axcelis

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June 19, 2019

By email: rule-comments@sec.gov
Mr. Brent J. Fields, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number 4-725 – SEC Staff 2018 Roundtable on the Proxy Process

Dear Secretary Fields:

I am submitting this letter in response to the Commission's 2018 Roundtable on the Proxy Process. Axcelis Technologies, Inc. ("Axcelis" or the "Company'), is a Delaware corporation listed on the Nasdaq Global Select Market since 2000. Axcelis manufactures capital equipment for the global semiconductor industry.

It has been almost six years since I submitted a letter to the Staff in reaction to the Commission's Concept Release on the U.S. Proxy System, Release Nos. 34-62495; IA-3052; IC-29340; File No. S7-14-10. In my letter dated July 19, 2013, I referred to a proxy advisory firm (a "PAF") as a "de facto regulatory authority over public companies." Looking back over the period since then, I must conclude that, if anything, the power of PAFs has only grown-- *growth completely unhampered by any regulatory efforts to protect the interests of investors in public companies.*

On the positive side, I appreciate the sophistication of Commissioner Elad L. Roisman's comments in his Keynote Remarks at the ICI Mutual Funds and Investment Management Conference on March 18, 2019, which have been posted on the SEC's website. His practical experience with the proxy process is very apparent. This fall, I will have booked 35 years of corporate legal practice. I have served as General Counsel to Axcelis for more than 18 years. Prior to that, as an associate and then a partner at a large Boston law firm, I worked with many other public companies, their Boards and investors. Much of the misguided commentary on this topic has come from academics, policy advocates, and government figures who have no or very little practical experience of the proxy voting process. Not all voices deserve equal weight, and I hope the Commissioners know the difference.

That said, I would like to begin with a disclaimer that I know much more about the problems created by PAFs that I know about the possible solutions. I understand that the Commission's exercise of regulatory authority would be focused on ensuring asset managers are fulfilling their duties to their investors, and not on ensuring public companies are not abused. While I worry mainly about negative impacts on public companies themselves (which indirectly hurts investors), I know the Commission has to work within the existing legislative and regulatory landscape. At the end of this letter, I make some recommendations on regulatory action for the Commission's consideration.

I firmly believe that it is ultimately *adverse to the interests of investors in U.S. public companies to have public companies wasting time and money on meeting demands of PAFs that achieve no general investor benefit, and in many cases, are contrary to the interest of investors, both in terms of financial impact and in terms of governance.*

In this letter, I address how PAFs drive the waste of corporate assets in two ways: (1) by forcing public companies to spend time, effort and money on "hot topic" governance policies[1] that deliver questionable (at best) benefits to stockholders and (2) in the case of Institutional Shareholder Services (ISS), by leveraging the transfer of voting power into a revenue-generating private consulting business which has no accountability to the investors with whom that voting power originates or to the laws that create those voting rights.

I will provide a few concrete examples of these issues.

1. <u>Pointless and Harmful Governance Policies Promoted by PAFs</u>.

(a) **Proxy access.** Proxy access provisions (among other ill-informed Congressional ideas in the 2010 Dodd-Frank Act) were pursued by certain institutional investors with great fervor, and avidly supported by PAFs. As you know, proxy access provisions are now broadly adopted, but have almost never been implemented[2] because it is a solution in the absence of a real world

[1] Under current circumstances, we can expect no end to new "hot topic" governance policies since, as discussed below, it is in the business interests of PAFs to continually adopt new governance policies unconstrained by any requirement that the policies make sense or actually benefit investors. In addition to PAFs, law firms, governance policy institutes and other players also benefit from an un-ending parade of new governance requirements which bring them revenues and influence.

[2] The history of the use of proxy access provisions currently includes two events. First, in November 2016, an activist investor (GAMCO Asset Management Inc.) asserted proxy access rights and then withdrew them in less than a month because it could not comply with "a typical requirement" that the nominating shareholder acquired the shares "in the ordinary course of business and not with the intent to change or influence control of the Company." See "*The Latest on Proxy Access*," Harvard Law School Forum on Corporate Governance and Financial Regulation, February 1, 2019. More recently, in 2019, a founder and former director of The Joint Corp. nominated a director for election under a proxy access bylaw. This category of stockholder—the out-of-power founder or family member—is the only constituency I can think of who would find proxy access appealing. Those individuals may have held substantial positions in the stock for years, have no fiduciary obligation to deliver returns to others, and may be motivated more by personal than financial objectives. Of course, that particular circumstance hardly justifies proxy access as necessary for the vast majority of public companies. I also wonder whether a founder or family member might not also run afoul of the requirement that the position has been acquired in the ordinary course of business.

problem.[3] The standard proxy access provision requires a holder (or group of holders) to have at least 3% of the outstanding stock for at least 3 years in order to earn the right to nominate a minority of the board of directors. The reality is that most investors holding significant stock positions *do not want to nominate directors and accrue insider status, which would inhibit their freedom to trade at will and would incur disclosure responsibilities.* Most investors will simply sell a stock if they lose confidence in the existing Board. This is consistent with asset managers' fiduciary duties—they are about delivering returns to shareholders, not fixing businesses run by others. These investors are not going to hold positions for years just to achieve the right to nominate a minority of the Board in the Company's own proxy statement. Of course, activist investors have a business model to drive stock prices higher by seeking to influence or change a target company's Board. Under corporate law and SEC regulation, an activist can own one share of stock[4] and immediately have the right, if they are willing to spend some money (which frequently gets reimbursed by the issuer in a settlement) to run a proxy contest and nominate directors for up to the full Board. The stark reality is that there is simply no investor constituency that truly needs or wants proxy access. Significant corporate time, effort and expense was incurred in fighting and then adopting these provisions, which were bolstered by voting recommendations from PAFs. Despite this waste of time and resources, ISS continues to give demerits to companies without proxy access in their Governance Quality Score, as discussed below.

(b) **Majority voting**. Similarly, charter and bylaw amendments to require majority voting in uncontested director elections were a huge issue for many years. Majority voting was pursued with incredible dedication and perseverance by some institutional investors and heavily supported by PAFs. As hopefully now everyone realizes, the effort was pointless. As we all know, most state corporate laws provide for plurality voting, which, in an uncontested election, mean that a candidate could receive less than a majority of votes and still be elected. Since there was no competition for the director's seat, by definition the sole candidate receives the plurality of votes cast in favor election, even if only one vote was cast in his favor. In a contested election, the candidate with the most votes wins, even if it is not a majority. Many companies like Axcelis, supplemented plurality voting with a resignation policy, requiring directors to offer to resign if they receive less than a majority of votes in favor of their election. Even when majority voting standards are adopted, most state corporate laws provides that a director remains in his position (as a "holdover") until his successor is elected. So, in uncontested re-election situations (which are the vast majority of annual meeting director elections), a director who failed to receive a majority of votes cast would remain in office until there is a successor, necessitating a resignation policy for majority voting standards as well as in plurality voting. *Our long standing corporate laws make sense—unless there is someone*

[3] The Council of Institutional Investors asserts that "Even if proxy access is rarely invoked, its availability makes boards more vigilant in their oversight of management and more responsive to the interests of the company's owners." https://www.cii.org/proxy_access This assertion is illogical: a provision which is almost never used will generate no change in behavior.

[4] Of course, most activists acquire 5% of a public companies stock before launching a full-fledged campaign, so that they can use the Commission's Schedule 13D filings to gain attention and credibility.

contesting a seat on the board, we need a way to continue to have a board of directors by allowing incumbents to remain until replaced. Ultimately, the decision of whether to accept a resignation, or elect a successor, is of course in the hands of the same Board that nominated the candidate in the first place. Of course, the Board may decide to accept a resignation, elect a successor or decline to re-nominate a director receiving low support. But that is true under plurality voting as well as in the extolled majority voting. Again, significant time, effort and expense was incurred in demanding, defending, advising, negotiating and arguing about a policy that made no difference in the outcome of a corporate process. Despite this pointlessness, ISS gives demerits to companies without a majority voting standard in their Governance Quality Score discussed below.

(c) **Opposition to Forum Selection Clauses** In May 2014, on the advice of outside counsel, Axcelis adopted a bylaw that made Delaware courts the exclusive forum for shareholder claims. We were part of a large, and growing trend to adopt these provisions. Paul Weiss reported that 122 companies amended their charters and bylaws to include exclusive forum provisions between June 1 and November 30, 2014. There are solid grounds to argue exclusive forum provisions benefit both the company and its shareholders, since the expense of multi-jurisdictional litigation and forum shopping are avoided, and cases are more likely to be resolved efficiently and wisely where expert forums are selected. In 2015 Glass Lewis withheld support for the chairmen of Nominating and Governance Committees of companies which adopted an exclusive forum bylaw. ISS didn't oppose exclusive forums in proxy voting, but the adoption of an exclusive forum provision leads to demerits in the Governance Quality Score even today. One has to wonder if the average investor really feels that giving stockholder plaintiffs unfettered access to any and all forums to litigate claims against public companies really justifies the expense associated from litigation complexities and gamesmanship. We know the plaintiff Bar would oppose exclusive forum provisions, but who else really benefits? This is another instance where PAFs have demonstrated their influence over, and ultimate benefit from, a policy debate, regardless of the legitimacy of the position they take.

(d) **Prohibition on actions by written consent and other constraints on stockholder rights.** Inexperienced advisors to institutional shareholders and PAFs oppose charter and bylaw provisions that protect the annual meeting process by limiting stockholders' rights to call special meetings or act by written consent. There is similar opposition to super-majority voting provisions. These players don't seem to care that these provisions *protect the interests of minority stockholders, which almost all investors in public companies are*. The Delaware Chancery Court's discussion of the power of DGCL Section 228 in *Espinoza v. Zuckerberg, et al., (Del. Ch. Oct. 28, 2015)* should lead thoughtful institutional investors to reconsider the position that stockholders should be free to act by written consent or call special meetings. As the court noted, unless prohibited by corporate documents, Section 228 allows the holder of a majority of the shares to take binding corporate action without prior disclosure or any opportunity to object. Zuckerberg, a controlling stockholder, failed to follow the formalities of Section 228, but the court noted that if he had, the minority stockholders in Facebook could not alter his unilateral decisions. The court noted that all Delaware law requires is that the non-consenting stockholders (i.e., all the public holders of Facebook) receive "prompt notification of the action," allowing them "to remain informed and to discover any potential breaches of fiduciary duty that would otherwise remain hidden."[5] Do institutional investors really want to find out about stockholder actions after the fact, or would they rather have advance notice of a formal meeting in which SEC regulation proscribes the required disclosure and proxies are solicited? Advance notice of stockholder votes also gives investors the option to simply sell before the vote rather than risk an undesirable outcome. Again, investors and asset managers are seeking to make money, which is not always achieved by exercising their right to vote. Similar arguments can be made about the prohibition against calling special meetings and super-majority voting protections on fundamental charter provisions. Despite the positive impact of these protective provisions on most investors, in the Governance Quality Score, ISS gives demerits for supermajority voting provisions, prohibitions on written consent and on the call of special meetings.

2. <u>Proxy Advisory Consulting Businesses.</u>

I was pleased to see Commissioner Roisman's acknowledgement of the Commission's role in the development of the problematic PAF consulting business model. Essentially, the power of the individual stockholder under corporate law and listing rules is first transferred to the asset manager, who then transfers the power to the PAF, who then uses that power to obtain consulting fees related to policies adopted by the PAF which, as noted above, may bear no relationship to the interests of the stockholder.

Sometimes the problem with the PAF consulting business is simplified into a misperception that when an issuer simply pays a consulting fee to a PAF it will directly impact the voting recommendations produced by the same firm. As a corporate client of a PAF[6], I will assure you that my consulting fees will not directly lead to a desired vote outcome, unless I scrupulously follow the direction of the consultants to change proposals and disclosure to meet the policy standards of the firm[7]. The firm I use has a very pleasant group of consultants who do their best to address the issues in a proxy and advise their corporate clients on how to ensure the company gets the votes they seek. That is what I am paying for. The firm I work with says they have a strict firewall between the two business units, and I believe them.

With a moment's thought, you realize that the PAF can't just sell positive votes. The primary customers of the PAFs are the asset managers and their "stewardship" staff can easily compare a proxy proposal with the PAF's policies to see whether the vote recommendation aligns with the PAF's policy. It would be foolish indeed for a PAF to undercut their fundamental deal with asset managers ("we develop

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[5] *Facebook: For Ratification, Controlling Stockholders Must Adhere to Formalities Under DGCL,* Practical Law Corporate & Securities, 29 Oct 2015

[6] Since my 2013 letter, Axcelis decided that it was more cost effective to engage the consulting services of a PAF than stumble in the dark. We were essentially forced into a consulting engagement once the ISS acceptable equity plan reserve calculations were made significantly more complicated and completely secretive. At the end of the day, Axcelis' obligations to its stockholders include not wasting money on principle.

[7] In fact, when I engaged a PAF to review our 2016 proxy statement for the primary purpose of ensuring support for an increase to our equity plan reserve, the consultants failed to identify a problem arising under an ISS voting policy relating to a proposed reverse stock split charter amendment, also was included in the 2016 proxy. As a result, the initial PAF report recommended against the reverse split amendment, necessitating a fire drill to correct the problem, followed by the issuance of a second PAF report supporting the reverse split.

policies, apply them to facts and then tell you how to vote") in order to have a bribery relationship with corporate issuers.

The real problem with the PAF consulting business is that it involves a misuse of the power of the stockholder, rights which are created by corporate laws and by exchange listing standards. I understand that there is implicit consent to this transfer of power—investors willingly turn over their voting rights to asset managers, and asset managers willingly turn over those rights again to PAFs. I don't know that it would be wise, or even possible, to stop that transfer of rights. But real harm arises when the control ends up with a player who has no true vested interest in the outcome and is simply in the business of making money off the process, sort of like the subprime mortgage crisis, where the mortgage originators took on no actual credit risk. Indeed, like stockbrokers, the players in the new "governance industry" (including but not limited to PAFs) benefit from the on-going "churn" of new governance initiatives, free from any obligation to present substantive evidence that investors actually benefit from them.

This consulting business has been wisely developed by ISS in particular. The robustness of the PAF consulting business rests on two key aspects: (1) the complexity and lack of transparency of voting policies and (2) the constantly changing nature of the voting policies and the use of relative ratings which work together to ensure companies never "finish" complying with objective standards. Secretive calculations underlying voting positions (such as on acceptable equity reserve levels), and the need to constantly monitor policy changes and relative rankings, ensure a busy General Counsel or Corporate Secretary will set aside some funds to get it right through a consulting relationship, in the same way they would get advice from outside counsel to ensure actual legal compliance.

For example, in order to determine whether or not ISS will support a request to increase the shares issuable under an equity plan, an issuer must complete a four page spreadsheet providing statistics on plan reserve, grant activity, grant terms, plan terms, overhang, etc. This spreadsheet is submitted to the consultant, who then puts it through a system that rates the various inputs and returns to the issuer a maximum number of shares that ISS will support. This rating process completely lacks transparency, so it simply could not be done without the consultant, although issuers might guess at aspects of the inputs that hurt or help them.

ISS's Quality Score product illustrates the constantly changing image risk which ISS imposes on public companies, driving consulting services. ISS has for many years provided a relative score on Board, Audit, Shareholder Rights and Compensation issues, which is currently called a Governance Quality Score. ISS gathers information (which issuers can correct via an online portal) on more than a hundred questions which are scored and weighted in undisclosed ways. One aspect of the Quality Score that is brilliantly designed from a business perspective is that each company's score is *relative to other companies.*[8] The score is essentially a decile rating—from one to 10, where one is the best—so it goes up and down depending on what other companies do as well as changes to the scored company's own practices. ISS sends public companies an email every month that provides the current score. So, if one of your comparator companies does something ISS likes, your Quality Score will go down. If you want it to go back up, you must figure out something you can change to make ISS give you more credit. It's a corporate form of "moving the goal posts," and ensures Corporate Secretaries are eager to stay engaged

[8] Does ISS rate issuers against all other companies or just those in the issuers industry or peer group—who knows? That's a secret too.

with the PAF consulting business so they at least have a good knowledge of the vulnerable aspects of their situation and are ready to explain suddenly reduced Quality Scores to their Board of Directors.

Just to keep the pressure on, in 2018 ISS rolled out new Environmental and Social Quality Scores which again provide relative scores of public companies based on hundreds of questions. Credit is only given for results and policies which are publicly disclosed. Companies such as Axcelis are now reviewing these questions and seeing what they can do to improve their ranking, and weighing the competitive disadvantages of making disclosures of operating metrics, like energy spending, which disclosure would get you credits in the ISS Environmental Score, but which might not otherwise be a smart business practice.

The bottom line is that if public companies want to do their best to obtain ISS's support for proxy proposals or maintain high Quality Scores, they are well advised to pay ISS for consulting services.

3. Recommendations.

If the Commission wants to impose some accountability on PAFs, who "operate as quasi-regulators of American's public companies, despite lacking any statutory authority,"[9] I recommend the following actions:

A. Balanced Disclosure of PAF Policies. Require PAFs to publish reports on each existing and proposed voting policy and on each item used to rate public companies (such as those used in ISS's Quality Score). These reports would provide both the rationale for the policy and adverse consequences of the policy. Lots of ideas sound great until you understand the full picture. In order to ensure balanced disclosure, these reports should be subject to a Rule 10b-5 disclosure standard, to ensure policies are not presented in misleading light.

B. Require Full Disclosure of Policy Calculations and Weightings. PAFs should be required to fully disclose their policies so that policy outcomes can be independently assessed against given facts. This will hurt the PAF's consulting business, but the current situation is frankly unjustifiable. Issuers with the means to pay for consulting services will likely still seek out PAF consulting support to ensure their policy analyses are correct. Full disclosure will also increase competition in the field of PAF consulting, where firms that don't adopt their own policies can offer services in interpreting other PAF policies.

C. Require an Opportunity for Feedback on Voting Recommendations. Several commentators have pointed out the tendency of PAFs to make misleading claims or outright errors in voting recommendations. Issuers should have the ability to respond and provide feedback to PAF vote recommendations so that shareholders are properly informed on certain issues prior to voting.

D. Asset Manager Disclosure. Asset managers should be required to annually disclose the use of PAFs, and their adherence to PAF recommendations. Asset managers should also publicly confirm their support of the PAF policies, and in doing so, republish the balanced disclosure of PAF policies described in item (A) above. Asset managers should have no liability for misleading

[9] Timothy M. Doyle, *The Realities of Robo-Voting*, November 2018, American Council for Capital Formation.

PAF policy statements; they are paying for that service and should be entitled to rely on the PAF work product.

E. Eliminate Relative Ranking of Public Companies. Relative ranking of public companies on governance, environmental disclosure and social policies creates an arms race environment, as public companies are pitted against each other and only one player benefits—the PAF. Relative ranking means that *smaller and smaller "governance" distinctions between public companies result in larger and larger distinctions in "governance" scores*. In exchange for handing over their voting rights, investors and asset managers deserve to see ratings that are accurate and provide material information about a public company's standings versus policies that are fully disclosed and understood.

As in 2013, I ask the Commission to protect U.S. investors and public companies by increasing transparency and reducing conflicts that are enabled by the extraordinary power of PAFs. Given the concentrated nature of this influential industry, the Commission should also consider whether other federal agencies have rule-making authority that could be brought to bear, such as the Federal Trade Commission or Department of Justice.

If you have any questions or request additional information, please do not hesitate to contact the undersigned at [redacted] or at [redacted]. Thank you.

Very truly yours,

Lynnette C. Fallon
Executive Vice President HR/Legal, General Counsel and Secretary

Cc: Mary G. Puma, President and CEO, Axcelis