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Via Email (rule-comments@sec.gov)

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
Attention: Ms. Vanessa Countryman, Secretary

Re: Release No. 34-87457 (Nov. 5, 2019); File No. S7-22-19

The Commission's proposed rule changes relating to proxy advisory firms (the "Proposal") are unnecessary, and would harm investors and undermine the purposes of the Securities Exchange Act. They would also violate both section 14 of the Exchange Act and the First Amendment, as well as the Commission's obligations to promote competition and engage in reasoned decision-making. Elliott Management Corporation ("Elliott") urges the Commission to abandon the Proposal.

Proxy advisory firms play a fundamental role in the efficient operation of the capital markets. They provide analytical resources and advice that would be difficult or impossible for any investor to obtain on its own. This advice enables institutional managers and other investors to vote their shares with the benefit of more complete information and impartial analysis. Elliott, which, as of December 31, 2019, manages approximately $40.2 billion in assets, is a client of the leading proxy advisory firms. And as a significant investor in public equities, Elliott also benefits from the contributions these firms make to the capital markets more broadly by empowering investors and enhancing corporate governance.

The Proposal would impose significant additional burdens on proxy advisory firms and expose them to new and substantially heightened litigation risks. Those changes would hamper the firms' ability to offer efficient and impartial advice, thereby eroding the foundation of the Exchange Act's disclosure regime, amplifying the views of issuers, and chilling valid criticisms. By distorting the information available to investors, the Proposal threatens the integrity of the markets.

There is no justification for the drastic changes in the Proposal, which seek to address a problem that does not exist. Conspicuously, the Commission has identified no real evidence of proxy advisory firms providing inaccurate or conflict-driven advice, and no real evidence that investors have such concerns. Nor has the Commission identified a valid statutory justification for the Proposal; to the contrary, by limiting the transparency and accountability that Congress sought to achieve in the proxy solicitation process, the Proposal undermines the purposes of the Exchange Act itself.

The Proposal is also unlawful. The Exchange Act cannot credibly be read to permit the Commission to treat proxy advisory firms as "soliciting" proxies. Although the Proposal invokes section 14(a) of the Act, that provision by its plain terms does not apply to persons, such as proxy advisory firms, whose activities are not intended to solicit proxies and who do *not* solicit proxies, but instead provide objective advice solicited by investors. As a matter of plain English, providing proxy advice is not "solicitation." The Proposal contorts straightforward concepts to justify regulatory overreach.

More fundamentally, the Proposal violates the First Amendment and puts the government in the business of regulating opinion. The Proposal would regulate proxy advisor advice, speech that the First Amendment fully protects. Because it targets the content of advice and particular speakers, the Proposal is presumptively unconstitutional and subject to strict scrutiny, a standard the Proposal does not come close to meeting. The Proposal is based only on vague and unsupported issuer "concerns," and concedes that the Act could be applied in a narrower and more targeted fashion. The Proposal's exemptions would also impose an unlawful prior restraint by requiring proxy advisory firms to submit their analysis to issuers for review, while unconstitutionally compelling them to distribute the issuer's response with their own advice. It verges on enabling corporate censorship of independent views.

Further, the Proposal violates the Commission's statutory obligation to promote competition. The Proposal would *harm* competition by needlessly increasing the barriers to entry in the highly concentrated proxy advisory market. What the Commission acknowledges is a possibility—that the additional costs "could cause some businesses to exit the market or potential entrants to stay out of the market"—is all but a certainty. The Proposal would make the industry even more concentrated than it is today and could easily turn the current duopoly into a monopoly. In other words, the Proposal would exacerbate the problem its proponents purport to lament.

Finally, the Proposal violates the Administrative Procedure Act's bedrock requirement of reasoned decision-making. The Commission's economic analysis is based largely on a single, issuer-produced study that uses flawed methodology and substantially overstates proxy advisory firm inaccuracies, and yet *still* indicates that proxy advisory firm advice is accurate 99.6 percent of the time—more accurate than the issuers who are agitating for the Proposal. The Commission likewise fails to take adequate account of the views of institutional investors, the costs that the Proposal would impose, and the substantial benefits that it would impair. In short, the Proposal is an issuer-led effort to rein in the influence of proxy advisors, supported by demonstrably ghost-written and false letters to the Commission, which would do nothing but harm investors.

Adopting the Proposal as drafted poses obvious risks to the Commission's institutional role and authority and is difficult to square with the Commission's primary role of protecting investors. If the Commission is nonetheless determined to proceed with the Proposal, it should significantly curtail its scope. In particular, the Commission should (1) establish a safe harbor shielding compliant proxy advisory firms from liability under Rule 14a-9, (2) clarify that proxy advisory firms need provide issuers with only specified categories of data and not draft reports or recommendations, and (3) exclude some categories of votes, such as votes on proxy contests and mergers, from the Proposal's requirements. These modifications would mitigate, but not resolve, the flaws in the Proposal and the damage that it would cause to the capital markets and the millions of investors who rely upon proxy advisory firms.

I. Adopting the Proposal Would Exceed the Commission's Statutory Authority.

The Proposal conflicts with the Exchange Act's carefully targeted approach to regulating the proxy process: Congress did not design the Act's proxy-solicitation provisions to sweep up objective advice, but instead sought to prevent interested parties from making inaccurate and misleading solicitations to investors. Extending the solicitation provisions to cover proxy advisory firms would thus undermine the Act's core purposes. For this reason and several others, the Commission lacks statutory authority to adopt the Proposal.

Like all federal agencies, the Commission "has no power to act ... unless and until Congress confers power upon it."[1] The Commission asserts authority to regulate proxy advisory firms under section 14(a) of the Exchange Act,[2] which allows the Commission to prescribe "rules and regulations" for persons who "solicit ... any proxy or consent or authorization" regarding a registered security.[3] Section 14(a) "govern[s] proxy *solicitations*"[4] and by its plain terms does not apply to persons who do *not* solicit proxies. That limitation is fatal to the Proposal because proxy advisory firms do not solicit—i.e., request—proxies, but instead offer their clients analysis and advice.

A. *Section 14(a)'s Purpose Does Not Support the Proposal.*

Congress crafted the Exchange Act's solicitation provisions with a narrow and specific purpose in mind: ensuring that proxy solicitations are accurate and non-misleading. As the Supreme Court has explained, "[t]he purpose of § 14(a) is to prevent management or others from *obtaining authorization* for corporate action by means of deceptive or inadequate disclosure in *proxy solicitation*."[5] The Commission's attempt to use section 14(a) to regulate proxy advisory firms—as opposed to proxy solicitations—is contrary to that purpose.

Congress sought "to control the conditions under which proxies may be solicited" because it had determined that "[t]oo often proxies are solicited without explanation to the stockholder of the real nature of the questions for which authority to cast his vote *is sought*."[6] The Exchange Act's legislative history underscores this limited purpose: "the rules and regulations promulgated by the Commission will protect investors from *promiscuous solicitation of their proxies*, on the

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[1] *La. Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374 (1986).

[2] *See* Release No. 34-87457 at 13 (Nov. 5, 2019) (citing 15 U.S.C. § 78n(a)) ("Release").

[3] 15 U.S.C. § 78n(a)(1).

[4] Release at 13 (emphasis added).

[5] *J. I. Case Co. v. Borak*, 377 U.S. 426, 431 (1964) (emphases added), *abrogated on other grounds*, *Ziglar v. Abbasi*, 137 S. Ct. 1843, 1855 (2017); *see also Greater Iowa Corp. v. McLendon*, 378 F.2d 783, 795 (8th Cir. 1967) ("The purpose of the Section becomes clear, to provide full and honest disclosure by *those who are seeking to maintain or gain control of a corporation* through solicitation of the corporate voting rights of the shareholders." (emphasis added)); *see also Cowin v. Bresler*, 741 F.2d 410, 427 (D.C. Cir. 1984) (similar).

[6] *Borak*, 377 U.S. at 431 (emphasis added; internal quotation marks and citation omitted).

one hand, by irresponsible outsiders *seeking to wrest control of a corporation* away from honest and conscientious corporation officials; and, on the other hand, by unscrupulous corporate officials seeking to retain control of the management by concealing and distorting facts."[7] The legislative history likewise reflects Congress's concern regarding misuse of proxies by corporate "[i]nsiders" as a means of "tak[ing] from the stockholders for their own selfish advantage valuable property rights."[8] Notably absent from these descriptions of section 14(a)'s purpose is any intent to regulate objective third-party analysis provided to investors.

Proxy advisory firms do not have a stake in the companies they analyze, do not seek to control those companies, and do not ask shareholders to vote a particular way. In fact, because proxy advisory firms follow each client's direction in preparing the requested analysis, they may make different recommendations based on the clients' priorities and direction for the same proxy, all based on the same information. Institutional Shareholder Services ("ISS"), for example, reports giving clients different voting advice on the same proposals, including recommending an "against" vote in some cases where warranted under the client's preferred faith-based guidelines and a "for" vote on the same proxy pursuant to a different client's preferred "benchmark" guidelines.[9] These facts preclude any argument that regulating proxy advisory firms as "soliciting" proxies is consistent with section 14(a)'s purpose.

Moreover, the Proposal would affirmatively undermine section 14(a)'s purposes by limiting sources of accurate information for investors. As explained in Parts III and IV below, the Proposal's new requirements would increase barriers to entry in the proxy advisory market, reduce existing proxy advisor firms' ability to provide analysis, and leave those firms with less time to respond to investor inquiries. These effects would *increase* the chance of inaccurate or incomplete assessments. That would in turn weaken a key mechanism for ensuring oversight of corporate governance and providing institutional managers and other investors with the data needed to invest with confidence in public companies. Indeed, without unfettered access to the analysis that proxy advisory firms provide, it is not difficult to see how the Proposal would undermine the ability of investors to fully understand "the real nature of the questions for which authority to cast [their] vote[s] is sought."[10]

B. The Proposal Contravenes the Plain Meaning of Section 14(a).

Even if the Proposal could somehow be characterized as advancing section 14(a)'s goals, that would not save the Commission's atextual interpretation. Supreme Court precedent dictates that "vague notions of a statute's 'basic purpose' are ... inadequate to overcome the words of its

[7] S. Rep. No. 1455, 73d Cong., 2d Sess., at 77 (1934) (emphasis added).

[8] H. Rep. No. 1383, 73d Cong., 2d Sess., at 14 (1934).

[9] ISS, Comment Letter on Statement Announcing SEC Staff Roundtable on the Proxy Process at 8 (Nov. 7, 2018), https://www.sec.gov/comments/4-725/4725-4629940-176410.pdf.

[10] *Borak*, 377 U.S. at 431.

text."[11] Here, the statute's purpose and its text point in the same direction—neither supports the Commission's interpretation.

The Proposal relies on an expansive and unjustified interpretation of the phrase "solicit any proxy." The Commission interprets that phrase to "include not only requests for proxies, but also any 'communication to security holders under circumstances reasonably calculated to result in the procurement, execution, or revocation of a proxy.'"[12] Although the first clause of that interpretation is unobjectionable, the second clause—which extends well beyond persons who solicit proxies—contravenes the statute's plain meaning.

The Exchange Act does not define "solicit" or "proxy." Traditional tools of statutory construction provide that "[w]hen a term goes undefined in a statute," the term is to be given "its ordinary meaning."[13] That inquiry ends the analysis where, as here, the meaning of a term is clear.[14]

The ordinary meaning of "solicit" is to request. When the Exchange Act was enacted, dictionaries defined "solicit" as "[t]o ask for with earnestness, to make petition to, to endeavor to obtain, to awake or excite to action, to appeal to, to invite."[15] That meaning remains the same today: Modern dictionaries continue to define "solicit" as "to make petition to," "to approach with a request or plea," or "to urge (something, such as one's cause) strongly."[16] Thus, a person "solicits" only if that person affirmatively requests something of another person. Under section 14(a), that something is a proxy, consent, or authorization related to a registered security.

"Proxy," in turn, means the "authority or power to act for another," "a document giving such authority *specifically*: a power of attorney authorizing a specified person to vote corporate stock," or "a person authorized to act for another."[17] As this definition makes clear, "proxy" refers to the authority or power to act on behalf of another person—in this context, to vote on

[11] *Montanile v. Bd. of Trustees of Nat. Elevator Indus. Health Benefit Plan*, 136 S. Ct. 651, 661 (2016) (alteration, punctuation, and citation omitted). Indeed, "even the most formidable argument concerning the statute's purposes could not overcome the clarity [present] in the statute's text." *Kloeckner v. Solis*, 133 S. Ct. 596, 607 n.4 (2012).

[12] Release at 14 (quoting 17 C.F.R. § 240.14a-1(*l*)(1)(iii)).

[13] *Taniguchi v. Kan. Pac. Saipan, Ltd.*, 566 U.S. 560, 566 (2012).

[14] *See Kisor v. Wilkie*, 139 S. Ct. 2400, 2415 (2019).

[15] Black's Law Dictionary (3d ed. 1933).

[16] Merriam-Webster, *https://www.merriam-webster.com/dictionary/solicit*; *see also* Oxford English Dictionary Online, https://oed.com/view/Entry/184207 (defining "solicit" as "[t]o entreat or petition (a person) for, or to do, something; to urge, importune; to ask earnestly or persistently").

[17] Merriam-Webster, *https://www.merriam-webster.com/dictionary/proxy*; *see also* Oxford English Dictionary Online, https://oed.com/view/Entry/153573 (defining "proxy" as "[a] document empowering a person to represent and act for another; a letter of attorney").

corporate matters on behalf of a shareholder.[18] Courts have thus explained that "proxy is a generic term which includes the broader statutory terms 'consent' and 'authorization.'"[19]

Putting these definitions together, the plain and controlling meaning of the phrase "solicit any proxy" is to request authority to vote a particular way on behalf of a particular shareholder.[20] This meaning is reinforced by the statutory terms that follow "proxy"—consent and authorization—both of which indicate that "solicitation" means to request authority in the context of a shareholder vote.

That plain meaning forecloses the Commission from extending Section 14(a) to statements "reasonably calculated to result in the procurement, execution, or revocation of a proxy" because that interpretation would encompass statements that provide objective analysis and do not request proxies. Specifically, the Commission's interpretation fails because it improperly substitutes "reasonably calculated to result in" for "solicit." A communication that is "reasonably calculated *to result in* the procurement, execution, or revocation of a proxy" is different than a communication that *requests* (i.e., solicits) "the procurement, execution, or revocation" of a proxy. A person may do many things that influence or lead to a result without requesting that it occur. For example, a journalist may write an article about a politician with some factual coverage that contributes to her success at the polls, but it would be absurd to describe the journalist as "soliciting" that outcome.

Applying the Commission's interpretation to proxy advisory firms demonstrates the point. Proxy advisory firms do not solicit proxies. They do not request or urge that a shareholder vote a certain way—much less request authority to vote on the shareholder's behalf. To the contrary, *shareholders* approach proxy advisory firms seeking advice on how the *shareholder* should vote. Institutional investors in particular often provide proxy advisory firms with unique criteria reflecting their investment strategies and particular concerns. Proxy advisory firms then apply these criteria to provide custom advice that reflects the client's priorities. In other words, the proxy advisory firm supports the investor's interests by providing tailored analysis.

The Commission's definition of proxy advisory firms reinforces this conclusion.[21] The Release notes that proxy advisory firms provide "voting *recommendations*" or "voting *advice*" that "[i]nvestment advisers and other institutional investors often" use "to *assist them* in making

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[18] *See* Black's Law Dictionary (11th ed. 2019) (defining "proxy" as "[s]omeone who is authorized to act as a substitute for another; esp., in corporate law, a person who is authorized to vote another's stock shares"); *see also* 17 C.F.R. § 240.14a-1(f) (defining "proxy" as "includ[ing] every proxy, consent or authorization within the meaning of section 14(a) of the Act," including "the form of failure to object or to dissent").

[19] *Sargent v. Genesco, Inc.*, 492 F.2d 750, 766 (5th Cir. 1974) (citing L. Loss, Securities Regulation 871 (2d ed. 1961)).

[20] Precedent requires "solicit" and "proxy" to be read together, and further directs that "two words together may assume a more particular meaning than those words in isolation." *FCC v. AT&T, Inc.*, 562 U.S. 397, 406 (2011).

[21] The Proposal, in relevant part, defines "proxy voting advice businesses" (i.e., proxy advisory firms) as "any person who markets and sells ... voting recommendations ... on specific matters presented at a registrant's shareholder meeting or for which written consents or authorizations from shareholders are sought in lieu of a meeting, along with the analysis and research underlying the voting recommendation." Release at 7–8.

their voting determinations."[22] But providing objective "recommendations" and "advice" under the direction of a shareholder is not the same thing as engaging in "solicitation"—investors ask proxy advisory firms for advice, not the other way around. Nor do the firms request a proxy, consent, or authorization—they provide recommendations and analysis that others may (or may not) use to inform voting on corporate matters.

Courts have repeatedly reaffirmed "the core administrative-law principle that an agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate."[23] That principle requires the Commission to construe "solicit any proxy" according to its ordinary, narrow meaning—a meaning that excludes proxy advisory firms.

C. *At a Minimum, the Commission Cannot Rely on Section 14(a) to Regulate Proxy Advisory Firms.*

Even assuming that the Commission is correct that solicitation under section 14(a) includes "any communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy," the Commission cannot rely on that interpretation to govern proxy advisory firms.

To the extent section 14(a) could be read to allow the Commission to regulate communications that are not express proxy solicitations, that authority at a minimum is limited to persons who solicit proxies in some manner. One might argue, for example, that to make the regulation of proxy solicitations effective, the Commission must also have authority to regulate closely related communications by the person making the solicitation, even if those communications are not themselves proxy solicitations. Even assuming section 14(a) grants the Commission this prophylactic authority over *persons* who request proxies, the Commission would still lack authority to regulate persons who do *not* solicit proxies—including proxy advisory firms.

The Commission, however, now seeks to expand its interpretation of section 14(a) beyond this narrow scope. For example, the Proposal would include within the definition of solicitation, in relevant part, "[a]ny proxy voting advice that makes a recommendation to a security holder."[24] But the text of section 14(a) does not support such an expansion. A person does not "solicit any proxy" when he or she "makes a recommendation," particularly one sought by a third party, regarding how to vote a proxy, because soliciting and making a recommendation are not the same thing.[25] Thus, applying the Commission's interpretation to proxy advisory firms—even if that interpretation lawfully may be applied to others—exceeds section 14(a)'s grant of authority.

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[22] *Id.* at 7 (emphases added).

[23] *Utility Air Regulator Group v. EPA*, 573 U.S. 302, 328 (2014).

[24] Release at 136.

[25] *See* Part I.A, *supra*.

D. *The Commission's Historical Interpretation of the Term "Solicit" Does Not Support the Proposal.*

The Commission acknowledges that the term "solicit" is capable of a narrower construction than the one given in the Proposal, but purports to rely on its "longstanding" view that section 14(a) applies more broadly to "any communications reasonably calculated to result in a shareholder's proxy voting decision."[26] That is insufficient; an agency's reliance on its historical position cannot trump the statutory text.[27] To the extent the Commission's historical practice is contrary to the plain meaning of section 14(a), its practice must yield to the statute.

Regardless, there is no conflict between the Commission's longstanding view and the conclusion that section 14(a) does not govern proxy advisory firms. Although the Commission adopted the "reasonably calculated to result in" interpretation in 1956, the Commission has never before applied that interpretation to proxy advisory firms. Instead, the Commission is proposing to amend rules that *exempt* proxy advisory firms from the information and filing requirements of the federal proxy rules. These exemptions have put a practical limit on an interpretation of section 14(a) that otherwise would be overbroad and have avoided contravening the Exchange Act as contemplated in the Proposal.

The Commission itself has recognized this limitation. In 1992, the Commission found that "[t]he literal breadth of the [1956] definition of solicitation was so great as potentially to turn almost every expression of opinion concerning a publicly-traded corporation into a regulated proxy solicitation."[28] And the Commission likewise acknowledged that the "excessive regulatory reach of [the 1956 definition of] 'solicitation'" would be a "distortion of the purposes of the proxy rules."[29] That is because in adopting the 1956 definition, the Commission intended "to address abuses by persons *who were actually engaging in solicitations of proxy authority* in connection with election contests."[30] The Commission attributed the apparent breadth of the 1956 definition to an accident, explaining that the 1956 Commission "does not seem to have been aware, or to have intended, that the new definition might also sweep within all the regulatory requirements *persons who did not 'request' a shareholder to grant or to revoke or deny a proxy*, but whose expressed opinions might be found to have been reasonably calculated to affect the views of other shareholders positively or negatively toward a particular company and its management or directors."[31] There is thus no historical basis for applying section 14(a) to proxy advisory firms.

Even if the Commission is correct that proxy advisory firms play a larger role in the market than they did in 1956 or a decade ago, section 14(a) has not changed during that time. It provides

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[26] Release at 18–19.

[27] *See Trump v. Hawaii*, 138 S. Ct. 2392, 2410–13 (2018) (rejecting argument that "historical practice ... justifies departing from the clear text of the statute"); *INS v. Chadha*, 462 U.S. 919, 944–46 (1983) (where text is sufficiently clear, the existence of a historical practice departing from the text cannot justify the departure).

[28] *Regulation of Communications Among Shareholders*, 57 Fed. Reg. 48276, 48278 (Oct. 22, 1992).

[29] *Id.*

[30] *Id.* at 48277 (emphasis added).

[31] *Id.* at 48277–78 (emphasis added).

a limited grant of authority to regulate a specific class of persons, and proxy advisory firms do not fall within that class. Courts will give no deference to the Commission's overbroad interpretation.[32]

II. The Proposal Would Violate the First Amendment.

The Proposal would violate the First Amendment by regulating the speech of proxy advisory firms based on its content. Proxy advisory firm analysis is fully protected speech under the First Amendment, and the Proposal does not come close to meeting the strict-scrutiny test that governs content-based speech restrictions. The Proposal's exemption provisions are equally unconstitutional: they would impose an unlawful prior restraint by requiring proxy advisors to submit their analysis to issuers for pre-publication review, while also unlawfully compelling proxy advisors to distribute the issuer's response along with their own advice.

The Release ignores these serious constitutional defects entirely. Although the Supreme Court has made clear that the First Amendment constrains the Commission's authority to regulate advice about securities,[33] the Release includes no analysis whatsoever regarding the Proposal's First Amendment implications, much less reasons why the Proposal meets the exacting requirements for regulating protected speech.

Statutes must be construed to "avoid constitutional difficulties" whenever possible.[34] Here, there is a straightforward way for the Commission to do so: It can limit section 14(a)'s reach to proxy solicitations and solicitors, without regulating firms that merely provide proxy advice requested by shareholders.

A. The First Amendment Fully Protects Advice Provided by Proxy Advisory Firms.

The advice that proxy advisory firms provide their clients is fully protected by the First Amendment. Courts have held that a broad range of market information and advice is entitled to First Amendment protection,[35] and the same rationale applies to proxy advisory firm advice.

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[32] The fundamental disconnect between the Commission's interpretation and section 14(a)'s text and core purposes dictates that the Proposal is ineligible for deference under *Chevron v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). It is an open question "whether *Chevron* ... remain[s]" good law, *SAS Institute, Inc. v. Iancu*, 138 S. Ct. 1348, 1358 (2018), and courts have recently and repeatedly reaffirmed that *Chevron* has no role to play where, as here, the traditional tools of statutory interpretation "supply an answer." *Epic Sys. Corp. v. Lewis*, 138 S. Ct. 1612, 1630 (2018).

[33] *See, e.g.*, *Lowe v. SEC*, 472 U.S. 181 (1985) (First Amendment bars SEC from prohibiting the publication of non-personalized investment advice).

[34] *Chamber of Commerce of U.S. v. FEC*, 69 F.3d 600, 605 (D.C. Cir. 1995); *see also Motion Picture Ass'n of Am., Inc. v. FCC*, 309 F.3d 796, 805 (D.C. Cir. 2002).

[35] *See, e.g.*, *Taucher v. Born*, 53 F. Supp. 2d 464 (D.D.C. 1999) (First Amendment bars requiring publishers of commodity trading information to register as commodity trading advisors); *Commodity Trend Serv., Inc. v. CTFC*, No. 97-C-2362, 1999 WL 965962 (N.D. Ill. 1999) (registration requirement for commodities trading advisors violates First Amendment).

As the Release acknowledges, proxy advisory firm advice addresses matters involving corporate governance and critical matters of social and political concern. The Commission concedes, for example, that the speech the Proposal seeks to regulate includes advice on specific policy positions, such as advising whether a particular corporate action would comport with a "socially responsible policy."[36] The question of what represents a "socially responsible policy" is exactly the subject matter afforded the First Amendment's fullest protection.

B. *The Proposal is Presumptively Unconstitutional as a Content-Based Regulation of Speech and Cannot Satisfy Strict Scrutiny.*

The First Amendment strictly limits the type of regulation proposed by the Commission because the Proposal would burden speech about proxy solicitations, rather than solicitations themselves.[37] The Commission admits that the Proposal is based on the content of proxy advisory firms' communications, explaining that "the determination of whether a communication is a solicitation depends upon both the *specific nature and content* of the communication and the circumstances under which the communication is transmitted."[38] Such content-based regulations are "presumptively unconstitutional" and subject to strict scrutiny.[39]

To satisfy the demanding standard of strict scrutiny, the government must show that the Proposal would serve a compelling government interest *and* that it is the least restrictive means of serving that asserted interest.[40] The Proposal fails both prongs of that test.

First, the Commission lacks any valid interest, much less a compelling interest, in regulating the analysis provided by proxy advisory firms. The Proposal asserts that it is intended to avoid the risk of proxy advisory firms providing "inaccurate or incomplete voting advice" and to enhance the accuracy, transparency of process, and completeness of the information provided by "proxy voting advice businesses."[41] But as the Commission itself concedes, "research on the role of proxy voting advice businesses in proxy voting has produced *inconclusive results with respect to the quality of voting advice*."[42]

The only study cited by the Commission on this subject identifies an error rate of only 0.4% and is itself flawed, as demonstrated in Part IV.A below. The Commission seeks to paper over this evidentiary void by noting that issuers "have expressed concerns about proxy voting advice," but such vague, unsubstantiated, and unquantified concerns do not come close to establishing the sort of compelling interest necessary to curb protected speech. As the Supreme

[36] Release at 18.

[37] *Cf. Washington Post v. McManus*, 944 F.3d 506, 515-516 (4th Cir. 2019) (direct participants in the political process may be regulated differently than those who publish information about the political process).

[38] Release at 15 (emphasis added).

[39] *Reed v. Town of Gilbert*, 135 S. Ct. 2218, 2226 (2015); *see also, e.g., R.A.V. v. City of St. Paul, Minn.*, 505 U.S. 377, 382 (1992); *Simon & Schuster, Inc. v. Members of New York State Crime Victims Bd.*, 502 U.S. 105, 115 (1991).

[40] *See United States v. Playboy Entm't Grp., Inc.*, 529 U.S. 803 (2000).

[41] Release at 11.

[42] Release at 81 (emphasis added).

Court has explained, "mere speculation and conjecture will not suffice."[43] And of course the issuers (however few or many they may be) are seeking to cabin the free expression of proxy advisers who often operate as a fact-check on issuers' statements and initiatives, such as when issuers want to raise executive compensation despite an inadequate basis for doing so.

Second, the Proposal is not the least restrictive means of promoting the Proposal's asserted goals of accuracy and completeness. The Proposal does not even attempt to evaluate whether less restrictive measures would be effective. Moreover, the Commission concedes that section 14(a) "arguably might be construed more narrowly"[44] and acknowledges that the Proposal "may, in certain circumstances impose burdens that deter communications useful to shareholders, and in such circumstances, may not be necessary to protect investors in the proxy voting process."

Those concessions understate the problem and are legally fatal in any event. By its very design, the Proposal sweeps broadly and impinges upon accurate and factual speech as well as the purported errors—for example by requiring proxy advisory firms to include a link to the issuer's response even when it is undisputed that the proxy advisory firm's analysis is correct and complete. The Proposal's vast reach is even more troubling because Rule 14a-2(b)(3), an exemption from the proxy solicitation requirements on which proxy advisory firms may rely, already (i) requires disclosure of any significant relationship with the issuer and relevant material interests, (ii) prohibits false or misleading statements, and (iii) prohibits advisors from receiving compensation from anyone other than the recipient of the advice.[45]

Even if proxy advisory firms may play a more "significant role" than they did in the past, as the Commission suggests, that development is not inherently negative and certainly does not justify the Proposal's fundamental shortcomings. Whether proxy advisory firms play a large or small role in the marketplace is irrelevant given the complete absence of evidence of errors or misstatements by those firms.[46] In fact, increased reliance by investors on proxy advice undercuts the basis for the Proposal, rather than supports it, by demonstrating that investors are satisfied with the advice they are receiving, and that such advice fills a genuine marketplace need. The mere possibility of errors, after decades where there has been no record of misstatements or omissions, cannot justify such a sweeping intrusion on speech.

C. *The Proposed Rule Would Impose an Unconstitutional Prior Restraint on Speech.*

The Proposal is also unconstitutional because it would impose a prior restraint by requiring proxy advisory firms to submit their advice to issuers for pre-publication review. Under the Proposal, only proxy advisory firms that comply with that prior restraint are eligible for

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[43] *Ibanez v. Florida Dept. of Business and Professional Regulation*, 512 U.S. 136, 142-143 (1994) ("[T]he State 'must demonstrate that the harms it recites are real and that its restriction will in fact alleviate them to a material degree.'") (quoting *Edenfield v. Fane*, 507 U.S. 761, 770-771 (1993)).

[44] Release at 18-19.

[45] *See id.* at 24-25.

[46] *See id.* at 25-26.

exemptions from the proxy solicitation regulations. The First Amendment prohibits the Commission from conditioning the availability of a regulatory exemption through a restriction on speech.[47]

Specifically, the Proposal would require proxy advisory firms to provide issuers an opportunity to review and comment on their advice "before ... disseminat[ing] [the] voting advice to clients, regardless of whether the advice on the matter is adverse to the registrant's own recommendation."[48] Such prior restraints on the freedom of speech are "the essence of censorship"[49] and "the most serious and the least tolerable infringement" of the First Amendment.[50] Indeed, the Proposal's prior-review requirement would chill the objective advice and recommendations of these firms, thereby impairing their ability to provide objective, data-driven advice needed to maintain the integrity of the capital markets. For these reasons, courts apply "a heavy presumption against [the] constitutional validity" of such prior restraints, and have struck down similar requirements as inconsistent with the First Amendment.[51]

D. The Proposed Rule Violates First Amendment Restrictions on Compelled Speech.

The government cannot force speakers and publishers to provide a right of reply. Despite that bright-line rule, the Proposal would require proxy advisory firms to include in their advice to clients a hyperlink to the issuer's response.[52] That mandate is unconstitutional.

The Supreme Court has long rejected government imposition of a "right of reply" requirement. In *Miami Herald Publishing Co. v. Tornillo*, the Court struck down a law requiring that newspapers provide political candidates an opportunity to respond to published criticism, stressing that it would be unconstitutional to compel a newspaper to print content that it would not otherwise include, and that the statute impermissibly intruded on the newspaper's editorial judgment.[53] And the Court held in *Pacific Gas & Electric Co. v. Public Utility Commission* that this constitutional protection applies equally in the commercial context, striking down an order requiring a utility to include a third party's newsletter in its billing envelopes.[54] As the *Pacific Gas*

[47] *See Speiser v. Randall*, 357 U.S. 513, 518 (1958) ("a discriminatory denial of a tax exemption for engaging in speech is a limitation on free speech").

[48] Release at 44-45.

[49] *Near v. Minnesota ex rel. Olson*, 283 U.S. 697, 713 (1931).

[50] *Nebraska Press Ass'n v. Stuart*, 427 U.S. 539, 559 (1976).

[51] *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58, 70 (1963).

[52] *See* Release at 48-49, 54.

[53] *Miami Herald Publishing Co. v. Tornillo*, 418 U.S. 241, 256-58 (1974).

[54] *See Pacific Gas & Elec. Co. v. Public Util. Comm'n*, 475 U.S. 1 (1986)

Court explained, "[f]or corporations as for individuals, the choice to speak includes within it the choice of what not to say."[55] The same principle applies here.[56]

As in *Tornillo* and *Pacific Gas*, the Proposal violates the First Amendment by requiring proxy advisors to distribute to their own clients the speech of third parties, regardless of whether they agree with that speech or would independently choose to convey it. While the Release states that the Proposal is intended to "improve the overall mix of information available to the clients of proxy voting advice businesses," it does not identify any precedent that authorizes the government to mandate a right to reply, or grapple with the broader First Amendment implications of requiring proxy advisors to transmit the speech of third parties. And the fallacy that hangs over the Commission's construct is that the issuer is currently in fact free to publish to the marketplace any response it chooses, as many times as it chooses, and in whatever manner it chooses, without hijacking the proxy advisor's report to do so. This begs the question of why, when the issuer has an unfettered ability to affect the overall mix of information in whatever way it wishes, the Commission believes it can improve that overall mix of information only by handcuffing the market's proven independent advisors.

E. None of The Typical Justifications for Regulating Speech Applies.

Although agencies often seek to justify speech regulations by arguing that the speech in question is entitled to reduced protection, or that a more relaxed form of scrutiny governs, none of those arguments applies here.

First, there is no basis for treating advice provided by proxy advisory firms as anything less than fully protected, core speech.

Proxy voting advice is not "commercial speech"—i.e., speech that "does 'no more than propose a commercial transaction'"[57]—because proxy advisory firm advice consists of objective research, analysis, and voting recommendations often related to market-wide issues of great importance. The fact that proxy advisory firms "market their expertise"[58] in researching and analyzing matters subject to a proxy vote does not alter this conclusion.[59] Nor is the publication of proxy voting advice "conduct" subject to more intrusive regulation. The only "conduct"

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[55] *Id.* at 2.

[56] *See Riley v. National Fed'n of Blind of N.C., Inc.*, 487 U.S. 781, 795 (1988) ("Mandating speech that a speaker would not otherwise make necessarily alters [its] content," including forcing the speaker simply to disclose "facts."); *see also id.* at 797-800.

[57] *Va. State Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 762 (1976) (quoting *Pittsburgh Press Co. v. Pittsburgh Comm'n on Human Relations*, 413 U.S. 376, 385 (1973)).

[58] Release at 16.

[59] *See Joseph Burstyn, Inc. v. Wilson*, 343 U.S. 495, 501-02 (1952) ("That books, newspapers, and magazines are published and sold for profit does not prevent them from being a form of expression whose liberty is safeguarded by the First Amendment."); *New York Times Co. v. Sullivan*, 376 U.S. 254, 266 (1964) ("That the *Times* was paid for publishing the advertisement is as immaterial in this connection as is the fact that newspapers and books are sold.").

involved is writing a report and providing advice.[60] The Commission is thus proposing to regulate "speech as speech."[61]

Likewise, the Commission cannot justify the regulation of speech, or the application of a lower level of constitutional scrutiny, by claiming regulation is necessary to regulate a profession. As the Supreme Court recently explained, "professional speech" is not "a separate category of speech" and "[s]peech is not unprotected merely because it is uttered by professionals."[62]

For similar reasons, the Commission cannot merely rely on its authority to regulate "in the public interest for the protection of investors."[63] Even where the government has the constitutional authority to regulate economic transactions, it does not necessarily have the authority to do so by regulating speech.[64] The Release cites New Deal-era case law,[65] but the Supreme Court has since made clear that the First Amendment prohibits government regulation that seeks to control how information is communicated, particularly where—as here—the proposed regulation favors selected market participants.[66]

Second, the Proposal would fail to pass constitutional muster even under intermediate scrutiny, which requires the government to show that its proposed regulation is necessary to serve an important or substantial governmental interest and narrowly tailored to serve that interest.[67] The Release only claims generally that prior review of proxy voting advice is intended to avoid "error" and provide "complete information." That does not demonstrate an important governmental interest; again, speculation and conjecture are not enough. Nor, in light of the inarguably higher error rate of issuers and their inherent bias, is there any credible basis to believe that allowing them to have input into proxy advisor advice would avoid "error" or provide more "complete information."[68] Moreover, the Release fails to demonstrate that the proposed

[60] *See, e.g.*, *Sorrell v. IMS Health Inc.*, 564 U.S. 552, 570 (2011) (rejecting argument that statute restricting use of prescriber-identifying information regulated "conduct" and not First Amendment-protected speech, explaining that "the creation and dissemination of information are speech within the meaning of the First Amendment").

[61] *National Inst. of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361, 2374 (2018).

[62] *Becerra*, 138 S. Ct. at 2371-72 (internal quotation marks omitted).

[63] Release at 68; *see Motion Picture Ass'n of Am., Inc. v. FCC*, 309 F.3d 796, 803, 805 (D.C. Cir. 2002) ("general provisions" of Section 1 of the Communications Act giving FCC authority to make regulations "consistent with the public interest" "have not been construed to go so far as to authorize the FCC to regulate program content").

[64] *See, e.g.*, *Expressions Hair Design v. Schneiderman*, 137 S. Ct. 1144, 1151 (2017).

[65] In a footnote, the Release refers to only one case that discusses First Amendment implications of SEC rules governing proxy solicitations – but the Release fails to address the constitutional issue at all. *See* Release at 14 n.31 (citing *Long Island Lighting Co. v. Barbash*, 779 F.2d 793 (2d Cir. 1985)). Judge Winter's dissent in that case focused on the "serious [F]irst [A]mendment issue" raised by the regulation at issue, *id.* at 797, but the Release ignores it.

[66] *See, e.g.*, *Sorrell*, 564 U.S. at 576-79.

[67] *See Heller v. D.C.*, 670 F.3d 1244, 1258 (D.C. Cir. 2011).

[68] *See, e.g.*, Nishant Mohan, *Companies Are Finding More Accounting Flubs*, WALL ST. J. (Sept. 20, 2018) ("During the first six months of 2018, 65 companies detected accounting mistakes significant enough to require them to restate and refile entire financial filings to regulators."); Audit Analytics, *2018 Financial Restatements Review* (Aug. 28, 2019), https://blog.auditanalytics.com/2018-financial-restatements-review/ (documenting hundreds of issuer restatements per year every year since 2010, many of which addressed "material error[s] that call[ed] for the reissuance of a past financial statement").

rule is narrowly tailored to achieve even these vaguely stated goals; as noted above, the Release concedes that section 14(a) could be interpreted and applied more narrowly.

The only interest the Proposal would serve is the interest of the corporations that the proxy advisory firms may, from time to time, oppose. That interest does not come close to justifying the Proposal's significant restrictions on constitutionally protected speech.

III. The Proposal Violates the Commission's Obligation to Promote Competition.

The Exchange Act requires the Commission to consider "whether [its] action will promote efficiency, competition, and capital formation,"[69] and the Commission may not adopt any "rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the [Act's] purposes."[70] The Proposal fails to comply with these requirements because it would hinder, rather than promote, competition in the market for proxy advisory services and would impose unnecessary burdens on the capital markets. These failures independently render the Proposal arbitrary, capricious, and contrary to law.[71]

A. The Proposal Would Raise Barriers To Entry in a Concentrated Market.

As the Commission acknowledges, the market for proxy advisory services is extremely concentrated; two firms—a duopoly—share approximately 97 percent of the market.[72] Competition may be harmed by action that "significantly heighten[s] barriers to entry" in a concentrated market.[73] Any Commission action that at best entrenches the existing duopoly and more likely impedes existing firms' ability to compete, rather than encouraging market participation, necessarily fails to promote competition.

The Proposal would reduce competition among the two existing firms (and even threaten the viability of the smaller firm), and would also exacerbate the entry barriers for new proxy advisory firms.

First, as the Commission acknowledges, the Proposal would impose new costs on proxy advisory firms. For potential entrants already facing substantial investment and commercial obstacles to entry, these new costs would be a further disincentive to compete with the incumbent firms.[74] *Existing* costs have been a sufficient barrier to prevent any significant new

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[69] 15 U.S.C. § 78c(f); *see also Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 283 (2007) (Commission must "take account of competitive considerations when it creates securities-related policy.").

[70] *Id.* § 78w(a)(2).

[71] *See Am. Equity Inv. Life Ins. Co. v. SEC*, 613 F.3d 166, 178 (D.C. Cir. 2010) (vacating proposed Commission rule as arbitrary and capricious where Commission failed to properly consider competitive effects).

[72] *See* Release at 89 & n.215.

[73] *N. Am. Soccer League, LLC v. United States Soccer Fed'n, Inc.*, 883 F.3d 32, 42 (2d Cir. 2018).

[74] *See* GAO Report to Congress, *Corporate Shareholder Meetings—Issues Relating to Firms that Advise Institutional Investors on Proxy Voting*, GAO-07-765 at 13-14 (June 2007), https://www.gao.gov/new.items/d07765.pdf (noting that entry requires the "significant expense" of upfront investment in comprehensive coverage and development of sophisticated technology).

recent entry; adding additional barriers would at best only further entrench the duopoly status quo. Indeed, these new costs may well be sufficient to drive the smaller current firm out of the market.

Second, the Commission understates the scope of the new costs and burdens that the Proposal would impose. For example, the Proposal would expose proxy advisors to greater risk of liability under Rule 14a-9, which provides a private right of action with respect to alleged false or misleading statements or omissions made in connection with a proxy solicitation. Courts have recognized the *in terrorem* effect of private litigation on companies, even when a plaintiff's claims are groundless.[75] This increased exposure to litigation from well-funded public companies and other parties, as well as the resulting potential liability, would be a major disincentive to participation in the proxy advisory market.[76]

Third, these new costs would disproportionately affect the decisions of potential entrants. Increased costs are more likely to be absorbed by incumbent market participants with sunk-cost investments in their business than by new entrants evaluating the attractiveness of a new opportunity. The net effect of this dynamic is that increased regulatory costs tend to deter new market entry and protect incumbents from competition.[77] Further, the type of entity most likely to bring increased competition to the market—one with substantial existing assets and operations—would be particularly concerned about exposing its overall business to the increased liability and litigation expense imposed under the Proposal. And even within the existing duopoly, these new costs would be felt disproportionately by the smaller firm, leading to that firm's diminished ability to compete and perhaps even its exit from the market.

In short, what the Commission acknowledges is a possibility—that the additional costs could "cause some businesses to exit the market or potential entrants to stay out of the market"[78]—is in fact a certainty. The Proposal would at best entrench the current duopoly, and its increased costs could drive one of the existing firms from the market, thus hindering competition by converting a duopoly into a monopoly. There is no possibility that the Proposal could promote competition.

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[75] *See Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 347 (2005); *Meyer v. Greene*, 710 F.3d 1189, 1196 (11th Cir. 2013).

[76] *See infra* § IV.B.

[77] *See, e.g.*, James B. Bailey & Diana W. Thomas, *Regulating Away Competition: The Effect of Regulation on Entrepreneurship and Employment*, 52 J. REG. ECON. 237 (Dec. 2017) (publishing data supporting thesis that increased regulatory costs deterred entry by new firms more than it stimulated exit by incumbent firms); Alberto Alesina, et al., *Regulation and Investment*, 3 J. EUROPEAN ECON. ASS'N 791 (2005), https://academic.oup.com/jeea/article/3/4/791/2280868 (finding that regulation in a product market typically serves as protection for incumbent producers).

[78] Release at 111.

B. There is No Evidence To Support the Proposal's Stated Potential Competitive Benefits.

There is no evidence in the marketplace—or in the Release—that "establishing requirements that promote accuracy and transparency in proxy voting advice" would increase competition in the proxy advisory market.[79] Specifically, the Commission has no basis for speculating that imposing the proposed requirements would stimulate demand for these services.

As a threshold matter, there is no evidence that consumers of proxy advisory services are limiting demand out of dissatisfaction with quality. On the contrary, the Release states that proxy advisory services are more widely used today than in the past. Further, as discussed above, consumers of proxy advisory services oppose the Proposal because they do not believe that it would improve quality (or any other relevant metric of competition) in the proxy advisory market.

More fundamentally, the Commission's speculation about increased demand fails as a matter of basic economics—it misapplies principles of pricing and demand. If the Commission could increase accuracy and transparency of proxy advice while holding all other factors constant, that would constitute a price decrease (in the form of enhanced services at the same price). Assuming adequate supply, economic theory suggests that this price change would lead to increased demand. Critically, however, the Proposal would not hold all other factors constant. Instead, and as acknowledged in the Proposal,[80] the only certainty is that the proposed requirements would impose additional costs on proxy voting advice business, *i.e.*, a price increase that would depress demand.[81]

Finally, the Commission's assertion that "the requirements that promote accuracy and transparency in proxy voting advice could stimulate competition among existing proxy voting advice businesses with respect to the quality of advice" is similarly flawed. Imposing these regulatory burdens would, if anything, *decrease* competition by replacing efforts to differentiate services based on "quality of advice" with adherence to a uniform regulatory scheme.[82]

Consumers of proxy advisory services—generally, sophisticated investors—rely on these firms to provide accurate and high quality advice. Economic principles and common sense suggest that investors already demand this quality and accuracy from their proxy advisory firms,

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[79] *Id.* at 110.

[80] *See id.*

[81] That is true whether or not the proxy advisory firms are able to pass on these costs to clients. If they are, that would reflect an actual price increase that affects demand. If they are not, that will affect the existing firm's investments in the market and decision whether to stay in the market, and a potential entrant's decision whether to enter the market.

[82] In fact, academic work suggests that the key to improving quality in the proxy advisory firm market is to increase the number of participants. *See* Tao Li, *Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry*, 64 MGMT. SCI. 2951, 2953 (2018) (reporting data suggesting that increasing the number of proxy advisory firms improved the quality of their services as measured by reduced influence of conflicts of interest).

and that firms accordingly compete on this basis. Indeed, we speak from experience—Elliott considers quality and accuracy of advice as an essential factor in retaining proxy advisory firms.

In this regard, the Proposal seeks to solve a problem through regulation that does not exist and that the market would be capable of addressing. The Commission believes that investors are relying on proxy advisory services to a greater degree today than ever before. That increased demand and the near total absence of investor support for increased regulation reveal the Proposal's true purpose: an issuer-led effort to rein in the influence of proxy advisors.[83] There is no clearer indictment of the true motivations underlying these proposals than the fact that an interest group funded by prominent issuers ghost-wrote letters of support that were falsely submitted to the Commission as supposedly authored by concerned shareholders.[84] Moreover, it appears this conduct continued even after it was brought to light by journalists.

In short, the notion that the Commission could increase competition by imposing costs and burdens on proxy advisory firms turns basic principles of economics on their head. Increasing costs would be expected to *decrease* demand, and the Proposal would cement the status quo or, worse, result in a monopoly if the smaller firm were to exit the market. To the extent the Commission is concerned about the quality of proxy advisory services, it should adopt policies that would ease entry and participation in this market, thereby increasing competition.[85] The Commission's failure to address these competitive issues and "adequately to assess the economic effects of a new rule" is arbitrary and capricious.[86]

IV. The Proposal Violates the Administrative Procedure Act.

The APA requires agencies engaged in rulemaking to adhere to a standard of reasoned decision-making.[87] The Proposal fails to satisfy this standard for multiple reasons.

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[83] *See, e.g.*, Michael T. Cappucci, *The Proxy War Against Proxy Advisors*, Harvard L. Forum on Corporate Governance and Financial Regulation (Nov. 27, 2019), https://corpgov.law.harvard.edu/2019/11/27/the-proxy-war-against-proxy-advisors/.

[84] *See* 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.

[85] *See Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005) (failure to consider a suggested alternative can itself violate the APA).

[86] *See Bus. Roundtable v. SEC*, 647 F.3d 1144, 1148–49 (D.C. Cir. 2011) ("Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.").

[87] *See Allentown Mack Sales & Service, Inc. v. NLRB*, 522 U.S. 359, 374 (1998) (APA "establishes a scheme of 'reasoned decisionmaking'" (quoting *Motor Veh. Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983))); *see also Baltimore Gas & Elec. Co. v. NDRC, Inc.*, 462 U.S. 87, 105 (1983). To satisfy this standard, the agency "must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *State Farm*, 463 U.S. at 43 (internal quotation marks and citations omitted).

A. The Proposal is Based on Flawed Economic Analysis and a Faulty Premise.

The Commission's economic analysis cannot be sustained. It is based largely on issuer criticisms and does not take adequate account of the views of institutional investors.

The Commission cites allegations of pervasive inaccuracy in proxy advisor reports as a principal reason for the Proposal. However, retail and institutional investors have not identified any such errors that would justify the imposition of new restrictions on proxy advisory firms. Nor is there a well-substantiated record of such errors from other sources. In fact, in their comment letters on the Statement Announcing the Commission Staff Roundtable on the Proxy Process (the "Staff Roundtable"),[88] institutional investors consistently emphasized the crucial importance of proxy advisors and the value of their proxy voting advice. The Commission itself admits that "research on the role of proxy voting advice businesses in proxy voting has produced inconclusive results with respect to the quality of voting advice."[89] And as mentioned above, the Commission's reliance on fraudulent letters—no doubt the product of the efforts of certain issuers and their consultants—moves the Commission's factual basis from elusive to illusory. For these reasons, the Commission's premise regarding the nature of the problem and its severity is deficient.

The Commission bases its contrary conclusion on unsound and insufficient information. The Commission points only to "concerns" expressed "by a number of commentators, particularly within the registrant community" that there "*could*" be factual errors or other inaccuracies and the "*perception* of many registrants" that they lacked sufficient opportunity to engage with the proxy advisory firms on these putative issues.[90] These are not facts or even hypotheses; rather, they are just "subjective feelings"—the Commission fails to cite empirical evidence that proxy advisory firm reports contain errors or misstatements.

The only study on alleged inaccuracies cited by the Commission, undertaken by the American Council on Capital Formation in October 2018, does not provide support for the Proposal. Even if taken as accurate, the study is insufficient to justify the Proposal; the study identifies only 139 errors among the tens of thousands of proxy advisory reports generated during the three-year (2016-2018) study period.[91] In an evaluation of the study, the Council of Institutional Investors ("CII") notes that there were in fact 31,830 reports generated by proxy advisory firms during the study period, so that the 139 errors cited amount to an annual error rate of only 0.4%.[92] Moreover, the study overstates the error rate in proxy advising and incorrectly identifies differences of opinion as flaws in proxy advice. CII determined that the error

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[88] *See* Comment Letters on Statement Announcing SEC Staff Roundtable on the Proxy Process, https://www.sec.gov/comments/4-725/4-725.htm (last updated Jan. 22, 2020).

[89] Release at 81.

[90] Release at 39 (emphasis added).

[91] *See* Council of Institutional Investors, Comment Letter on Statement Announcing SEC Staff Roundtable on the Proxy Process (Oct. 24, 2019), https://www.sec.gov/comments/4-725/4725-6357861-196392.pdf.

[92] Frank M. Placenti, *Are Proxy Advisors Really A Problem?*, American Council for Capital Formation (Oct. 2018), http://accfcorpgov.org/wp-content/uploads/2018/10/ACCF_ProxyProblemReport_FINAL.pdf.

rate was actually between 0.057% and 0.123%, meaning that out of 31,830 reports, proxy advisory firms made between 18 to 39 errors *in the aggregate*.[93]

Even with respect to this miniscule number of errors, the Commission has undertaken no substantive review, including to determine whether the alleged errors materially bear on the recommendations of the proxy advisory firm. Nor has there been a review and tally of the beneficial analysis that has made the information in the marketplace more accurate than it otherwise would have been in the absence of the proxy advisory firms' analyses. That significant informational benefit undoubtedly far outstrips any cost resulting from the infinitesimal number of errors.

The Commission's premise regarding the nature of the problem and its severity is also flawed because the major proxy advisory firms already provide issuers an opportunity to review data used as a basis for their advice. Glass Lewis provides an "Issuer Data Report" to issuers in the United States and several other countries.[94] To receive a report, the issuer must register with Glass Lewis and provide its proxy statement 30 days prior to the annual meeting. Glass Lewis then provides the data it uses as a basis for its proxy advice to the issuer for review. The issuer has 48 hours to provide any corrections substantiated by publicly-available information. Glass Lewis also commits to engaging with issuers directly; in 2017, Glass Lewis met with more than 2,300 issuers, including nearly 1,400 formal meetings in person or by phone with almost 1,100 issuers.[95] Significantly, Glass Lewis declines only six percent of meetings requested by issuers, exclusively because the meetings would violate its internal policies of not engaging with issuers during the solicitation period preceding the issuer's annual meeting.[96] ISS similarly allows issuers to verify its "QualityScore"[97] data online for a week-long period in November.[98]

The Proposal cannot be justified in light of the extremely low risk of error by proxy advisory firms and the existing processes for issuer review of proxy advisory firm data. Beyond this, reducing the time period in which proxy advisory firms would have to undertake their analysis and prepare their voting recommendations could *increase* the error rate, contrary to the Proposal's stated goals, because proxy advisory firms would be stretched even thinner and have significantly less time to confirm the accuracy of their reports.

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[93] *See* Council of Institutional Investors, *supra* note 91 at 3.

[94] Glass Lewis, *Issuer Data Report (IDR)*, www.glasslewis.com/issuer-data-report/ (last visited Jan. 30, 2020).

[95] Glass Lewis, Comment Letter on Statement Announcing SEC Staff Roundtable on the Proxy Process at 7 (Nov. 14, 2018), https://www.sec.gov/comments/4-725/4725-4649188-176490.pdf.

[96] *See id.* at 8.

[97] QualityScore is a rating of a corporation's governance quality and risk, based on board structure, compensation, shareholder rights, and audit/risk oversight.

[98] *See* ISS, *Data Verification*, https://www.issgovernance.com/esg/ratings/data-verification/ (last visited Jan. 30, 2020).

B. *The Proposal's Flawed Analysis Fails to Fully Account for the Proposal's Significant Costs.*

The Commission also fails to properly account for the full costs that the Proposal would impose on proxy advisory firms, institutional investors, and main street investors.

The regulatory burdens imposed by the Proposal would require proxy advisory firms to hire additional staff and undertake significant additional steps to serve their clients. The firms would not be in a position to absorb these costs; as some firms have already acknowledged in previous comment letters, the profit margins in the proxy advisory market are low.[99] As a result, proxy advisory firms would have no choice but to pass on the increased costs to their clients, mainly investment advisers and institutional investors. Such increased fees could, in turn, be passed on to the ultimate beneficiaries of the investment management services provided by proxy advisory firms' clients, including individuals whose stock investments are managed, directly or indirectly, by investment advisers and institutional investors.

Moreover, and as described above, the Proposal would expose proxy advisory firms to increased litigation under Rule 14a-9. Even meritless litigation is costly and burdensome, and could place a significant burden on proxy advisory firms given their low margins. In addition to this potential financial burden, the risk of increased litigation against proxy advisory firms would negatively affect the quality and reliability of proxy advisory firms' advice, because the threat of such litigation (even if ultimately meritless) could create incentives for proxy advisory firms to curry favor with issuers, steer away from potentially important but controversial positions, and chill their willingness to provide negative recommendations or otherwise raise difficult issues. Indeed, under the Commission's imposed framework, the issuer could threaten litigation until it is satisfied with the proxy advisory firm's report; that of course completely unbalances the dynamic between the issuers and the advisory firms.

The Commission's analysis fails to properly analyze or account for any of these costs. Instead, the Proposal would have individual investors ultimately bear the costs and impacts of the rule changes, while at the same time suffering the effects of a decline in the quality of investment advice provided by those who manage their investments.

C. *The Proposal Fails to Properly Value the Benefits Provided by Proxy Advisory Firms.*

At the same time, the Proposal makes no effort to quantify or take into account evidence of the significant benefits that proxy advisory firms provide to their clients and to the efficient operation of the capital markets. This failure raises serious concerns under the APA.[100]

Proxy advisors allow institutional investors to save time and resources by engaging specialized support in their assessment and monitoring of companies' management. Studies have

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[99] *See, e.g.*, Egan-Jones Proxy Services, Comment Letter on Statement Announcing SEC Staff Roundtable on the Proxy Process (July 23, 2019), https://www.sec.gov/comments/4-725/4725-5858827-188628.pdf.

[100] *See State Farm*, 463 U.S. at 43.

found that proxy advisory firms facilitate the aggregation of information for institutional investors and reduce the cost of making an informed voting decision by aggregating information for multiple clients.[101] These services provide a significant economic benefit to all investors (institutional and retail). They deliver proxy voting advice at a lower cost, and on a faster timeframe, than would be achievable by institutional investors or investment advisers on their own, and in many instances provide analyses that at least some investors simply could not replicate.

In addition, proxy advisors have a critical role in helping to ensure that individual investors who hold shares in pension plan funds, individual retirement accounts, and other similar plans realize the full benefits of their investments, by providing objective and dependable proxy analysis to the institutional investors and investment advisers who manage such investments. Many experts have concluded that proxy advisory firms add value to issuers by diversifying information access through the provision of advice to all subscribing shareholders and thus serving as a check on questionable governance policies that would decrease an issuer's valuation.[102]

# # #

In sum, the burdens imposed by the Proposal outweigh the benefits, if any, to be achieved. The benefits of the Proposal are illusory, as the Commission is responding to a manufactured problem in the market for proxy advisory services. The burdens, in contrast, are tangible and will be imposed on all players in the market. Proxy advisory firms will be forced to hire more staff to handle the increased regulatory burden imposed by the Proposal. The timeframe available for the firms to undertake their research and draft their recommendations will decrease. The resulting increased risk of inaccurate and unreliable proxy voting advice runs directly contrary to the Commission's stated goal of addressing concerns about the accuracy of the work of the proxy advisory firms, and it runs counter to the Commission's mandate to protect main street investors. The Commission should reconsider the Proposal in its totality.

V. The Proposal Should Be Revised to Address Significant Practical Concerns.

The market for proxy advisory services and the proxy voting process will be significantly disrupted and harmed if the Proposal is adopted. If the Commission nonetheless adopts the Proposal, it should make significant modifications to ensure the continued availability of quality and timely proxy voting advice. We describe a number of such modifications below, which would mitigate, but not resolve, the Proposal's serious flaws.

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[101] *See, e.g.*, Yonca Ertimur, et al., *Shareholder Votes and Proxy Advisors: Evidence from Say on Pay*, 51 J. ACCOUNTING RESEARCH 951 (2013); Paul H. Edelman, et al., *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV. 1359 (2014).

[102] *See* Paul Calluzzo & Evan Dudley, *The Real Effects of Proxy Advisors on the Firm* (working paper, July 24, 2017), https://ssrn.com/abstract=2619698; Sanford J. Grossman & Oliver D. Hart, *One Share/One Vote and the Market for Corporate Control*, 20 J. FIN. ECON. 175 (1988), https://www.nber.org/papers/w2347.pdf (discussing the failure of small investors to research and vote their proxies without assistance).

A. *The Commission Should Establish a Safe Harbor For Proxy Advisors to Shield Them From Liability Under Rule 14a-9.*

The Proposal would needlessly expose proxy advisory firms to greater risk of liability under Rule 14a-9, which prohibits statements related to the proxy process that are false or misleading as to any material fact, including statements rendered false or misleading by omission.[103] By including proxy voting advice within the scope of "solicitation," the Proposal would provide an explicit basis for issuers (and perhaps others) to sue proxy advisory firms by claiming that proxy advisory firms' reports and voting recommendations are materially false and misleading. Moreover, courts have held that, unlike with Rule 10b-5, it is not necessary to plead scienter to allege a violation of Rule 14a-9.[104] Combined with the Proposal's reduction in the time available for proxy advisory firms to produce their reports (thus increasing the likelihood that firms will make accidental errors during the process), these changes would significantly increase the firms' litigation costs and potential liability.

To address these concerns, we strongly encourage the Commission to establish a safe harbor for proxy advisory firms to shield them from liability under Rule 14a-9 if they comply with all of the requirements of the Proposal. The Commission has established safe harbors from liability in this manner in other contexts. For example, Rule 10b-18 provides a safe harbor from most liability for violations of the anti-manipulation provisions of Rule 10b-5 provided that the issuer complies with the conditions of the safe harbor.[105] A safe harbor would fairly shield proxy advisory firms from the increased risk of liability caused by the increased regulatory burden of the Proposal.

B. *Proxy Advisory Firms Should Be Required to Provide Issuers with Only Specified Categories of Data for Review, and Not Their Draft Report and Voting Recommendations.*

As described above, many proxy advisory firms already provide issuers an opportunity to review data used to inform their advice. We strongly encourage the Commission to modify the Proposal by replacing the requirement that an issuer have the opportunity to review the draft proxy advisory report and recommendations with a less burdensome, yet still valuable, requirement that issuers have the opportunity to review only the data used by the proxy advisory firm in preparing its report and recommendations. Issuers will thereby be further able to detect any errors in the raw data used, which will avoid accidental harm to issuers. Proxy advisory firms will likewise not be required to share confidential information with issuers, limiting insider trading concerns and diminishing the risk of premature leaks. Moreover, a standardized review period would ease the burden for issuers by streamlining their communications with proxy advisory firms, each of which currently operates under its own process for administering data

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[103] *See* 17 C.F.R. § 240.14a-9.

[104] *See Gerstle v. Gamble-Skogmo*, 478 F.2d 1281, 1301–02 (2d Cir. 1973); *see also Knurr v. Orbital ATK Inc.*, 276 F. Supp. 3d 527, 539–540 (E.D. Va. 2017) (noting that scienter is not a requirement for Rule 14a-9 and that most circuits have held that negligence is sufficient for the plaintiff to prevail).

[105] *See* 17 C.F.R. § 240.10b-18.

review periods. Further, if the scope of information to be shared with issuers is limited to data, proxy advisory firms will have more time to ensure the accuracy of their reports and voting recommendations. This solution would reasonably satisfy the issuers' desire to prevent proxy advisory firms from issuing erroneous advice, while better balancing the timeline and regulatory burdens faced by the proxy advisory firms.

C. Reports and Voting Recommendations on Certain Shareholder Votes Should Be Excluded from the New Requirements.

We encourage the Commission to modify the Proposal to exclude certain categories of shareholder votes, such as votes on proxy contests and merger transactions, from the new requirements. Imposing a new set of procedural requirements in a process that is already complicated and time-sensitive would be unproductive for all parties. The costs of including these categories of votes would be greater than the benefits achieved by doing so.

The risks of insider trading and leaks involving proxy voting advice are also higher when a shareholder vote involves a material event. The Proposal would put the draft proxy voting advice—potentially market-moving information—in the hands of issuers before it is provided to the investors who will act on it. This selective disclosure would necessarily increase the risk that the information will be misused or leaked, whether accidentally or deliberately.[106]

VI. Conclusion

Elliott Management Corporation appreciates the opportunity to submit comments on this important matter and is available to provide any additional information the Commission requests.

Sincerely,

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[106] Recognizing the analogous concern that insiders might trade on information that has not yet been disclosed on an 8-K filing, the U.S. House of Representatives recently passed legislation (by a 384-7 vote) barring company leaders from trading in the company's stock during the period between a major corporate event and its public disclosure. *See* 8-K Trading Gap Act, H.R. 4335, 116th Cong. (2019); House Roll Call Vote 14, 116th Cong., 2d Sess. (Jan. 13, 2020), http://clerk.house.gov/evs/2020/roll014.xml (passing H.R. 4335).