January 27, 2020

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File S7-23-19

Dear Secretary Countryman,

The Interfaith Center on Corporate Responsibility (ICCR), a coalition of more than 300 institutional investors collectively representing over $500 billion in invested capital, appreciates the opportunity to comment on changes to the shareholder resolution process proposed by the Commission in Exchange Act Release No. 87458, "Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8" (the "Release"). Our members are a cross section of religious investors, foundations, asset managers, pension funds, and other long-term institutional investors. ICCR members have nearly 50 years of experience as pioneers in the shareholder resolution process, and our long-term engagement on environmental, social, and governance issues has brought about valuable improvements in corporate accountability and transparency. We strongly oppose the changes to Rule 14a-8 proposed in the Release (the "Proposed Amendments").

For decades, the shareholder proposal process has served as a cost-effective way for corporate management and boards to gain a better understanding of shareholder priorities and concerns, particularly those of longer-term shareholders concerned about the long-term value of the companies that they own. Engagement by ICCR members and other shareholders has served as a crucial "early warning system" for companies to identify emerging risks. The history of ICCR demonstrates literally hundreds of examples of companies changing their policies and practices in light of productive engagement with shareowners.

The Proposed Amendments would, by the Commission's own estimates, gut the existing shareholder proposal process, which has long served as a cost-effective way for shareholders to communicate their priorities and concerns, in exchange for minuscule and poorly supported benefits for companies. The Release appears to be based on a wholly unsupported assumption that shareholder proposals are simply a burden to companies and have no benefits for companies or non-proponent investors. In doing so, the Release completely glosses over the cost of foregone reforms, missed opportunities for engagement, and lost outside perspectives if the Proposed Amendments are adopted. The Release makes no effort to weigh those costs, which are substantial, against the alleged, meager benefits of the Proposed Amendments.

The Commission's effort to curtail shareholder rights runs directly counter to broader trends in the business and investor communities toward greater accountability to stakeholders and investor reliance on environmental, social and governance ("ESG") performance in investment and stewardship decisions. Despite these developments, the Commission is proposing to move backward, in the direction of less accountability and transparency. The Proposed Amendments are a disservice to investor interests and will, over time, increase the cost of capital for U.S. companies.

Background

In the last few years, traditional concepts of corporate purpose have been upended as both business leaders and investors recognize the dangers of negative externalities and a single-minded focus on short-term profit maximization. In August 2019, the Business Roundtable (the "BRT") issued a "Statement on the Purpose of the Corporation" articulating a "fundamental commitment" to all stakeholders, including respecting "people in our communities" and protecting the environment.[1] The BRT's Statement was signed by nearly 200 CEOs of large U.S. companies.

Leo Strine, the recently-retired Chief Justice of the Supreme Court of Delaware, wrote in late 2019 that "[t]he incentive system for the governance of American corporations has failed in recent decades to adequately encourage long-term investment, sustainable business practices, and, most importantly, fair gainsharing between shareholders and workers." To remedy that situation, he urged that "workers must be given more voice within the corporate boardroom, and top managers and directors must give greater thought to how they treat their employees."[2]

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1 Business Roundtable, "Statement on the Purpose of a Corporation" (2019) (https://opportunity.businessroundtable.org/wp-content/uploads/2019/12/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf)

2 Leo E. Strine, Jr., "Toward a Fair and Sustainable Capitalism," at 1-2 (Sept. 2019) (https://www.law.nyu.edu/sites/default/files/Fair%20and%20Sustainable%20Capitalism%20Proposal%20-%20White%20Paper_09.26.19%20FINAL.pdf)

Investors increasingly recognize the relevance of concerns once characterized as "social" or "political" to the long-term viability of the markets in which they invest. In a 2018 Edelman study of 610 global institutional investors, 98% agreed that "public companies are urgently obligated to address one or more societal issues to ensure the global business environment remains healthy," with income inequality and workplace diversity identified among the top five issues companies should address.[3]

Investment strategies that incorporate ESG issues are surging. BlackRock CEO Larry Fink recently announced that the company would undertake several initiatives to "place sustainability at the center of [its] investment approach," noting that "climate change is almost invariably the top issue that clients around the world raise with BlackRock."[4] Morningstar data shows that net flows into sustainable funds are triple those in 2018.[5] According to a survey by RBC Global Asset Management, 70% of institutional investors in Canada, the U.S. and the U.K. "apply ESG principles to investment decisions," with 53% of respondents citing mitigation of risk and higher returns as reasons for doing so.[6] Investors with over $80 trillion in assets under management have signed on to the Principles for Responsible Investment, whose members commit to incorporate ESG issues into their investment decisions.[7] Bank of America Merrill Lynch, touting ESG performance as a superior predictor of future earnings risk, recently estimated over $20 trillion in asset growth in ESG funds over the next 20 years.[8] In this context, the Commission's effort to cut off communication about ESG matters is particularly wrongheaded.

This Comment first addresses the overall costs and benefits of the Proposed Amendments, making the case that the Commission has not fulfilled its obligation to identify, discuss, analyze and balance the likely costs and benefits of the Proposed Amendments. We then comment specifically on the proposed changes to the ownership threshold, resubmission thresholds and other procedural requirements.

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[3] "Edelman Trust Barometer: Special Report: Institutional Investors," at 14 (2019) (

[4] https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

[5] Leslie P. Norton, "Sustainable Funds Set to See a 'Tsunami' of New Capital," *Barron's* (Nov. 19, 2019) (https://www.barrons.com/articles/sustainable-funds-set-to-see-a-tsunami-of-new-capital-51574254801?mod=article_inline)

[6] Hazel Bradford, ""70% of Institutional Investors Apply ESG to Investment Decisions—Survey," *Pensions & Investments*, Oct. 16, 2019 (https://www.pionline.com/esg/70-institutional-investors-apply-esg-investment-decisions-survey)

[7] Robert G. Eccles & Svetlana Klimenko, "The Investor Revolution," *Harvard Business Review*, May-June 2019 (https://hbr.org/2019/05/the-investor-revolution)

[8] Bank of America Merrill Lynch, "ESG Matters—US; 10 Reasons You Should Care About ESG" (Sept. 23, 2019) (https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID19_1119/esg_matters.pdf?mod=article_inline)

The Costs and Benefits of the Proposed Amendments

The Commission is required to analyze the economic impact of a proposed rule and potential alternatives, and a rigorous cost-benefit analysis is a key part of that process.[9] We agree with Commissioner Robert J. Jackson, Jr., who stated in his dissent from the Commission's approval of the Release that "careful, data-driven analysis of these questions, rather than resort to ideological intuition, is especially important in the hotly contested area of balancing the power of corporate insiders and investors."[10]

The Release's economic analysis falls far short. Because the financial benefits of the Proposed Amendments are small, their potential costs need not be large to tip the balance away from adoption. Even by the Commission's own estimates, the potential impact on the number of shareholder proposals is substantial—roughly a 37% drop--and the Release does not analyze costs associated with that loss. Instead, it dismisses the value-promoting corporate reforms and communication that will not occur, and ignores other negative consequences of a drastic reduction in proposals. Such a cursory examination of costs does not satisfy the Commission's obligation to clearly define the baseline for evaluating the economic impact of the Proposed Amendments and analyze the costs and benefits of adopting them, as required by the 2012 Guidance.

The neglect of potential negative effects on investors is especially concerning in light of the emphasis placed on a handful of comment letters, ostensibly from individual investors, pressing the Commission to regulate proxy advisors. Chairman Clayton cited those letters at the open meeting where the Commission approved the Release, stating that the investors, "including an Army veteran and a Marine veteran, a police officer, a retired teacher, a public servant, a single Mom, and a couple of retirees who saved for retirement," expressed concern that their retirement funds were "being steered by third parties to promote individual

[9] Memorandum to Staff of the Rulewriting Divisions and Offices from the Division of Risk, Strategy and Financial Innovation and Office of General Counsel re: Current Guidance on Economic Analysis in SEC Rulemaking, at 1 (Mar. 16, 2012) https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf ("2012 Guidance").

[10] Commissioner Robert J. Jackson, Jr., "Statement on Proposals to Restrict Shareholder Voting," fn.15 (Nov. 5, 2019) (https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting#_ftnref13) (citing Commissioner Paul S. Atkins, *Shareholder Rights, the 2008 Proxy Season, and the Impact of Shareholder Activism* (remarks at the U.S. Chamber of Commerce, July 2008) (correctly noting that "[c]ritical thinking about costs and benefits ought to be at the center of the Commission's regulatory philosophy" in the context of proposed reforms to the rules addressed in today's release)).

agendas."[11] These letters, it turned out, were generated by an advocacy group underwritten by companies pushing to curtail shareholders' rights to submit proposals and to regulate proxy advisors, and were submitted by relatives of the group's staffers and others with connections to the group, some of whom disclaimed knowledge of the letters they signed or said they allowed the group to use their names on letters the group had written.[12]

These letters were used to obscure the fact that calls for change in the shareholder proposal process have come not from investors, but from issuers and their representatives.[13] A similar emphasis on company, rather than investor, interests permeates the Release. We urge the Commission to focus on the interests of investors by using data to examine the "hotly contested area" of Rule 14a-8 rather than falling back on partisan innuendo about abuse of the process and the burdens imposed by the rule.

<u>The Benefits Lost From Sharply Curtailing the Shareholder Proposal Process</u>

The Commission glosses over the negative consequences of the Proposed Amendments, which by the Commission's own estimates would reduce the number of shareholder proposals by approximately 37%. The Release glancingly mentions, "To the extent that [newly excludable] shareholder proposals would be value-enhancing, the potential exclusion of value-enhancing proposals could be detrimental to companies and their shareholders."[14] The Commission notes in passing that benefits of such proposals could include limitation of management entrenchment and communication of shareholder views[15] but does not discuss studies showing the financial impact of such entrenchment.

More broadly, the Commission does not discuss the extensive academic literature on the link between ESG and corporate performance, nor does it analyze whether the meager benefits discussed in the previous section outweigh the potential costs of excluding value-enhancing proposals, which are substantial. The Release also ignores important functions served by Rule 14a-8, which would be impaired by the Proposed Amendments—shareholder communication and the "early warning" of

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[11] Statement of Chairman Jay Clayton on Proposals to Enhance the Accuracy, Transparency and Effectiveness of Our Proxy Voting System" (Nov. 5, 2019) (https://www.sec.gov/news/public-statement/statement-clayton-2019-11-05-open-meeting).

[12] Zachary Mider & Ben Elgin, "SEC Chairman Cites Fishy Letters in Support of Policy Change," Bloomberg (Nov. 19, 2019) (https://www.bloomberg.com/news/articles/2019-11-19/sec-chairman-cites-fishy-letters-in-support-of-policy-change)

[13] <u>Contrast</u> Roundtable comments cited in fn. 19 of the Release supporting increases in the ownership and resubmission thresholds, all of which came from companies or their organizations, <u>with</u> Roundtable comments cited in fn.20 of the Release opposing such changes, which came from a mix of investors, their organizations, individuals and anonymous.

[14] Release, at 141.

[15] Release, at 112.

emerging issues and risks provided by outside perspectives. Finally, without evidence, the Commission minimizes the role of the shareholder proposal process in spurring dialogue, which is wholly inconsistent with the long experience of ICCR members.

Loss of Value-Enhancing Governance, Policy and Disclosure Changes

The Release depicts the shareholder proposal process as a vehicle by which proponents burden companies in the pursuit of self-serving and value-destroying goals. That portrayal is at odds with empirical evidence and the extensive experience of ICCR members.

The shareholder resolution process has driven innumerable value-enhancing corporate governance, policy and disclosure changes through private ordering. Abundant evidence supports the positive effect on firm value and corporate performance of superior ESG performance. A 2018 Bank of America study "found that firms with a better ESG record than their peers produced higher three-year returns, were more likely to become high-quality stocks, were less likely to have large price declines, and were less likely to go bankrupt.[16] Deutsche Asset & Wealth Management and researchers from the University of Hamburg surveyed the academic literature and found that 62.6% of meta-analyses showed a positive relationship between ESG and corporate financial performance.[17] A 2010 study found that shareholder proponents target "firms that both underperform and have generally poor governance structures" and concluded that the evidence did not support the claim that proponents "pursue self-serving agendas."[18]

More specifically, empirical studies have found a consistent negative relationship between governance arrangements insulating boards from shareholder influence ("entrenching" arrangements), which are often the subject of shareholder proposals, and company performance.[19] An influential 2003 study found that companies whose

[16] Robert G. Eccles & Svetlana Klimenko, "The Investor Revolution," *Harvard Business Review*, May-June 2019 (https://hbr.org/2019/05/the-investor-revolution)

[17] Gunnar Friede et al., "ESG and Corporate Financial Performance: Mapping the Landscape," p.7 (Dec. 2015) (https://institutional.dws.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf)

[18] Luc Renneboog & Peter G. Szilagyi, "The Role of Shareholder Proposals in Corporate Governance," at 16, 20-21 (July 2010) (https://edwards.usask.ca/centres/csfm/_files/papers2010/3b-The%20Role%20of%20Shareholder%20Proposals%20in%20Corporate%20Governance,%20L.%20Renneboog%20and%20P.%20Szilagyi.pdf)

[19] We recognize that these conclusions have been vigorously contested, see, e.g., Martijn Cremers & Simone M. Sepe, "Board Declassification Activism: Why Run Away From the Evidence" (2017) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2991854), but given the amount of scholarly attention devoted to the impact of entrenching governance arrangements,

governance provisions provided the strongest shareholder rights and lowest management power, as measured using a governance index sometimes referred to as the "G Index," outperformed those with the weakest shareholder rights and highest management power by a statistically significant 8.5% per year. Weaker shareholder rights were also associated with lower profitability and sales growth.[20] Similar results were obtained in a more recent study using the G-Index over a longer time period.[21]

Classified boards are associated with lower firm value and less performance-sensitive compensation.[22] Another study found that five specific entrenching governance arrangements, dubbed the "E-Index," are associated with lower firm value.[23] In a later study, performance on the E-Index was not correlated with stock market performance, consistent with the theory that the market was beginning to incorporate information about the impact of entrenching governance arrangements into prices, though correlations with firm value and operating performance persisted.[24]

Strong evidence also supports the effect on performance of ESG policies and practices not related to entrenchment. Diversity and inclusion, for example, has been found to reduce risk and improve financial performance. A Bank of America Merrill Lynch study "found that companies with high scores on gender/diversity measures, including board diversity, women in management and company policies on diversity/inclusion, generally saw lower subsequent price and EPS volatility and higher subsequent returns on equity than those with low scores."[25] Companies with one or more women on boards delivered higher average returns on equity, lower leverage, better average growth and higher price/book value multiples in a six-year Credit Suisse Research Institute study of 2,360 global companies.[26] Corporate leadership in the top quartile for racial and ethnic diversity was associated with 35

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and the relevance of that research to the wisdom of limiting shareholder proposal rights, we would expect the Commission to analyze this literature and articulate a view on it.

[20] Paul Gompers et al., "Corporate Governance and Equity Prices," Quant. J. Econ., 118(1), 107-155 (Feb. 2003) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=278920)

[21] Martijn Cremers & Allen Ferrell, "Thirty Years of Shareholder Rights and Firm Valuation" (2013) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1413133)

[22] Olubunmi Faleye, "Classified Boards, Firm Value, and Managerial Entrenchment," 83 J. F. Econ. 501 (2007) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=877216)

[23] Lucian Bebchuk et al., "What Matters in Corporate Governance," Rev. Fin. Stud., Vol. 22, No. 2, 783-827 (Feb. 2009) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=593423)

[24] Lucian Bebchuk et al., "Learning and the Disappearing Association Between Governance and Returns," J. Fin. Econ., Vol. 108, No. 2, 323-348 (May 2013) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1589731)

[25] See https://newsroom.bankofamerica.com/system/files/2019_Environmental_Social_Governance.pdf

[26] Credit Suisse, "Does Gender Diversity Improve Performance?" Jul. 31, 2012 (https://www.credit-suisse.com/us/en/about-us/research/research-institute/news-and-videos/articles/news-and-expertise/2012/07/en/does-gender-diversity-improve-performance.html)

percent higher likelihood of financial returns above their national industry median in a 2015 McKinsey study.[27] Shareholder proposals aimed at improving diversity and inclusion are thus likely value-enhancing.

Ignoring this literature without explanation, the Release focuses on event studies of share price reactions to the shareholder proposal process. This treatment is inconsistent with the 2012 Guidance, which states, "Where the Commission is giving greater weight to some empirical evidence/studies than to others, it should clearly state the reason(s) for doing so."[28] The Commission explains that its review of studies focuses on "short-term market reactions to shareholder proposals" because long-term effects are more difficult to attribute to proposals. But shareholder proposals are not intended or designed to benefit short-term traders in the company's shares; instead, they promote changes that enhance value over the long term. Indeed, the Release emphasizes the importance of a long-term orientation in justifying longer ownership duration requirements. The value of the proposal process should not be measured by reference to short-term share price reactions.

Another shortcoming of stock price event studies is that they reflect only market participants' expectations about the implications of particular proposal-related developments, which may be incorrect. It can be difficult to identify the most meaningful event to use in event studies and the appropriate inferences to draw. For example, reactions to majority votes may reflect beliefs about the likelihood (and not just the desirability) of implementation. Share price reactions on the day of a shareholder proposal vote may reflect market participants' beliefs about other matters on the ballot at that meeting, such as director elections and approval of executive compensation arrangements.[29] A negative reaction to a proposal filing by an institutional investor may stem from the market's supposition that management has resisted the investor's private overtures, perhaps suggesting inflexibility or entrenchment, rather than a negative view of the proposal's subject matter.[30]

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[27] Vivian Hunt, Dennis Layton & Sara Prince, "Diversity Matters," McKinsey & Company, Feb. 2, 2015 (http://www.diversitas.co.nz/Portals/25/Docs/Diversity%20Matters.pdf); see also Guido Giese, "Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, and Performance," J. Portfolio Mgmt., at 4-5 (July 2019) (https://www.msci.com/documents/10199/03d6faef-2394-44e9-a119-4ca130909226) (finding that high ESG-rated companies paid higher dividends, earned more profits, and had fewer "idiosyncratic risk incidents" involving large stock price drops).

[28] 2012 Guidance, at 14.

[29] Given that companies do not have to disclose vote results until several days after a shareholder meeting, share price movements on the meeting day may not incorporate information about such results.

[30] See Andrew Prevost & Ramesh Rao, "Of What Value Are Shareholder Proposals Sponsored by Public Pension Funds," J. Business (Apr. 2000) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=178912)

Longer-term benefits of shareholder engagement have been identified in the academic literature. A 2018 study of global engagements primarily on environmental and social issues found that successful engagements led to higher sales growth and that successfully engaged firms with low ESG scores prior to engagement had statistically significant excess cumulative abnormal returns compared with similar non-engaged firms in the year following closure of the engagement. The study also found "no evidence that targets are negatively affected by the activism."[31]

That federal and state legislation and regulations have incorporated ideas proposed in shareholder resolutions reinforces their value. For example, the shareholder advisory vote or "say on pay" required by the Dodd-Frank Wall Street Reform and Consumer Protection Act and implemented by Commission regulation[32] was introduced in the U.S. through shareholder proposals first submitted in 2007.[33] Before the Commission and stock exchanges adopted independence requirements for boards and key committees, shareholders used the shareholder proposal process to urge companies to adopt those practices.[34]

ICCR members have achieved many valuable ESG improvements through the shareholder resolution process. Recent examples include:[35]

- Christian Brothers' shareholder proposal persuaded Sanderson Farms to adopt a proxy access bylaw.
- A resolution filed by Friends Fiduciary prompted Western Digital to agree to adopt a comprehensive global human rights policy and publish human rights due diligence metrics.
- Proposals by ICCR members at Atrion, Cambrex, IQVIA, Ligand Pharmaceuticals and Wisdom Tree led to strengthened board diversity commitments, and IQVIA and Ligand added diverse board members within one month of the agreements.
- Private prison operator CoreCivic agreed, after receiving a proposal from SEIU and the Jesuits, to incorporate respect for inmate and detainee human rights into senior executive incentive compensation metrics.

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[31] Tamas Barko et al., "Shareholder Engagement on Environmental, Social, and Governance Performance" (Sept. 2018) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977219)

[32] See https://www.sec.gov/news/press/2011/2011-25.htm

[33] See Paul Hodgson, "A Brief History of Say on Pay," *Ivey Business Journal*, Sept./Oct. 2009 (https://iveybusinessjournal.com/publication/a-brief-history-of-say-on-pay/)

[34] See https://corpgov.law.harvard.edu/2019/02/06/the-long-view-the-role-of-shareholder-proposals-in-shaping-u-s-corporate-governance-2000-2018/

[35] See https://www.iccr.org/sites/default/files/page_attachments/catalyzing_corporate_change_2019_10.17.19.pdf; https://www.iccr.org/sites/default/files/iccr_-_catalyzing_corporate_change_2018_073018.pdf

- Mercy Investments' shareholder proposal convinced U.S. Steel to set quantitative, science-based greenhouse gas emission reduction targets.
- The Sisters of St. Francis of Philadelphia's proposal led ConocoPhillips to return to in-person annual meetings.

Contrary to one of the governing assumptions of the Release—that success requires majority shareholder voting support—nearly all of the reforms listed above were achieved following votes that did not reach majority support or without the need to go to a vote at all. ICCR members' experience has shown that approximately one-third of filed resolutions result in settlements, making voting support an inappropriate yardstick for measuring success.

An indirect value of the shareholder proposal process receives no attention in the Release. The possibility of receiving a shareholder proposal may influence companies to maintain more accountable governance structures, especially where high-profile proposal initiatives on an issue are under way. For instance, as proponents began submitting proxy access shareholder proposals, some companies proactively adopted proxy access bylaws. Similarly, majority voting for director elections was implemented by some companies that were not targets of a shareholder proposal campaign on the issue in order to "be seen by shareholders to be proactive."[36] In this way, the impact of the shareholder proposal process extends beyond the universe of companies that receive proposals.

Shareholder resolutions can also lead to enhanced ESG disclosure by companies. Whether or not they are following explicitly ESG strategies, investors increasingly say they want and use data on companies' ESG performance. Dutch pension fund ABP requires portfolio managers to evaluate ESG factors for every investment.[37] Generation Investment Management "uses ESG data sources as part of its fundamental investment process" but wishes more contextual ESG data were available.[38] Robust ESG data is necessary for sophisticated climate hedging strategies like decarbonized equity indexes.[39]

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[36] See https://www.dorsey.com/newsresources/publications/client-alerts/2016/12/recent-developments-in-proxy-access; https://www.davispolk.com/files/2015-02-18_Proxy_Access_a_Decision_Framework.pdf; https://www.complianceweek.com/majority-vote-lite-companies-adopt-modified-policies/6961.article

[37] Robert G. Eccles & Svetlana Klimenko, "The Investor Revolution," *Harvard Business Review*, May-June 2019 (https://hbr.org/2019/05/the-investor-revolution)

[38] Julie Segal, "Who Says You Can't Trust ESG Data? One of the Biggest Names in ESG," Institutional Investor, Dec. 5, 2019 (https://www.institutionalinvestor.com/article/b1j9y9f2p1hr7s/Who-Says-You-Can-t-Trust-ESG-Data-One-of-the-Biggest-Names-in-ESG)

[39] Mats Andersson et al., "Hedging Climate Risk," *Financial Analysts Journal*, Vol. 72, No. 3 (2016) (https://www0.gsb.columbia.edu/faculty/pbolton/papers/faj.v72.n3.4.pdf)

Filling the gaps between disclosure mandated by the Commission and the ESG information investors need has depended on the shareholder resolution process.[40] ICCR members have obtained enhanced disclosure of ESG information by numerous companies through that process. Recent examples include:[41]

- Twelve companies, including Endo and Cardinal Health, published reports on oversight of risks related to the opioid crisis following receipt of shareholder proposals from ICCR members and other participants in Investors for Opioid Accountability.[42]
- Alkermes, Cambrex, Kaiser Aluminum and Booking Holdings agreed to track and report on environmental and sustainability issues as a result of resolutions filed by Trillium, Pax World Mutual Funds, and Zevin Asset Management.
- A proposal filed by Arjuna Capital and As You Sow persuaded Dominion Resources to commit to disclosing methane intensity information.
- WEC Energy Group and CMS Energy agreed to produce reports on how their business plans align with the Paris Climate Agreement goal of limiting global average temperature rise to under 2 degrees Celsius, following receipt of proposals from School Sisters of Notre Dame and Sisters of the Presentation, respectively.
- AT&T, JPMorgan Chase, and IBM, spurred by shareholder proposals submitted by Walden Asset Management, agreed to significantly improve their lobbying disclosures.

Outside Perspective or "Early Warning"

Cognitive biases and blind spots can keep boards from appreciating risks and opportunities, and shareholder resolutions can serve as a kind of "early warning" system by bringing outside perspectives on such matters to boards' attention. Goldman Sachs recently acknowledged this function served by resolutions, stating

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40 See, e.g., Virginia Harper Ho, "Nonfinancial Risk Disclosure and the Costs of Private Ordering," Am. Bus. L. J., Vol. 55, Issue 3, 407-474 (Fall 2018) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3108363); Sarah C. Haan, "Shareholder Proposal Settlements and the Private Ordering of Public Elections," Yale L. J., Vol. 126, Issue 2, 262-344 (2016) (https://www.yalelawjournal.org/article/shareholder-proposal-settlements-and-the-private-ordering-of-public-elections).

41 See https://www.iccr.org/sites/default/files/page_attachments/catalyzing_corporate_change_2019_10.17.19.pdf; https://www.iccr.org/sites/default/files/iccr_-_catalyzing_corporate_change_2018_073018.pdf

42 Investors for Opioid Accountability, *Two-Year Progress Report*, at 12 (https://www.iccr.org/sites/default/files/page_attachments/ioa_two_year_summary_report.pdf)

that "shareholder resolutions can offer additional insight into emerging material risks and externalities for issuers."[43]

Over the years, ICCR members have sounded the alarm many times about risks or opportunities that were later understood by the investment community as having significant impact on long-term value. Members submitted proposals on predatory lending in the subprime market as early as 2000, asking for stronger board oversight, but the Staff of the Division of Corporation Finance allowed exclusion on ordinary business grounds. Again in 2007, as problems mounted in the housing market, members filed resolutions at financial institutions asking for disclosure of risks associated with the "mortgage securities crisis," but the Staff deemed the subject—"evaluation of risk"—to be ordinary business. The ensuing financial crisis, precipitated in large part by mortgage-backed securities, confirmed that risks associated with subprime lending had not been fully priced into those securities, nor had those risks been appreciated by organizations hired to assign ratings to those securities.

Likewise, ICCR members were among the shareholders that flagged climate change as a risk for companies as early as 1991. Although early proposals received low levels of support, as awareness has grown of the potentially catastrophic impact of climate change on companies and the broader investing environment, proposals seeking climate-related disclosure have received majority support. Large asset managers have now recognized the centrality of climate change to companies and investing: BlackRock's Fink recently wrote in his annual letter to CEOs:

> Climate change has become a defining factor in companies' long-term prospects. Last September, when millions of people took to the streets to demand action on climate change, many of them emphasized the significant and lasting impact that it will have on economic growth and prosperity – a risk that markets to date have been slower to reflect. **But awareness is rapidly changing, and I believe we are on the edge of a fundamental reshaping of finance**.[44] (emphasis in original)

Finally, nearly 20 years ago ICCR members began identifying human rights violations as a risk for companies, and shareholder resolutions led companies such as Coca-Cola, HP, Ford and The Gap to adopt human rights policies and supply chain codes of conduct.[45] More recently, ICCR promulgated three pillars for

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[43] Derek Bingham et al., "Shareholder Engagement in the Age of Transparency" (Goldman Sachs Equity Research) (June 12, 2019) (https://www.eticanews.it/wp-content/uploads/2019/06/Shareholder-engagement-in-the-age-of-transparency-1.pdf)

[44] https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

[45] https://www.churchpublishing.org/contentassets/6b43e41ba21b4187af645d0a7419f45e/faithful-investing_history-of-iccr.pdf

companies to use as a framework to avoid trafficking and forced labor when labor brokers or recruiters are used: no fees paid by workers, freedom of movement (i.e., no confiscation of passports), and written employment contracts. The pillars were introduced in 2014 through shareholder proposals and ongoing dialogues with companies that had received earlier proposals addressing human rights, which led to a multi-stakeholder roundtable and incorporation of the "no worker-paid fees" framework into the Electronic Industry Citizenship Coalition's (now "Responsible Business Alliance's") code of conduct.

Communication

Rule 14a-8 helps to mitigate the collective action problem resulting from widely dispersed shareholdings in public companies by providing a cost-effective mechanism for proponents to communicate with fellow shareholders and for shareholders as a group to communicate with management through votes on proposals.[46] Then-Senator Christopher Dodd lauded shareholder proposals as providing an "essential democratic shareholder right to speak to each other."[47]

The Commission has previously recognized the value of this communication function, which is not dependent on the level of voting support achieved. In the 1998 Release, the Commission declined to raise the threshold beyond $2,000 "in light of Rule 14a-8's goal of providing an avenue of communication for small investors."[48] An advantage of the shareholder proposal process is its clarity; as one academic put it, the communication of shareholder expectations to management is "harder to overlook or misinterpret than stock market performance."[49]

The Release admits that the Proposed Amendments "could increase companies' ability to exclude certain proposals, which could restrict proponents' ability to use this avenue to communicate with other shareholders" or with management, and deter the filing of particular kinds of proposals.[50] Proponents are not the only shareholders whose communication ability would be affected by the Proposed Amendments. Non-proponent shareholders would lose the ability to communicate their views to management using the voting process if the Proposed Amendments are adopted. Some large shareholders may refrain from filing proposals due to business or regulatory considerations, but nonetheless value the opportunity to support proposals filed by others. The Release asks whether larger shareholders

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[46] Alan R. Palmiter, "The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation," 45 Ala. L. Rev. 879, 901 (1994) (https://wakespace.lib.wfu.edu/handle/10339/26139)
[47] "Dodd Stands Up for Shareholder Rights" (Nov. 1, 2007) (https://www.banking.senate.gov/newsroom/minority/dodd-stands-up-for-shareholder-rights)
[48] Exchange Act Release No. 40018 (May 21, 1998)
[49] Patrick J. Ryan, "Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy," 23 Ga. L. Rev. 97, 112 (1988) (https://heinonline.org/HOL/LandingPage?handle=hein.journals/geolr23&div=10&id=&page=)
[50] Release, at 142.

would begin submitting proposals if the ownership threshold is raised, and we believe that is unlikely to happen. Building a stewardship capacity takes time and resources, and some larger shareholders are deterred from submitting proposals by business and/or regulatory considerations.[51]

Cost of Capital

In addition to investor protection, the Commission must consider the impact on competition, efficiency and capital formation when it engages in rulemaking.[52] Although small cost savings and reduced accountability to shareholders may be appealing to companies, over the longer term we believe that the degradation of ESG performance that will likely result from a significant weakening of the shareholder resolution process will raise companies' cost of capital.

Academic studies lend support for our conclusion. Companies with better corporate social responsibility performance had lower costs of equity capital in a 2011 study, which identified improved employee relations, environmental policies and product strategies as specific drivers.[53] A more recent study by MSCI analyzed the impact of changes in ESG ratings and concluded that improved ESG performance is causally related to lower cost of capital.[54] In surveys, a substantial proportion of institutional investors have indicated that they are willing to pay a significant premium for well-governed companies.[55]

In his recent CEO letter, BlackRock's Fink recognized the relationship between ESG performance and cost of capital. He opined, "Over time, companies and countries that do not respond to stakeholders and address sustainability risks will encounter growing skepticism from the markets, and in turn, a higher cost of capital."[56] The Release does not mention this possibility or weigh it against the modest cost savings the Commission projects.

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[51] For example, some commentators have suggested that asset managers using passive strategies in a competitive market might not be able to justify expending additional resources on value-enhancing activism because resulting gains would be shared with competitors using the same strategy.

[52] See 15 U.S.C. section 78c(f).

[53] Sadok El Ghoul, "Does Corporate Social Responsibility Affect the Cost of Capital?" J. Banking & Fin., Vol. 35, Issue 9, 2388-2406 (2011) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1546755)

[54] Guido Giese, "Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, and Performance," J. Portfolio Mgmt., at 10-11 (July 2019) (https://www.msci.com/documents/10199/03d6faef-2394-44e9-a119-4ca130909226)

[55] See http://www.eiod.org/uploads/Publications/Pdf/II-Rp-4-1.pdf; http://www.qualified-audit-partners.be/user_files/ITforBoards/GVCR_McKinsey-Coombes_Paul___Watson_Mark_Three_surveys_on_corporate_governance_2000.pdf; http://www.theiafm.org/publications/244_Investor_Perspectives_Corp_Governance.pdf

[56] https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter

The Indispensability of Rule 14a-8

The 14a-8 process is necessary to achieve all of the benefits discussed above. The Release implies that dialogue between shareholders and companies, and the resulting reforms, have become decoupled from the 14a-8 process due to technology and company willingness to engage: "Much has changed since the Commission last considered amendments to Rule 14a-8, including the level and ease of engagement between companies and their shareholders. For instance shareholders now have alternative ways, such as through social media, to communicate their preferences to companies and effect change."[57]

We emphatically do not believe that avenues of communication other than the 14a-8 process have become more available or effective in facilitating communication regarding governance, policy and disclosure reforms.[58] While Twitter may be an effective avenue for complaining about subpar customer service, it does not allow aggregation of shareholder preferences or accommodate discussions about complex subjects of the type raised in shareholder proposals.

In ICCR members' experience, while some companies are willing to engage without the filing of a proposal, others are unresponsive to informal overtures such as letters, agreeing to talk only after a proposal submission and, in some cases, an unsuccessful no-action request. Moreover, the possibility of a filing operates in the background and likely motivates at least some of the companies that do not require a proposal filing to engage.

In sum, the Release does not adequately identify or analyze the benefits of the shareholder proposal process, which is an indispensable element of the cost-benefit analysis it must perform. The 2012 Guidance provides that discussion of costs and benefits must be evaluated "even-handedly and candidly,"[59] The Release falls short of that standard.

<u>The Vanishingly Small Financial Benefits of the Proposed Amendments for Companies</u>

The Release estimates the annual financial benefits for <u>all</u> Russell 3000 companies of the higher ownership thresholds and one-proposal rule for representatives as between \$1.4 million and \$70.6 million[60] and the savings from the higher

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[57] Release, at 18.
[58] <u>See</u> Release, Question 14, at 28.
[59] 2012 Guidance, at 14.
[60] Release, at 137-138.

resubmission thresholds at between $3.1 million and $8.9 million, for a total savings of from $4.5 million to $79.5 million.[61]

Before discussing the shortcomings of the data on which those estimates are based, it is worth noting how insignificant even the high end of that range is, in the context of Russell 3000 companies. The Russell 3000 index is made up of 3,020 companies with market capitalizations ranging from $152.3 million to $974.2 billion, weighted by market capitalization.[62] The average Russell 3000 company, then, can expect to enjoy annual cost savings of between $1,490.07 and $26,324.50 as a result of the Proposed Amendments.

Analyzing large and small Russell 3000 companies puts these savings in perspective. Microsoft, a larger constituent at 3.575% of the index,[63] had 2018 net income of $16.571 billion, and would thus stand to save .000159% of its net income if the Proposed Amendments are adopted. Even a small company like Titan International, whose shares make up only .001 of the index, would enjoy cost savings equal to only .2% of its $13.05 million 2018 net income, and a company of that size would rarely receive a proposal.[64] The average Russell 3000 company receives one shareholder proposal every 7.7 years,[65] so indirect costs are not substantial, though they are likely to be higher for the largest companies, which receive more proposals. Large companies, however, are better able to absorb such costs. All told, the estimated financial benefits of the Proposed Amendments are little more than a rounding error, and it is extremely unlikely that they "could be a positive factor in the decision of firms to go public," as the Release suggests, without support.[66]

Unreliable Data on Company Cost Savings

There is good reason to be skeptical of the data underlying the cost savings estimates relied on in the Release. The Release cites several different cost estimates provided by companies or their representatives in comments on the Statement Announcing SEC Staff Roundtable on the Proxy Process (the "Roundtable"): "Two commenters cited an estimate indicating an average cost to companies of $87,000 per shareholder proposal, another commenter estimated its own cost at more than $100,000 per proposal, and a third commenter cited a cost of approximately

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61 Release, at 140.

62 https://www.ftserussell.com/research-insights/russell-reconstitution/market-capitalization-ranges

63 See https://www.ftserussell.com/analytics/factsheets/home/constituentsweights for constituent weightings.

64 See https://www.cii.org/files/10_10_Shareholder_Proposal_FAQ(2).pdf (noting that 77% of proposals received by Russell 3000 companies were received by the very largest companies, in the S&P 500).

65 See https://www.cii.org/files/10_10_Shareholder_Proposal_FAQ(2).pdf

66 See Release, at 150.

$150,000 per proposal."[67] A review of the underlying sources casts doubt on the validity of all of these figures.

The two commenters that provided the $87,000 per proposal cost estimate were BlackRock and the Society for Corporate Governance. BlackRock based this figure not on its own shareholder experience with the 14a-8 process—it is a public company and sought no-action relief in 2016 and 2019—but rather on an unpublished 2008 study by Joao Dos Santos and Chen Song, "Analysis of the Wealth Effects of Shareholder Proposals." BlackRock did not disclose that the U.S. Chamber of Commerce paid for the Dos Santos and Song study and controlled much of the study methodology, including identifying the 10 "sample" companies for its poorly-designed event study, but those facts are readily apparent from a review of the study.[68]

Notably, Dos Santos and Song did not themselves obtain any data from companies or vendors to estimate the costs associated with a shareholder resolution. Instead, they relied on calculations from a 2003 law review article, which in turn cited Commission data from a 1997 survey.[69] Thus, the data behind the $87,000 per proposal estimate is now nearly 22 years old. Although one would expect outside counsel to bill at a higher rate now, printing, mailing and distribution costs are much lower, given the widespread use of Notice and Access and electronic voting platforms. The Release asks about the impact of Notice and Access on such costs, and data from Broadridge suggests that impact is substantial. Broadridge recently stated that its "technologies and processing for e-delivery, house-holding and account consolidations . . . saved corporate issuers and mutual funds over $1.7 billion in paper, printing and postage in comparison to what they would have spent had all materials been mailed as full sets" in 2019 alone. Broadridge distributed proxy materials for 4,216 meetings, yielding average cost savings per meeting of over $403,000.

The Commission survey data itself also has hallmarks of unreliability, which the Release appears to acknowledge.[70] The $87,000 figure is the product of data from two survey questions. The first asked the company to indicate what it spent to determine whether to include or exclude a proposal, and the average of the 80 responses was $37,000. The range of responses was enormous, from a low of $10 to a high of "approximately $1.2 million."[71] The notion that determining whether a

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[67] Release, at 12 (footnotes omitted).
[68] See Joao Dos Santos & Chen Song, ""Analysis of the Wealth Effects of Shareholder Proposals," at 1, 6 (2009)(https://www.uschamber.com/sites/default/files/legacy/reports/080722wfi_shareholder.pdf)
[69] See Dos Santos & Song, at 13; Exchange Act Release No. 40018 (May 21, 1998) (describing results of 1997 survey).
[70] See Release, at 116, 158.
[71] Exchange Act Release No. 40018 n.95 and accompanying text (May 21, 1998).

single shareholder proposal is excludable could cost anything approaching $1.2 million, which represents 1,200 hours of law partner time billed at $1,000 per hour, is ludicrous. One explanation for such an incredible value is suggested by the Commission's acknowledgment that some responses "may have accounted for consideration of more than one proposal,"[72] which the Release also mentions.[73] That the average was likely skewed upward by a few unrealistically high values is evidenced by the fact that the median response, $10,000, was significantly lower than the average.

Similarly, the $50,000 average estimate for costs of printing, postage and tabulation for a single proposal was the product of 67 estimates ranging from $200 to nearly $900,000, which, again, "may have accounted for the printing of more than one proposal."[74] The $10,000 median response, only one-fifth as large as the average, shows that a few very high values skewed the average. The cost estimates from the Dos Santos and Song study are insufficiently reliable to be used in a cost-benefit analysis of changes to Rule 14a-8.[75]

The Roundtable comment letter cited for the $100,000 per-proposal estimate came from Exxon Mobil Corp. Exxon Mobil estimated that each proposal costs the company $100,000, "even for identical, repeat proposals."[76] It is difficult to believe that no economies would result from having analyzed, challenged and opposed a proposal in previous years. A general counsel willing to pay outside lawyers the same amount year after year to analyze and challenge an identical proposal would raise concerns about basic competency, and ICCR members report that no-action requests for the same proposal tend to be very similar from one year to the next. Companies reuse statements in opposition, with minor revisions if company practices or other factors have changed from the previous year. Indirect costs, representing time spent by management and the board, would also be reasonably expected to decrease as a result of previous familiarity with a proposal.

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72 Id.

73 Release, at 158.

74 Exchange Act Release No. 40018, n.107 and accompanying text.

75 The Release also cites a Roundtable comment letter from the Society for Corporate Governance (the "Society"), which offered the same $87,000 figure as BlackRock/Dos Santos and Song, crediting the Center for Capital Markets Competitiveness ("CCMC") but not citing a source. Given that the CCMC is a US Chamber of Commerce initiative (https://www.bloomberg.com/profile/company/0815774D:US), it seems reasonable to assume that the $87,000 figure proffered by the Society came from the Dos Santos and Song study. In testimony cited in footnote 64 of the Release (the "Stuckey Testimony"), Society President and CEO Darla Stuckey explained that her cost estimates were based on both the $87,000 figure and "anecdotal discussions with Society members." Written Testimony of Darla C. Stuckey, President and CEO, Society for Corporate Governance, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, at 8 (Sept. 21, 2016) (https://republicans-financialservices.house.gov/uploadedfiles/hhrg-114-ba16-wstate-dstuckey-20160921.pdf)

76 https://www.sec.gov/comments/4-725/4725-5879063-188728.pdf

Finally, the $150,000 per-proposal estimate, which formed the basis for the Commission's Paperwork Reduction Act calculations,[77] derived from a Roundtable comment by the American Securities Association (ASA), a trade association representing regional financial services firms.[78] The ASA did not submit cost estimates furnished by its members (which in any event would have been an unrepresentative group), but instead cited a report by the House Financial Services Committee. That report simply asserted the $150,000 figure without citing any source or describing what it included.[79] Thus, the ASA's figure does not provide an adequate basis for the Commission's cost savings estimates.

Evaluating the costs and benefits of the Proposed Amendments requires reliable data, and the Commission is best positioned to obtain it. The 2012 Guidance states that the Commission should identify relevant data, and "consider mechanisms by which to seek such data," before issuing a proposing release.[80]

The Commission could conduct (or partner with an organization like the Society to conduct) another survey of issuers (and not just those seeking no-action relief), making efforts to obtain a statistically valid number of responses and asking whether costs are the same for proposals that are voted, omitted and withdrawn, as the Release's Paperwork Reduction Act analysis assumes to be the case.[81] To test companies' assertions that the costs of determining whether a proposal is excludable and seeking no-action relief are the same even when the proposal has previously been submitted, the Commission could analyze no-action requests on substantially similar proposals to determine the extent to which companies or their outside counsel are recycling material from one year to the next and/or across companies and thereby leveraging economies of scale. Technology would enable the Commission easily to quantify such similarities.

Similarly, the Commission could request information from vendors such as Broadridge and financial printers to ascertain the range of costs for printing, mailing /emailing and tabulating an additional proposal for shareholders with different numbers of shareholders/accounts to solicit. Leaving data collection and submission to commenters, as the Release hopes to do, is an abdication of the Commission's responsibilities, deprives other commenters of the ability to challenge

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77 The Commission did not explain why it viewed the $150,000 figure—the highest one cited by commenters—as the best one on which to base its Paperwork Reduction Act calculations.

78 See https://www.sec.gov/comments/4-725/4725-5646621-185668.pdf

79 Report on H.R. 5756, "To Require the Securities and Exchange Commission to Adjust Certain Resubmission Thresholds," at 2 (Aug. 24, 2018) (https://republicans-financialservices.house.gov/uploadedfiles/crpt-115hrpt904.pdf) It is worth noting that the report stated that the "cost of a proposal *can run* $150,000 per measure" (emphasis added), suggesting that this figure is at the high end of a range of costs.

80 2012 Guidance, at 12.

81 Release, at 138 fn.272.

estimates relied upon in making rulemaking decisions, and circumvents the notice and comment process.

Cost Savings for Non-Proponent Shareholders Associated with the Shareholder Proposal Process

The Release asserts that the shareholder resolution process imposes costs on non-proponent shareholders, and that reduction of these costs, at least when they are generated by what the Commission defines as non-value-enhancing proposals, is a benefit of the Proposed Amendments. But the Proposed Amendments are not tailored to eliminate only non-value-enhancing proposals, and indeed the Release provides evidence, as discussed below in the section on the ownership thresholds, that higher ownership thresholds would disproportionately allow exclusion of proposals that are likely to obtain majority support.

The benefit of lower shareholder costs therefore cannot be considered without analyzing whether they are offset by the negative performance effects from the loss of proposals that will be excludable as a result of the Proposed Amendments. There is widespread recognition that investors have incentives to underinvest in influencing corporate behavior because resulting benefits will be enjoyed by all shareholders. Rule 14a-8 allows non-proponent shareholders to free ride on proponents' efforts and benefit from value-enhancing reforms they did not fund. The Commission must weigh shareholder cost savings against the loss of this benefit, which discussed in the previous section.

In sum, the Commission has not satisfied the requirement that it establish the economic baseline against which to assess the Proposed Amendments and weigh the costs of those amendments against their benefits. The Release does not identify and analyze the costs—the loss of important benefits generated by the shareholder resolution process—against the small purported benefits. What's more, the data used to produce the Release's estimate of those benefits is not sufficiently reliable to support the Commission's conclusions. Accordingly, the Proposed Amendments should not be adopted.

Ownership Threshold and Other Eligibility Requirements

The Release proposes to change the existing ownership threshold for eligibility to submit a shareholder resolution from shares worth $2,000 for at least one year to a tiered structure in which a shareholder must satisfy one of the following amount/duration combinations:

Amount	Duration
At least $2,000 but less than $15,000	3 years
At least $15,000 but less than $25,000	2 years

At least $25,000	1 year

The Commission supports this change by conclusively asserting that "holding $2,000 worth of stock for a single year does not demonstrate enough of a meaningful economic stake or investment interest in a company to warrant the inclusion of a shareholder's proposal in the company proxy statement," in light of inflation and the growth of the markets since the $2,000 threshold was established in 1998, and that the proposed new thresholds "more appropriately balance" the interests of shareholders and companies.[82] We do not believe that the Commission has adequately explained how the increases it proposes, which the Commission estimates could result in up to a 56% reduction in the number of proposals submitted, meets the more incremental need for updating identified by the Commission.[83]

In our view, the proposed 12-fold increase in the ownership threshold is unwarranted and unfair. It is entirely inconsistent with the Commission's oft-touted focus on protecting smaller investors. Chairman Clayton has stated repeatedly that the "common theme" of the Commission's work is "serving the interests of our long-term Main Street investors."[84]

The Commission concedes that the higher ownership thresholds will have a "disproportionate impact" on individual proponents. [85] Given that fact, one might expect to see data in the Release justifying that impact on the ground that individuals or holders of smaller amounts of stock submit less meritorious or successful proposals than institutions. But the Commission's own data tells the opposite story: Individuals submit more value-enhancing proposals, at least as measured through event studies,[86] and the Commission found a negative and statistically significant relationship between ownership level and the likelihood of a proposal obtaining majority support.[87] The Commission buried the latter finding in a footnote.

The Release argues that the proposed ownership threshold changes do not disadvantage smaller investors because the $2,000 threshold would stay in effect for

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[82] Release, at 19-20..

[83] See 2012 Guidance, at 5 ("Rule releases must include a discussion of the need for regulatory action and how the proposed rule will meet that need.").

[84] "Remarks to the Economic Club of New York" (Sept. 9, 2019) (https://www.sec.gov/news/speech/speech-clayton-2019-09-09); see also, e.g., Transcript, "Perspectives on Securities Regulation Featuring a Conversation With U.S. Securities and Exchange Commission Chairman Jay Clayton," Brookings Institution (Sept. 28, 2017) (https://www.brookings.edu/wp-content/uploads/2017/10/es_20170928_securities_clayton_transcript.pdf).

[85] Release, at 144.

[86] Release, at 144.

[87] Release, at 94 fn.188.

shareholders holding for three years or longer. The Commission appears to hold the mistaken belief that shareholders are easily able to conform their investment decisions to meet longer holding duration requirements, as the Release states that shareholders have "discretion in how frequently they trade shares."[88] Many institutional investors, including ICCR members, separate the investment and stewardship functions. Investors following passive strategies buy and sell shares as indexes are reconstituted. Tax considerations may influence non-tax-exempt investors' decision making. Ownership continuity can be disrupted through a change in broker or investment manager.

With respect to the proposed increased duration requirement, the Release considers two dimensions—dollar value and duration—to determine whether a shareholder has a "sufficient investment interest in the company."[89] Although "investment interest" is not defined, the context makes clear that the Commission is concerned that proponents with an insufficient investment interest are more likely to abuse the shareholder proposal process. Thus, "investment interest" goes to the strength of a shareholder's incentives.

The significance of a small shareholder's holding in the context of its overall investments would shape incentives at least as much as dollar amount or duration. This approach has been used in regulatory definitions of director independence, for example.[90] A similar metric would be a reasonable alternative for the Commission to consider, perhaps as an alternative to the dollar value/duration thresholds if they are increased.

Resubmission Thresholds

Currently, a three-year cooling-off period is imposed on proposals addressing "substantially the same subject matter" as a proposal that was previously voted on by shareholders and did not obtain a specific level of support. That level depends on how many times the proposal was voted on in the previous five years: 3% if the proposal was voted on once, 6% if it was voted on twice, and 10% if it was voted on three times (referred to as "3/6/10%").

The Release proposes to raise those resubmission thresholds to 5/15/25% and allow exclusion of a proposal that has been voted on three or more times in the past five years and has achieved at least a 25% (but not majority) vote if support the last time it was voted on dropped by more than 10% compared to the immediately preceding vote (the "Momentum Requirement").

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88 Release, at 126 fn.251.
89 See, e.g., Release, at 22
90 See NYSE Listed Company Manual, section 303A.02(b)(v) (https://www.ghco.com/static-files/60538d32-b4e0-481e-801c-2df74b4163c6)

We strongly believe that the 3/6/10% thresholds ensure that proposals that do not enjoy meaningful support relatively soon do not continue to appear in the proxy statement, while recognizing that emerging issues may require a period of education and discussion in order to achieve widespread acceptance. The proposed higher resubmission thresholds would impair shareholders' ability to pursue more nuanced or complex proposals whose value is not immediately apparent to other investors.[91]

The danger of cutting off communication too early is heightened by the Staff's expansive interpretation of when a proposal addresses "substantially the same subject matter" as a previously-submitted proposal. Proponents can use feedback obtained both directly from shareholders and through voting results to improve a proposal. For example, a proponent might learn that shareholders believe that the issue raised in a proposal is a worthy one, but that the specific solution the proponent offered was suboptimal—perhaps it was too prescriptive, or would have been overly burdensome to implement. Because the resubmission bar attaches to proposals on substantially the same subject matter, however, a proposal using that feedback to suggest an action that is more likely to enjoy shareholder support would be excludable if the initial proposal fell below the required threshold. With each vote, the ability of a proponent to submit an improved version of a proposal diminishes.

In analyzing the effect of the resubmission thresholds and Momentum Requirement, the Release focuses on the likelihood of obtaining majority support under various scenarios. The Release emphasizes majority support because, it claims, proposals that receive majority support are more likely to be implemented. But the study cited in the Release considered only proposals that came to a vote, ignoring proposals that were implemented through a settlement and thus never produced voting results. ICCR member experience has shown that approximately one third of resolutions filed, including on subjects that rarely garner majority support, result in settlements. Implementation statistics that disregard negotiated settlements are incomplete and potentially misleading. Whether the proposed resubmission thresholds "better distinguish those proposals that are on a path to meaningful shareholder support" is the wrong benchmark if it assumes that the only meaningful support involves a majority vote.[92]

Increasing the resubmission thresholds and adopting the Momentum Requirement could prevent consideration of value-creating reforms. It took many years for board declassification proposals, which debuted with votes under 10%, to obtain majority support. As Commissioner Jackson pointed out in his dissent, the proposed resubmission thresholds would allow exclusion of 40% of proxy access proposals and more than half of proposals to limit senior executive stock sales, which have been

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[91] See Question 43, Release, at 57.
[92] See Release Question 37, at 56.

shown to create value,[93] for three years. Resolutions at fossil fuel companies asking for reporting on climate risks often received under 5% support when they were first submitted; by 2017, a proposal seeking a business plan in alignment with the 2° C warming threshold established in the Paris Climate Agreement achieved a 67% vote at Occidental Petroleum, 62% at ExxonMobil, 50% at PNM Resources and 48% at Dominion Resources. The Release does not analyze the impact of losing the ability to resubmit such value-enhancing proposals.

The Commission rejected the notion of adjusting resubmission thresholds at companies with dual-class capital structures. Such companies may benefit even more from the accountability provided by Rule 14a-8 than companies with one class of stock; the Commission recognized that applying a different vote-counting methodology at dual-class companies to make it easier to achieve the resubmission threshold "potentially could mitigate management entrenchment for those firms."[94] The communication value of proposals is not obviated simply because implementation is less likely.[95] Commissioner Jackson's dissent describes how higher resubmission thresholds can be used to thwart even proposals that enjoy support from a substantial majority of non-insider shareholders:

> For example, just last year Facebook's outside investors overwhelmingly voted to change its dual-class structure. Facebook, Inc. Form 8-K (May 30, 2019) (reporting that, at the company's last annual meeting, some 82% of votes not controlled by Facebook's founder voted in favor of such a change). That proposal has previously been brought several times. Because of Facebook's dual-class structure, support from more than 80% of outside investors amounted to just 24.5% of the overall vote—meaning that, under the rules in today's release, this proposal will soon be removed from Facebook's ballot for three years."[96]

If the Commission adopts higher resubmission thresholds, it should keep the thresholds at 3/6/10% (and no Momentum Requirement) for companies that have multiple classes of stock with disparate voting rights or adopt a vote-counting methodology that focuses on non-insider support.

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[93] Commissioner Robert J. Jackson, Jr., "Statement on Proposals to Restrict Shareholder Voting," fns.9 and 12 (Nov. 5, 2019) (https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting#_ftnref13)

[94] Release, at 155.

[95] Cf. Release, at 155 ("The disadvantage of [making it easier to reach resubmission thresholds] is that companies and their shareholders would continue to incur costs associated with processing proposals that are less likely to garner majority support and be implemented by management.").

[96] Commissioner Robert J. Jackson, Jr., "Statement on Proposals to Restrict Shareholder Voting" (Nov. 5, 2019) (https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting#_ftnref13)

The Release opined that a benefit of the higher resubmission thresholds would be incentivizing proponents to "adjust their proposals over time based on interactions with companies and other shareholders with an eye toward garnering more support."[97] ICCR members already make such adjustments. For example, ICCR members have implemented shareholder feedback that a proposal would be easier to support if framed as requesting disclosure rather than a specific governance or policy change. Other proponents with whom we work do the same. It is therefore a stretch to suggest that the Proposed Amendments would have the benefit of boosting proposal quality.

The Release does not adequately explain the basis for the Commission's choice of a 10% trigger for the Momentum Requirement. In our view, the Momentum Requirement threatens to allow exclusion of proposals that experience a slight dip in support—indeed, the Release's example is of a proposal that went from 30 to 26% support—without any basis for concluding that this would serve any of the Commission's ostensible objectives. The Release states that the Commission "believe[s] that a 10 percent decline in the percentage of votes cast may demonstrate a sufficiently significant decline in shareholder interest to warrant a cooling-off period."[98] We note that even this conclusory assertion is qualified by the word "may," so the Release relies on the mere possibility that a 10% decline is indicative of something to justify the Momentum Requirement. What's more, the Commission has provided no data to support the notion that a single dip in support is associated with waning voting support in future years or a lower likelihood of implementation by the company. Nor does the Release analyze whether any particular kinds of proposals have greater volatility in voting results and would be more likely to be affected by the Momentum Requirement. Without such information, it is not possible to weigh the economic impact of the Momentum Requirement or analyze reasonable alternatives to it.

The Momentum Requirement could also have unintended and inefficient consequences. Because it would "allow companies to exclude proposals that do not meet but are close to the majority threshold,"[99] it would encourage companies to expend corporate resources to prevent a proposal from obtaining majority support. This would occur even if the proposal itself is value-enhancing. There is evidence that companies already use their power over the voting process, including real-time "access to data about the ongoing voting process," to "systematically affect voting outcomes" on shareholder resolutions when support is close to a majority.[100] We are concerned that any systematic advantage for management would be amplified if the Commission adopts the burdensome requirements it recently proposed for proxy

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[97] Release, at 134.
[98] Release, at 59.
[99] Release, at 146.
[100] Laurent Bach & Daniel Metzger, "Are Shareholder Votes Rigged?" (Dec. 2016) (http://www.law.nyu.edu/sites/default/files/upload_documents/Daniel%20Metzger%20paper.pdf)

advisory firms,[101] which we believe would have the effect of strengthening management's hand in the proxy voting process.

The Release floats the possibility of imposing a five-year rather than three-year cooling off period if a proposal fails to achieve the required level of support to be resubmitted.[102] We believe that a three-year period is more than sufficient. Changes at a company, in its industry or in the broader social, political and regulatory environment may lend urgency to an issue, improving a proposal's prospects. An overly long wait could delay value-enhancing governance, policy or disclosure reforms.

Limitations on Submission by a Representative

The Release proposes a suite of new limitations on a shareholder's right to use an agent to represent it in part or all of the shareholder proposal process. The Proposed Amendments include informational requirements, a limitation of one proposal per person (including a representative) at a given company and a mandate that the shareholder, not its agent, make itself available to meet with the company about the proposal shortly after its submission.

ICCR members both use representatives and serve as representatives for shareholders in the 14a-8 process. Our members include faith-based investors that submit proposals through other faith-based partners that offer capacity, expertise in the shareholder resolution process and shared sensibilities; asset managers and service providers that file resolutions on behalf of clients; and faith-based investors that maintain a program for collective investment and professional management of religious institutions' endowment, operating and other funds. In some cases, proposals are submitted in the shareholder's name, with the representative designed as a point of contact; others are submitted in the name of the representative.

The Commission presents no evidence that using a representative is associated with abuse or that representatives have submitted proposals on behalf of un-consenting shareholders. The Release asserts that "some observers have suggested that it may be difficult in some cases to ascertain whether the shareholder in question in fact supports the proposal that has been submitted on their behalf."[103] The source cited for that proposition, the Stuckey Testimony, claims that "so much abuse has occurred with these types of submission, that it is impossible for companies to determine whether a proposal actually reflects the interests of the shareholder rather than the proponent, who is not a shareholder." [104] Her evidence of "so much

[101] Exchange Act Release No. 87457, File No. S7-22-19 (Nov. 5, 2019).
[102] Release, Question 41, at 57.
[103] Release, at 30.
[104] Stuckey Testimony, at 10.

abuse," however, is that in one case a submission letter from an investment adviser did not contain sufficient information showing that it was authorized to submit a proposal. That letter was submitted before the Staff's 2017 guidance requiring proof of authorization[105] and that situation would thus be unlikely to recur.[106] As well, as the Release suggests in Question 21,[107] a representative that provides proof of ownership on behalf of the shareholder can be presumed to have that shareholder's consent to submit the proposal, as the shareholder's consent would be required.

The Release states, without support, that "there may be a question whether the shareholder [that submits through a representative] has a genuine and meaningful interest in the proposal, or whether the proposal is instead primarily of interest to the representative, with only an acquiescent interest by the shareholder."[108] Our members that submit proposals through representatives or act as representatives do so pursuant to established contractual or institutional arrangements that would prevent such self-interested submissions. Proposals submitted by or on behalf of ICCR members are the product of detailed engagement plans that direct representatives' actions on shareholders' behalf. Representatives that are registered investment advisers are bound by fiduciary duties, which "oblige an adviser to act in the best interests of its clients and not to place its own interests ahead of its clients' interests."[109] We believe that submission through representatives in established business or institutional relationships with shareholders does not create any risk of abuse.

Limiting a representative to one proposal at a company would infringe on the shareholder-representative relationship, which is governed by state agency law. A representative working with multiple shareholders that wish to submit a proposal at a particular company would be required to violate its obligations to all but one of those shareholders, an unintended consequence[110] that could compromise their ability to fulfill contractual or fiduciary obligations. Thus, we believe that the relevant question is not whether there are "legal implications" in "allowing a principal-agent relationship in the context of the shareholder proposal process," as Question 20 of the Release asks,[111] but rather whether it is appropriate for the Commission to limit such relationships in the 14a-8 setting.

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105 Staff Legal Bulletin 14I (Nov. 1, 2017) (https://www.sec.gov/interps/legal/cfslb14i.htm)

106 Question 33 asks whether the informational requirements included in the Proposed Amendments for submissions through a representative would alleviate concerns regarding unauthorized submissions, see Release, at 40, and we believe that they would.

107 See Release, at 32-33.

108 Release, at 30.

109 Commission Interpretation Regarding Standard of Conduct for Investment Advisers," Advisers Act Release No. 5248 (July 12, 2019) (https://www.sec.gov/rules/interp/2019/ia-5248.pdf)

110 See Release, Question 30, at 39.

111 Release, at 32.

The Release offers no clear rationale for this abrogation of state-law rights. Confusingly, the Commission argues that the one-proposal-per-representative rule "would prohibit shareholders from imposing disproportionate costs on the company and other shareholders by submitting multiple proposals for the same meeting"[112] and that allowing a representative to submit multiple proposals at a company is an "unreasonable exercise of the right to submit proposals at the expense of other shareholders and also may tend to obscure other material matters in the proxy statement."[113]

No shareholder is submitting multiple proposals for the same meeting; regardless of whether they use the same representative, each proposal must be submitted by a different shareholder who has the requisite ownership interest in the company. Given that fact, how could the simple fact of using a representative transform the submissions into an "unreasonable exercise"? Similarly, if shareholders acting on their own behalf could submit a particular number of proposals, why do those same proposals "obscure other material matters" when submitted by a representative? The meaning of "disproportionate" here is unclear—disproportionate to what?

The illogic of these arguments suggests that the true objective of the one-proposal-per-representative rule is simply to reduce the number of proposals submitted at a company, which we strongly oppose.[114] Any numerical limitation would be arbitrary, encourage gamesmanship (including by those who oppose the shareholder proposal process and seek to frustrate shareholders' exercise of their rights) and present logistical challenges, such as determining which proposals are includable if too many are submitted.

The language of the Proposed Amendments limiting a representative to one proposal at a company is hopelessly vague. The Release proposes to revise Rule 14a-8(c), which currently states that "each shareholder" may submit one proposal for a meeting, to provide that "each person, directly or indirectly," may submit one proposal. Although explicitly submitting through a representative would obviously qualify as an "indirect" submission, it is not difficult to imagine issuers arguing that other circumstances constitute an indirect submission. Would the Staff resolve factual disputes regarding the subjective intention of shareholders and representatives in response to company requests for no-action relief? In our view, the current limitation of one proposal per shareholder works well, and the Commission has not established any need to revise it.

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112 Release, at 139.

113 Release, at 38.

114 See Release, Questions 34-35, at 40.

<u>Proponent Obligation to Discuss Proposal</u>

The Proposed Amendments would require a shareholder submitting a proposal to state that it is available to meet with the company in person or by phone no less than 10 nor more than 30 days after the submission date to discuss the proposal and to provide specific dates and times for such discussions. The Commission's ostensible purpose for this requirement is to "encourag[e] engagement."[115]

As an initial matter, we believe that promoting engagement is beyond the authority granted to the Commission in section 14(a) of the Exchange Act. Although shareholder proposals may spur engagement, engagement is not integral to ensuring that shareholders have accurate information about matters to be voted on at a shareholder meeting, facilitating shareholders' exercise of their state-law proposal rights in the proxy voting context, or balancing those rights against the costs of including proposals. In enacting section 14(a) of the Exchange Act, "Congress's central concern was with disclosure."[116] Adding an engagement requirement as a prerequisite to shareholders' exercise of their right to submit a proposal would serve no disclosure objective and would constitute an impermissible intrusion on state regulation of corporate governance.

Even assuming that encouraging engagement is a legitimate goal for rulemaking, the Release does not explain why requiring shareholders to indicate their availability early in the shareholder resolution process would accomplish that objective. First, and most fundamentally, the Proposed Amendments impose no parallel requirement on companies to take proponents up on their offer to meet. That asymmetry reinforces the unsupported assumption running through this section of the Release that shareholder unwillingness prevents constructive dialogues from occurring. To the contrary, ICCR members always try to engage with companies; in their experience, failures to dialogue generally result from company unwillingness.

Second, the Commission does not explain why constructive dialogue requires a meeting shortly after a proposal is submitted, as opposed to during the many months between the submission deadline and the mailing of proxy materials. There is good reason to believe that a very early meeting is likely to be *pro forma*, rather than substantive. Companies that submit no-action requests—which are submitted on approximately 30% of proposals[117]--are often unwilling to engage substantively until after they receive a determination. Constructive dialogue usually requires companies to assemble teams appropriate for the proposal's subject matter, which is difficult to do on short notice, especially during the November to December holiday

[115] Release, at 33.
[116] *Business Roundtable v. SEC*, 905 F.2d 406 (D.C. Cir. 1990).
[117] "What You Need to Know Heading Into the 2020 Proxy Season" (https://ethicalboardroom.com/what-you-need-to-know-heading-into-the-2020-proxy-season/)

period during which most submission deadlines fall. Dialogues without such participation, in ICCR members' experience, tend not to produce agreement or improve understanding.

Finally, the requirement would excessively burden proponents. Proponents that submitted through representatives would not be permitted to rely on them for these mandated early meetings. This section of the Release raises many questions. For how long would proponents be required to hold open time slots in which they have indicated they are available to meet? Would a company be allowed to wait until the day before such a time slot and insist on meeting during it? Opportunity costs are imposed when a proponent is unable to schedule other events or activities during such time periods. How would compliance with this requirement be policed? If a proponent offers a time slot that becomes unavailable, would companies be able to ask the Staff for permission to exclude the proposal? Would certain reasons for a proponent's unavailability to meet—a family emergency, for instance, or a medical reason—excuse compliance? The requirement that proponents offer and hold open meeting times during a busy period is thus "unduly burdensome and subject to abuse," as the Commission asked in Question 22,[118] and unlikely to produce any benefits.

* * *

In conclusion, the Commission's evaluation of the impact of the Proposed Amendments is highly flawed, because it uses unreliable data to determine the cost savings for companies and gives virtually no consideration to the substantial cost of undermining the long-time, effective shareholder resolution process. As well, the Release fails to establish that the radical changes proposed by the Commission are necessary to protect investors or promote capital formation. Accordingly, we urge the Commission not to adopt the Proposed Amendments in their current form.

We appreciate this opportunity to provide our views to the Commission on this important matter. Please feel free to contact me with any questions.

Sincerely,

Josh Zinner
CEO
Interfaith Center on Corporate Responsibility
[redacted]

[118] Release, at 35.

cc: Hon. Jay Clayton, Chairman
Hon. Robert J. Jackson, Jr., Commissioner
Hon. Allison Herren Lee, Commissioner
Hon. Hester M. Peirce, Commissioner
Hon. Elad L. Roisman, Commissioner