responded to the shareholder concerns and agreed to compile gender/race wage gap data and close the pay gap – the first big bank to do so.[24] Shareholders of Travelers voted 36.38 percent in favor of diversity reporting, 28.7 percent at First Republic Bank and 34.7 percent at Starbucks.[25] Shareholders won LGBT rights proposals at National Oilwell Varco, and SBA Communications. National Oilwell Varco agreed to clarify and update their diversity policy to include gender identity and expression, SBA agreed to publicize their equal employment opportunity and LGBT inclusive policies.

G. Affecting Large Market Stakes in Monitoring and Improving ESG Performance

These diversity and LGBT inclusive proposals that seek targets and specific changes to policy are just one example among a range of proposals addressing environmental and social performance. About a fifth of assets under professional management in the US ($8.72 trillion as of 2016) are engaged in sustainable, responsible or impact investing in the United States.[26] These investors and advisors bear responsibility, through contract and client expectations to ensure that investments are managed consistent with a client's or trustee's strategy/investment mission and, including in many cases a commitment to directly engage with portfolio companies on long-term risks and opportunities.

Moreover, index and passive investors are becoming increasingly aware that they cannot ignore, but rather must be attentive to, the systemic effects of their portfolio investments. For institutional investors whose diversified portfolios are necessarily spread broadly across the whole economy, there is growing recognition of a fiduciary obligation to consider the prospects both for longer-term performance and for systemic impacts, i.e., of the issuer's effects on the whole economy and environment. This brings heightened

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more likely to have financial returns above their respective national industry medians. Companies in the top quartile for gender diversity are 15 percent more likely to have financial returns above their respective national industry medians." The report also found that companies with less diversity tend to perform worse: "Companies in the bottom quartile both for gender and for ethnicity and race are statistically less likely to achieve above-average financial returns than the average companies in the data set (that is, bottom-quartile companies are lagging rather than merely not leading)." https://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters

[24] https://www.prnewswire.com/news-releases/citi-is-first-us-bank-to-respond-to-shareholder-pressure-to-close-gender-pay-gap-300582388.html

[25] http://www.trilliuminvest.com/approach-to-sri/shareholder-proposals/

[26] US SIF, *Report on US Sustainable, Responsible and Impact Investing Trends 2016,* pp 5. Worldwide, the assets committed to responsible, long-term investment includes over 1,400 signatories managing more than US$59 trillion that have endorsed the global Principles of Responsible Investment. United Nations Environmental Programme – Financial Initiative, *Principles for Responsible Investment: An investor initiative in partnership with UNEP Finance initiative and the UN Global Compact*, 2016, pp 4.

attention and sensitivity by the investors to issues of long-term risk, especially "low road" business strategies demonstrating efforts by the corporation to attempt to externalize costs (e.g., pollution of the atmosphere) on the rest of society. In a growing number of instances, even at large investment firms like BlackRock and Vanguard, this leads to support for shareholder proposals addressing long-term ESG issues such as climate change.[27]

Are proposals that address the wide range of systemic risks, portfolio wide risks and ESG performance now in the crosshairs of the Staff's "new micromanagement"? That would be a tragic and costly "error of omission." Without clarification, the decisions of the recent season would seem to create open season on all kinds of proposals, including diversity proposals, that ask companies to take specific action including setting targets.

H. Specific Methods for Implementing Complex Policies

The application and scope of the newly articulated "specific methods on complex policies" doctrine of micromanagement appears inconsistent with the Commission's prior statements recognizing the validity of proposals addressing large business strategy questions related to a significant policy issue.

If the Staff will exclude proposals whenever they suggest specific methods for addressing complex policies, many other long-standing shareholder proposals will also become subject to challenge. For example, shareholder proposals that address issues of executive pay have sought clawbacks – the recovery of executive pay as an effective means to hold executives accountable for misconduct – and accordingly often submit shareholder proposals requesting their companies to adopt clawback policies. In light of recent misconduct at Valeant Pharmaceuticals International, shareholders submitted a proposal requesting that the company claw back some of its executive pay incentives. Shareholders proved successful in this instance as Valeant agreed to their demands.[28] Similarly, in 2013 shareholders successfully withdrew a proposal as Wells Fargo and Co. agreed to expand its clawback policy. This proved vital in the wake of Wells Fargo's 2016 corruption scandal, where $60 million was clawed back from two top company executives.[29]

Most issues of concern to investors are likely to involve "complex policies" at their companies. Complexity is not equivalent to "adequacy."

Most issues of concern to investors are likely to involve "complex policies" at their companies. Under the securities rules, the correct avenue for evaluating such company activities as a basis for exclusion of a proposal is under Rule 14a-8(i)(10) (substantial implementation), which involves a rigorous analysis of whether the company's activities are reasonably consistent with the proposal, not under a vague determination that the company policies (however inadequate they may be) are "complex" under Rule 14a-8(i)(7).

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[27] A recent state of the industry report, "Tipping Points 2016" found that financial returns and risk reduction are two primary motivators for a growing portion of capital providers to approach investment decisions on a systemic basis. http://tiiproject.com/tiiping-points-2016 (hereinafter "Tipping Points") The study collected data from a group of 50 institutions, including 28 asset owners and 22 asset managers. The report sought to assess whether and to what extent institutional investors consider and manage their impacts on environmental, societal, and financial systems, and to what extent they consider those systems' impacts on their portfolios.

[28] http://www.iccr.org/sites/default/files/resources_attachments/2017iccrimpacts04.20.17.pdf

[29] https://www.nytimes.com/2017/06/16/business/wells-fargo-clawback-fair-choice-act-shareholders.html

(3)

BOARD OF DIRECTORS "FINDINGS"

On November 1, 2017 the SEC issued Staff Legal Bulletin 14I (SLB 14I), inviting boards of directors to submit their findings regarding whether a policy issue raised by a proposal is "significant" to the company under Rule 14a-8(i)(7) and economically relevant under Rule 14a-8(i)(5).

SLB14I raised concern among investors regarding the potential for abuse, because it effectively encouraged companies and boards to seek exceptions for companies allowing exclusion of proposals that had previously been found non-excludable. Proponents were concerned that some companies, with support from their external counsel, routinely engage in knee-jerk efforts to exclude proposals. The Bulletin could empower boards to exclude proposals, even where the proposals were addressed to significant board and management blind spots.

The Staff had made it clear in public communications that the thrust of the Bulletin was on inviting boards of directors to focus on whether a proposal addressed a topic that the board did not consider "significant" to the company.[30] In the board deliberations and submissions that followed, boards had a strikingly difficult time asserting that issues in proposals like climate change, the opioid crisis and human rights are insignificant for their companies.[31] In only one instance, Dunkin' Brands Group, Inc., the board asserted and the Staff accepted the notion, that a proposal addressed an insignificant issue for the company for purposes of Rule 14a-8(i)(5).[32]

Proponents were left with a sense that the Bulletin had caused boards of directors to overreach in asserting proposal topics were insignificant to their companies. This wasted resources of proponents and companies, attempting to revisit long-standing precedents.

Indeed, some companies' boards of directors reportedly avoided submitting such findings because they were unwilling, considering their fiduciary duties and liabilities, to make such assertions of insignificance. Notably,

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[30] Matt McNair (Senior Special Counsel, Office of Chief Counsel, SEC's Division of Corporation Finance):

> …the SLB addresses nexus. If a company can demonstrate that a proposal isn't sufficiently significant to its business notwithstanding the social significance or other significance, there would be a basis I think to exclude.

It is really the board's analysis that is going to help us determine whether there's a sufficient nexus. [Note: This was McNair signaling his personal opinion as a member of the Staff, but not necessarily the official view of the SEC. Nevertheless, it represented the best available clarification of the meaning of the Bulletin.] https://www.thecorporatecounsel.net/Webcast/2017/11_14/transcript.htm

[31] For instance, from the very first company implementation of the Bulletin, in submissions by Apple Inc., it was apparent that the Board of Directors was unable to assert that issues of climate change, freedom of expression and human rights are not "significant" to the company. Instead, the Company and its board took the position that proposals addressed issues that were quite significant to the company. The board and management asserted that the company had already considered the issues and adopted complex policies for addressing the issues, such that shareholder proposals and deliberation were unwarranted and impractical.

[32] That proposal addressed the use of so-called K cups by Dunkin' Donuts as a waste generation issue. The board's findings that this was not a significant issue for the company for purposes of Rule 14a-8(i)(5) was not met by a response by the proponent. *Dunkin Brands Group, Inc*. (February 22, 2018).

the Staff rejected certain exclusion requests under Rule 14a-8(i)(7) or Rule 14a-8(i)(5) expressly because the no-action request failed to include a Board of Directors opinion (*Verizon Communications Inc.* March 7 and 8, 2018) and *General Motors Company* (April 18, 2018).

Instead, boards of directors attempted to redirect their findings to avoid asserting insignificance. In mid-November, Apple Inc. filed the first letters from any company responding to the bulletin, on proposals requesting a human rights committee, sustainability metrics linked to executive compensation, a report on freedom of expression and setting net zero greenhouse gas goals. Notably, in the description of findings by Apple's Board of Directors, the board was unable to assert that the issues behind the proposals were not "significant" for the company. Instead, the board claimed that it had complex policies in place to address the subject matter and therefore the proposals were not appropriate for shareholder deliberation.[33]

As the season evolved, it became clear that it is difficult for most companies to successfully assert that the issues raised in proposals are "insignificant" to their companies. A number of such assertions by companies were rejected by the Staff based on the lack of compelling analysis demonstrating insignificance to the company and its shareholders.

Lack of Clarity in the Bulletin About Degree of Substantive Analysis Required

The Staff Legal Bulletin is ambiguous in its description of how the board should address the subject matter of a proposal, including the merits. The bulletin only states that the board section of a no-action request should include "a discussion that reflects the board's analysis of the proposal's significance to the company."

It is not surprising therefore, that most of the Board findings lacked specific analysis of the merits or substance of proposals. Even where the board findings have asserted "insignificance" or "irrelevance," they have seldom gone into a direct analysis of the substance of the proposal.

Reviewing the no-action correspondence at the end of the season, it became apparent that the submissions from boards of directors were variable. Some boards submitted relatively detailed substantive discussions; but others appear to follow a checklist script provided by a corporate secretary or external counsel describing the minimum requirements that might be implied under the Bulletin. Some of these

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[33] While two of the Apple proposals were resolved under other rules, two of the proposals were resolved by the Staff based on the board findings. The Staff declined to exclude the proposal to establish a board human rights committee related to ordinary business, noting that "We are unable to conclude, based on the information presented in your correspondence…that this particular proposal is not sufficiently significant to the Company's business operations such that exclusion would be appropriate. As your letter states, "the Board and management firmly believe that human rights are an integral component of the Company's business operations." Further, the board's analysis does not explain why this particular proposal would not raise a significant issue for the Company.

However, a second proposal that asked the company to set a target date to eliminate its carbon footprint did not meet the same fate. The staff allowed the proposal to be excluded based on micromanagement, noting, "In our view, the Proposal seeks to micromanage the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment."

"checklist" responses omitted any substantive discussion of the specifics of the proposal, and merely described the board process in a way that was opaque to both investors and the Staff.

The Staff found numerous instances where board findings were submitted, but failed to provide adequate explanation, counterargument or data to demonstrate the insignificance of the proposal to the company. *Entergy Corporation* (March 14, 2018) distributed energy strategy for climate change, *Goldman Sachs* (March 12, 2018) lobbying disclosure, and *AmerisourceBergen Corporation* (January 11, 2018) opioids crisis.[34]

Proponents were left with a sense that the Bulletin had caused boards of directors to overreach in asserting that their companies were exceptional – that proposals which have long been found to represent a significant issue were insignificant to their companies. In the course of the process, substantial resources were wasted by both proponents and companies revisiting long-standing precedents. In practice, where there has been long-standing acceptance of proposals supported by staff decisions at numerous companies there is and should be a high burden of persuasion on the board to claim an exclusion.

(4)

CONFLICTING PROPOSALS

Rule 14a-8(i)(9) provides that a proposal may be excluded when it "directly conflicts with one of the company's own proposals to be submitted to shareholders at the same meeting." During the 2018 season, the Staff interpreted this provision in favor of allowing seven companies to exclude proposals to lower the number of shareholders required to call a special meeting by substituting – after the fact – a management proposal that merely ratified the company's existing higher threshold.

This power to call a Special Meeting is typically of interest to shareholders when there is a major governance issue at the company that must be attended to before the next annual meeting. Typical examples include efforts by shareholders to elect a director with particular expertise, to dismiss certain members of the board, or to make amendments to bylaws.[35] In these instances, as well as in many others, shareholders need and deserve the right to call a Special Meeting to discuss items of import.

As a result of broad support by investors of proposals previously filed on Special Meetings, a majority of S&P 500 companies allow a group of investors to call a Special

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[34] For example, in *AmerisourceBergen* where the company's board findings vaguely stated that the governance committee discussed various questions and then:

> "Upon completion of the discussion, the Governance Committee determined that, based on its understanding of the SEC Staff's views and the Governance Committee's consideration of the Company's business, there is not a sufficient nexus between the Proposal's focus on the abuse of opioid medications and the Company's core operations as a distributor of pharmaceutical products to hospitals, pharmacies and other customers, and between the Company's business of providing services and distributing pharmaceutical products, on the one hand, and opioid use, abuse and dependency, on the other." *AmerisourceBergen Corporation* (January 11, 2018).

[35] http://www.theactivistinvestor.com/The_Activist_Investor/Special_Meetings.html

Meeting;[36] however, many of these Special Meeting bylaws require 25 percent or more of the company's share ownership to request a Special Meeting. In contrast, many institutional investors, believe that 10 percent is a more appropriate threshold recognizing that this still represents a large number of shares and share owners in most instances.

During the 2018 season, shareholders filed proposals at 68 companies to lower the requisite number of shareholders required to call a Special Meeting.[37]

A principal group of shareholders with corporate governance concerns have been instrumental in addressing this issue at numerous companies.[38] At some companies, such as United Natural Foods, Inc. and Allergan, PLC, there was no right of shareholders to call a Special Meeting prior to the proposals filed by shareholders. Prompted by shareholder support for the proposals, in 2013 at Allergan and 2014 at United Natural Foods, the companies adopted bylaws that allow 25 percent of shareholders to call a Special Meeting. These efforts have had a broad impact on corporate governance throughout the marketplace. According to Institutional Shareholder Services Inc. (ISS):

> Since 2010, shareholders have voted on 183 proposals to adopt the right to call a special meeting, and 48 of these proposals received the support of majority of votes cast, with an average support rate of 43% of votes cast.

ISS also notes:

> Since 2008, the percentage of S&P 500 firms giving shareholders the right to call a special meeting has increased from 41% to 67%.[39]

In the 2018 proxy season, average support for these proposals to lower the thresholds has been roughly 41percent support, while seven proposals received majority votes.[40] Despite, or perhaps because of, the sweeping success of these Special Meeting proposals, a number of companies sought SEC support in 2018 for exclusion of the proposals. The most frequently used method of blocking votes on these proposals was to attempt to substitute a management proposal that would ratify the existing 25 percent threshold, and to claim that the existence of the management proposal represented a "conflicting" proposal, such that the shareholder proposal could be excluded.

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[36] https://corpgov.law.harvard.edu/2016/09/02/special-meeting-proposals-2/

"As of June 30, 2016, 295 companies in the S&P 500 already provided their shareholders with the right to call a special meeting outside of the usual annual meeting, as compared with 286 companies at this time last year. Among companies in the Russell 3000, approximately 1,300 provide their shareholders with the right to call special meetings."

[37] https://www.issgovernance.com/file/publications/early-look-us-proxy-season-trends.pdf?elqTrackId=7846f924a48945b3a09d4b10a6fcbde9&elq=5b1e2a2f47614e91be34274828a71922&elqaid=1192&elqat=1&elqCampaignId

[38] John Chevedden, James McRitchie, Myra Young, and Kenneth Steiner.

[39] https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf?elqTrackId=607d7315a2944ad5ba8c985c962ab84d&elq=f2c0137114f44df4b9287db6d4e4fb5d&elqaid=1083&elqat=1&elqCampaignId= (15).

[40] Webinar, Latham and Watkins, "2018 Proxy Season: Lessons Learned and Coming Attractions". June 19, 2018.

The "conflicting proposal" rule does not exist to provide an avenue for management to develop after-the-fact "counterproposals" solely for the purpose of excluding properly submitted shareholder proposals.[41] During the 2018 season, Staff seemingly surrendered to this form of company gamesmanship by excluding shareholder proposals. Although two early decisions in the season simply allowed companies to exclude the proposals,[42] six later decisions added a requirement that the company include information in the proxy noting:

> Accordingly, we will not recommend enforcement action to the Commission if the Company omits the Proposal from its proxy materials in reliance on rule 14a-8(i)(9), provided that the Company's proxy statement discloses, consistent with rule 14a-9:
>
> - that the Company has omitted a shareholder proposal to lower the ownership threshold for calling a special meeting,
> - that the Company believes a vote in favor of ratification is tantamount to a vote against a proposal lowering the threshold,
> - the impact on the special meeting threshold, if any, if ratification is not received, and the Company's expected course of action, if ratification is not received.[43]

This new approach[44] of allowing after-the-fact company ratifications to displace properly submitted shareholder proposals (even with a modicum of disclosure regarding the proposal displaced) has directly undermined the established ownership right of shareholders to file proposals for inclusion in the proxy. Ratification of the status quo in lieu of a shareholder's proposal, besides being unnecessary, means that shareholders only ever hear management's side of an issue, and undermines the ability of shareholders to request specific reforms. Voting on watered down ratification proposals eliminates the possibility of robust debate on the merits of an issue. As a precedent it invites additional corporate gamesmanship, which is highly problematic.

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[41] *Cypress Semiconductor Corp*. (March 11, 1998) denying exclusion under 14a-8(c)(9): "[S]taff notes that it appears that the Company prepared its proposal on the same subject matter in *or* significant part in response to the Mercy Health Services proposal." *Genzyme Corporation* (March 20, 2007) denying exclusion under 14a-8(i)(9). "[W]e note your representation that you decided to submit the company proposal on the same subject matter to shareholders, in part, in response to your receipt of the AFL-CIO Reserve Fund proposal."

[42] *AES Corporation* (December 19, 2017), *CF Industries Holdings, Inc*. (January 30, 2018).

[43] *eBay Inc.* (February 26, 2018), *Capital One Financial Corporation* (February 21, 2018), *ITT Inc.* (February 22, 2018), *Skyworks Solutions, Inc.* (March 23, 2018), *JPMorgan Chase & Co.* (February 26, 2018), *NetApp, Inc.* (June 26, 2018).

[44] Examples of prior Staff decisions declining to apply the rule to exclude a proposal based on a company's attempt to game the system include *Cypress Semiconductor Corp*. (March 11, 1998) denying exclusion under 14a-8(c)(9): "[S]taff notes that it appears that the Company prepared its proposal on the same subject matter in or significant part in response to the Mercy Health Services proposal." *Genzyme Corporation* (March 20, 2007) denying exclusion under 14a-8(i)(9). "[W]e note your representation that you decided to submit the company proposal on the same subject matter to shareholders, in part, in response to your receipt of the AFL-CIO Reserve Fund proposal."

Former Securities and Exchange Commission chair Mary Jo White noted that this gamesmanship was a possibility that the Staff should be attentive to preventing:

> In impartially administering the rule, we must always consider whether our response would produce an unintended or unfair result. Gamesmanship has no place in the process.[45]

From a shareholder rights perspective, the only time when a shareholder proposal potentially "conflicts" with a management proposal would be when two binding proposals are on the proxy, such that there would be a genuine legal conflict – i.e., where the two proposals, if both approved, would mandate legally contradictory requirements.

In contrast, most shareholder proposals are not binding but only advisory in nature, which obviates the possibility of legal conflict. In contrast, the rulings allowing companies to ratify existing policy have the effect of giving companies an assured way to block any corporate governance proposal submitted by shareholders.

This new approach of allowing company ratifications of the status quo to displace properly submitted shareholder proposals has negated shareholder rights.

There has been some discussion about whether it might possibly be confusing to have two proposals on a similar or the same topic with different outcomes, such as the management proposal to ratify the existing threshold and the shareholder's proposal to lower the threshold. There is nothing inherently confusing in the inclusion of these two proposals, as the company is free to explain how it will interpret and resolve any apparent conflict between a show of support on both proposals, should that occur.

The 2018 season included an illuminating demonstration of how this can work. At Spirit AeroSystems Holdings, Inc., a company that builds fuselages for the Boeing 737, a management proposal to ratify the existing 25 percent Special Meeting threshold appeared on the proxy alongside a shareholder proposal to lower the threshold to 10 percent. Shareholders demonstrated a decidedly strong preference to lower the threshold with 65 percent supporting the proposal to lower the threshold, while only 42 percent supported the ratification proposal.[46] It is clear that shareholders were not confused by these two proposals appearing side-by-side, so Staff should not succumb to management protestations to this effect.

In summary, the efforts underway and interpretations this season undermine the Rule's original intent, and allow the worst form of gamesmanship to supplant the shareholder right to file proposals on corporate governance.

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[45] https://www.sec.gov/news/speech/observations-on-shareholders-2015.html

[46] Shareholders voted 65 percent supported 10 percent threshold votes for: 63,795,634 votes against 33,500,429

42 percent supported 25 percent threshold votes for: 41,316, 966 votes against: 56,002,609

(5)
RECOMMENDATIONS

Restoring Shareholder Rights

The 2018 micromanagement and "conflicting proposals" rulings undermined shareholder rights and threatened to disrupt long-standing, productive relationships between investors and companies on environmental and social issues, and between small and large investors on corporate governance.

SEC guidance could reduce the need for proponents to file proposals just to find out what Staff decisions mean, and help eliminate costly "kitchen sink" arguments in no-action correspondence by companies and proponents.

1. Confirm that proposals requesting action are not considered micromanagement unless they attempt to direct the minutiae of the company's operations. Continue to recognize that investors have a practical ability to request both disclosure and action on long term business strategy on ESG matters, including goal setting and increasing the scale, pace and rigor of responses to significant policy issues.

   Delineate clear limits on the new micromanagement doctrine of excluding proposals that seek specific methods for addressing complex policies. The fact that a company has complex policies in place is not a basis for exclusion of proposals. Complex policies can also be ineffectual policies. The correct path for evaluating the adequacy of company activities as a basis for exclusion is under Rule 14a-8(i)(10) (substantial implementation) not under Rule 14a-8(i)(7).

2. Prevent the abuse of Rule 14a-8(i)(9). The rule should be limited to instances where two binding proposals could not both be legally enacted simultaneously without creating a legal conflict. Advisory proposals as a general proposition, cannot conflict with management proposals. Of particular concern is recent gamesmanship by companies in which they introduced "conflicting proposals" that merely ratified the "status quo". There should be a rebuttable presumption against a "conflict" when management seeks ratification of an existing policy.

Reducing Inefficiencies and Uncertainties

Staff Legal Bulletin 14I increased uncertainty and encouraged boards of directors to waste resources asserting that their firms were exceptions to the general understanding of significance of many categories of proposals and policy issues. It encouraged all parties to make "kitchen sink" arguments that drove up companies' and investors legal costs.

3. Provide additional detail in staff no-action decisions, concisely applying the decision-making rule to the facts and language of the proposal to clarify the decisive issues in each decision for both proponents and companies. This practice could eliminate guesswork and reduce the need for proponents to file proposals to seek clarification of the decisions, and for "kitchen sink" arguments in no-action correspondence by companies and proponents.

4. Identify categories of proposals in which Board of Directors "findings" tend to be less relevant to determination of significance for purposes of Rule 14a-8(i)(7) and Rule 14a-8(i)(5). We would recommend that these include instances where the Board of Directors is in no better position than proponents or the Staff to assess significance to shareholders, such as where a proponent has documented that:

    - The company's externalities can impose portfolio-wide impacts;
    - The company's activities may pose systemic risks;
    - The company has material gaps in its ESG disclosure.

5. Identify the categories of proposals that the Staff views as "governance" proposals that are exempt from relevance and significance challenges.

6. Clarify the adequacy of board submissions. Clarify the need for the board section of a no-action request to include analysis of the substance and significance of the proposal, as well as documentation regarding the content of the board process. The Staff should encourage boards to include appropriate specifics relative to their "findings," including backup data, minutes and records of board discussion, identifying any personnel or experts consulted by the board on the issue, or references to material reviewed or evaluated to reach their conclusion.

CONCLUSION

For the reasons outlined above, the members of the Shareholder Rights Group respectfully submit that these six recommendations are prudent and fully aligned with the Commission's mandate to protect and serve investors and the capital markets.

The Shareholder Rights Group welcomes the opportunity to further discuss these findings and recommendations with policymakers, including SEC Commissioners and Staff, as well as fellow investors, corporate counsel, and boards.

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March 14, 2018

via e-mail: shareholderproposals@sec.gov

Via electronic mail

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Mr. William Hinman
Director, Division of Corporation Finance
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Messrs. Clayton and Hinman,

We are writing as long-time legal practitioners in the Rule 14a-8 no-action letter process to express our concern about an apparent doctrinal shift in how the staff characterizes a proposal as engaging in micromanagement.

The recent decision in *EOG Resources, Inc.* (February 26, 2018) involved the exclusion of a form of shareholder proposal that has long been considered by the SEC staff to be acceptable and to not constitute micromanagement for purposes of Rule 14a-8(i)(7). We are concerned that this decision may signal a sharp deviation in the micromanagement doctrine, representing a significant change from prior staff letters, without providing clear guidance or justification.

Although we understand that Staff interpretations at the SEC do vary over time, they must adhere to the standards established and articulated by the Commission, specifically SEC Release No. 34-40018 (May 21, 1998) citing Exchange Act Release No. 12999 (Nov. 22, 1976). The apparent change in the staff approach to micromanagement reflected in the EOG letter appears inconsistent with these prior interpretations of micromanagement, which have been limited to excluding shareholders' efforts to manage the minutiae of the company's business rather than addressing large questions of business strategy associated with a significant policy issue.[1]

We also recognize that the EOG letter may be an anomaly. In that case, we are writing out of an excess of caution to ensure that you are aware of the importance we place on consistency in staff decision-making and, in particular, the importance of retaining staff's historic approach to

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[1] Prior decisions this season regarding the net zero greenhouse gases proposal also appeared to be a radical departure, but could be seen as an anomaly associated with that particular innovative proposal model. See, for instance, *Apple, Inc.* (Jantz), (December 21, 2017) and *Verizon Communications, Inc.* (March 6, 2018). In contrast, the model of proposal found to micromanage in the EOG decision had been found in numerous prior staff decisions to NOT entail micromanagement.

micromanagement decisions.

For decades, shareholder proponents and corporate counsel have relied upon reasonably consistent decision-making in this area, allowing us to craft our proposals and our arguments to steer clear of micromanagement. It has been our understanding that this analysis has historically focused on the form of the request, as opposed to the nature of that request. In other words, a target-setting proposal would generally be appropriate, but a target-setting proposal that specified an unreasonable timeframe for completion, or detailed specific targets with set dates, would arguably constitute micromanagement as these additional details would invite shareholders to delve too deeply into complex matters that should be reserved for management.

Since climate change is a recognized significant policy issue, the only question relevant to micromanagement for this decision should have been the form of the request, i.e., whether shareholders are seeking involvement in minutiae. The proposal in *EOG Resources, Inc.*, asking the company to set targets for greenhouse gas reduction, did not seek to engage shareholders in minutiae, but rather sought the adoption of an effective business strategy scaled to the magnitude and urgency of recognized significant policy issues facing the company and society that many other large companies are pursuing. The proposal was designed to allow management to determine appropriate targets within an appropriate timeframe. As this precise proposal has been deemed to not constitute micromanagement many times before, we are left with the conclusion that the staff's approach to micromanagement has changed.

We urge you to reject any changes to the micromanagement doctrine, which has long been a functional and reasonably predictable element of decision-making by the Staff under Rule 14a-8(i)(7). We would be pleased to discuss this with you at your convenience.

Respectfully Submitted,

Danielle Fugere, President, As You Sow
Adam Kanzer, Managing Director of Corporate Engagement, Domini Impact Investments LLC
Sanford J. Lewis, Attorney and Director, Shareholder Rights Project
Rob McGarrah, Attorney
Paul M. Neuhauser, Attorney

Cc:
David Fredrickson
Associate Director and Chief Counsel
Division of Corporation Finance

SEC Commissioners
Robert J. Jackson Jr.
Hester M. Pierce

Michael S. Piwowar
Kara M. Stein

Investor Advisory Committee
Anne Sheehan, Chairman
Director of Corporate Governance
California State Teachers' Retirement System
ASheehan@CalSTRS.com

Office of the Investor Advocate
InvestorAdvocate@sec.gov