

# 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.

## 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 lower 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.<sup>1</sup> 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,<sup>2</sup> the SEC shareholder proposal rule, Rule 14a-8, imposes minimal

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

<sup>2</sup> 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**.<sup>2</sup> 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](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.<sup>3</sup>

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.<sup>4</sup>

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

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<sup>3</sup> 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](http://www.fcltglobal.org/docs/default-source/default-document-library/a-roadmap-for-fclt.pdf?sfvrsn=7b2e258c_0)

<sup>4</sup> 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.<sup>5</sup> 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.<sup>6</sup>

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.<sup>7</sup>

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.<sup>8</sup> 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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<sup>5</sup> Activist Investors and the Rise of Short-Termism 2.0, Laura Gitman, Senior Vice President, BSR, June 21, 2017.

<sup>6</sup> 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](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.

<sup>7</sup> 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](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1437791)

<sup>8</sup> 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.<sup>9</sup>

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

## 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.<sup>11</sup> 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.<sup>12</sup>

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<sup>9</sup> 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/>

<sup>10</sup> 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.

<sup>11</sup> 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.

<sup>12</sup> 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.<sup>13</sup> 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.<sup>14</sup> 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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<sup>13</sup> 2017 S&P Money Market Directory.

<sup>14</sup> 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 not 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.<sup>15</sup>

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.<sup>16</sup>

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.<sup>17</sup>

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<sup>15</sup> Petition 4-674, p. 14.

<sup>16</sup> 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.

<sup>17</sup> 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%.<sup>18</sup>

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<sup>19</sup> 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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<sup>18</sup> 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.

<sup>19</sup> 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.<sup>20</sup> 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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<sup>20</sup> 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.<sup>21</sup>

**(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

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<sup>21</sup> 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.<sup>22</sup>

**(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

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<sup>22</sup> 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.

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.<sup>23</sup>

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.<sup>24</sup>

**(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.<sup>25</sup> The Sustainability Accounting Standards Board (SASB) analyzed the comment letters received by the SEC in response to the 2016 Concept Release.<sup>26</sup> 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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<sup>23</sup> 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>

<sup>24</sup> 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>

<sup>25</sup> SASB, Blog, August 16, 2016, <https://www.sasb.org/investors-sec-sustainability-disclosure/>

<sup>26</sup> <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,”<sup>27</sup> 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

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<sup>27</sup> <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.<sup>28</sup>

*Responsible Investor* published an article in 2015 that reviewed the implications of insider shareholding on vote outcomes.<sup>29</sup>

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<sup>28</sup> 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.

<sup>29</sup> 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.

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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.<sup>30</sup>

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## 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.

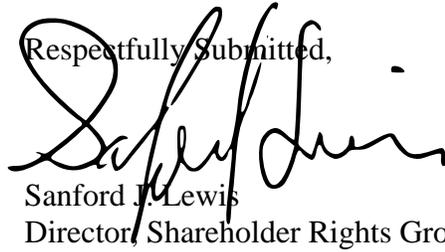
Investors who engage in the shareholder proposal process to bring their time, talent and treasure to the table to provide early warnings or emerging risks, and early opportunities for innovation, accountability, and leadership. Viewed from the perspective of services to the corporation, the process enabled 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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<sup>30</sup> 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