

February 3, 2020

Vanessa Countryman, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-0609

*Via e-mail to rule-comments@sec.gov*

**Re: File No. S7-22-19  
Amendments to Exemptions from the Proxy Rules for Proxy  
Voting Advice**

Dear Ms. Countryman:

We submit this letter on behalf of the Council for Investor Rights and Corporate Accountability (“CIRCA”). We are a consortium of investors who believe that a well-functioning system of checks and balances between boards of directors and shareholders is fundamental to this country’s long-term economic growth and prosperity.

This letter responds to the request of the Securities and Exchange Commission (the “Commission”) for comment on S7-22-19, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice (the “Proposing Release”).<sup>1</sup>

The Commission’s proposed rules regarding proxy voting advice are seriously flawed.

- The proposed rules are aimed at a problem that does not exist. We are unaware of any documented instances of misstatements or omissions of material facts by proxy advisors—much less examples of litigation brought by

<sup>1</sup> Securities and Exchange Commission, Release No. 34-87457, Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice (November 5, 2019), <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.

the SEC or any private parties over any such abuses. The registrant community's assertions about factual errors in proxy voting advice are anecdotal and unsubstantiated. The bulk of those assertions are really disagreements over methodology and analysis, not factual accuracy.

- The Commission's proposal to subject proxy advisors to its anti-fraud rule would arm registrants with a weapon to influence proxy advisors' recommendations. Because proxy advisors lack the financial resources to litigate with registrants, the mere threat of litigation by a registrant, whether explicit or implicit, could compromise the independence and integrity of proxy voting advice. Proxy advisors' only avenue to avoid potentially crippling litigation would be to take registrant-friendly stances—particularly in response to specific complaints by registrants.
- The Commission's proposed imposition of a mandatory, two-step review process by registrants of draft proxy voting advice would unconstitutionally regulate the speech of proxy advisors; empower registrants to pressure proxy advisors into altering their recommendations; and impose unprecedented and unwarranted burdens on proxy advisors.

In sum, the proposed rules would unconstitutionally infringe freedom of speech, impair the independence and integrity of proxy voting advice and unnecessarily and unduly interfere with the private contractual relationship of investors and proxy voting advice businesses, all to the detriment of shareholders and the legitimacy of proxy voting.

## **Proposed Codification of the Commission’s Interpretation of “Solicitation” Under Rule 14a-1(l) and Proposed Note (e) to Rule 14a-9**

### *Proxy Voting Advice Does Not Constitute a Solicitation under Current Rule 14a-1(l)*

The Commission’s Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice (August 21, 2019) (the “August Guidance”) wrongly concludes that proxy voting advice is a “solicitation” under existing rules. The current rule defines “solicitation” as including a “communication to security holders under circumstances reasonably calculated to result in the *procurement . . . of a proxy*” (emphasis added). Proxy voting advice does not fit the plain meaning of this definition.<sup>2</sup> The Merriam-Webster Dictionary defines “procure” as meaning “obtain.” Yet proxy voting advice businesses do not obtain proxies. What is more, the Commission equates the term “solicitation” to the term “induce,” as in “induce” the giving of a proxy. The verbs “procure,” “obtain” and “induce” are transitive and imply that the actor wants to achieve the object of the verb—that is the casting of a proxy vote in a desired manner. Proxy voting advice, however, is not intended to cause or induce its recipients to vote in a particular way—or even to vote at all. To the contrary, proxy advisors have no stake in the registrant conducting a shareholder vote or in the outcome of the vote. They are indifferent to whether their clients vote or how they vote. Instead, the business of a proxy advisor is providing information and research to its clients, including its analysis of how and why *it would* vote shares if it owned them.

<sup>2</sup> We recognize that some proxy voting advice businesses’ clients routinely vote in accordance with the businesses’ advice without independent review of that advice. That fact, in our view, is based on the policy of those clients, not on intent of the proxy voting businesses. The fact that an institutional investor adopts the analysis of an independent third party as a matter of policy does not mean that analysis induced or caused the result. The pre-advice policy of the institution to vote in accordance with the advice, without regard to its content, is what causes the result. Indeed, the rote nature of the institution’s behavior makes clear that the contents of the proxy voting advice had no role in the institution’s vote.

The Commission’s reasoning mistakes proxy advisors’ expressed views on how it would vote with a statement of how clients should vote—that is, a directive to a third party on how to vote. Proxy advisors do not urge their clients to vote a certain way. In contrast to proxy solicitations by registrants and insurgents, they do not attempt to persuade or induce; they instead set out their independent opinion to inform their clients’ analysis and voting decision.

Indeed, the use of the term “advice” in the August Guidance (and throughout the Proposing Release and Proposed Rules) is subtly misleading. The Merriam-Webster definition of the word “advice” makes clear that the term does not necessarily imply a recommendation to follow a course of action, but also means “information” given to third parties. The latter definition is the meaning that fits the work of proxy advisors. Proxy advisors’ opinions are not presented to clients as a directive (that is, a “should” or “ought” exhortation), but rather as a statement of the conclusions and beliefs of an independent third party on the issues presented. Thus, a more appropriate—and less prejudicial—term for the work product of “proxy voting advice businesses” is “information” or “analysis”.

The Commission has advanced several justifications for its conclusion that proxy advisors’ work product is a “solicitation” under Rule 14a-1(1). None is persuasive.

- “The proxy voting advice generally presents . . . a “vote recommendation for each proposal that indicates how the client *should* vote” (italics added). “[S]hould” is inaccurate in this context. Proxy advisors make clear that each voting decision is that of the client alone. The fact that the advisors provide voting recommendations to clients who follow bespoke voting policies for all votes or to clients who do not subscribe to the advisors’ analytical services underscores that the proxy advisors do not expect or intend to change their clients’ voting intentions.

- “Proxy advisory firms market their expertise in researching and analyzing matters . . . for the purpose of assisting their clients in making voting decisions.” This is an accurate description of proxy voting advice businesses. But rather than support the conclusion that the businesses are “soliciting” proxies, it highlights advisors’ informational role.
- “Many clients of proxy advisory firms retain and pay a fee to these firms to provide detailed analyses, including advice regarding how the clients *should* vote . . . .” (italics added). Not so. As pointed out above, “would,” not “should,” is the appropriate word.
- “Proxy advisory firms typically provide their recommendations [and the rest of their report] shortly before a shareholder meeting . . . .” How could proxy advisory firms do otherwise? As the Commission observes in the Proposing Release, the compressed time frame of proxy season, the great number of shareholder meetings crammed into this time frame, and the short period between a registrant’s publication of its proxy statement and its shareholders’ meeting foreordain that proxy voting advice is issued shortly before proxy votes. Far from being the advisors’ choosing, that timing is the burden placed upon them by the circumstances in which they operate. Thus, the timing is simply not relevant to whether the businesses seek to cause a certain vote.

Two analogies highlight the fallacy in the Commission’s conclusion that proxy voting advice constitutes “solicitation” under the Proxy Rules.

- First are the activities of a range of advocates of specific proxy voting policies—Say on Pay or separation of the offices of CEO and Board Chair, for example. Academics, institutional shareholders (particularly state

and local pension funds and union pension funds), members of the registrant community and their trade associations, corporations, environmental, philanthropic and investor-based associations, academics and other “influencers” routinely advocate for or against general or specific proxy voting policies. These advocates do so with the intent to cause shareholders to vote a certain way. They want to induce or cause behavior. Yet no one asserts that this advocacy constitutes a “solicitation.” If these activities do not constitute a “solicitation,” how could the opinions of proxy voting advisors, which hold themselves out as independent providers of proxy voting analysis—and which intend only to provide information, not to induce shareholders to vote in accordance with their advice—be labeled “solicitations”?

- Another analogy is the bond rating business. Bond rating agencies are paid by issuers of debt, the users of the ratings. And their ratings are a critical part of the sale of corporate debt. Yet no one asserts that bond rating agencies are “underwriters” under the Securities Act of 1933, despite the statutory definition of “underwriter” encompassing “any person who . . . has a direct or indirect participation” in an underwriting subject to that Act. Why is that so? Because while the rating agencies express their (critically important) views on the creditworthiness of the debt issuer, they do not seek to procure a sale of the underwritten debt obligation. Like proxy voting advice, the ratings are an expression of the views of an independent third party, not an attempt to obtain anything or to procure a particular result.

The empirical evidence also undercuts interpreting proxy voting reports to be “solicitations.” We are unaware of any acknowledgement or action by any registrant, proxy advisor, or any other proxy voting

stakeholder that proxy voting advice is a “solicitation.” Nor are we aware of any lawsuit asserting that a proxy voting advice business violated Rule 14a-9—this despite the “concerns” expressed by the “registrant community” about factual inaccuracies, methodological weaknesses and errors, undisclosed conflicts of interest, and inappropriate analysis. What is more, we are unaware of registrants asserting Rule 14a-9 liability in formal or informal complaints about specific proxy voting advice in conversations with proxy voting advice businesses or the Commission. In fact, the registrant community has long lobbied the Commission to publicly assert that the term “solicitation,” embraces proxy voting advice—efforts aimed at bringing proxy advice within the scope of Rule 14a-9. There would have been no need for these lobbying efforts if the participants in the proxy voting process understood the Commission’s August interpretation of “solicitation” to reflect the correct, or even just the better, interpretation of the term.

For these reasons, the Commission’s August Guidance asserting that proxy voting advice is a “solicitation” under the Proxy Rules is unsupported and poorly reasoned. Accordingly, the proposed amendment of Rule 14a-1(1) is not merely a codification of existing law. Instead, it amounts to *de novo* rulemaking—and should be explained and justified as such. And we think the Commission’s articulated justification for this new rule is seriously flawed, in particular because it relies mainly on the erroneous reasoning and conclusions of its August Guidance and on untested narrative statements in other Commission releases (principally its 2010 Concept Release on the U.S. Proxy System, which was akin to a White Paper seeking input on various aspects of our proxy system, and not a considered statement of the law as interpreted by the SEC).

*Proposed Amendment to Rule 14a-1(1) Will Undermine the Independence and Candor of Proxy Voting Advice Businesses by Raising the Specter of Litigation*

The Commission’s proposed amendment to Rule 14a-1(1) codifying the Commission’s August Guidance that proxy voting advice constitutes a “solicitation” under the Securities Exchange Act of 1934 (the

“Exchange Act”)—and therefore is subject to Rule 14a-9—will raise the specter of spurious and potentially vexatious litigation by registrants against proxy advisory firms. This is especially so given the Commission’s gloss on the applicability of Rule 14a-9 to methodology and analysis. This *in terrorem* effect will erode proxy advisors’ independence and candor—and thus the utility of their analysis and recommendations.

A consequence of the Commission’s interpretation that proxy voting advice is a “solicitation” would be to unlock a Pandora’s Box of Rule 14a-9-based litigation or threats of litigation, explicit or implicit, against proxy advisors. Registrants know full well that proxy advisors have no rational incentive—let alone the financial wherewithal—to fight public companies in litigation over purported misstatements or omissions in the advisors’ voting recommendations. Registrants could censor proxy advisors’ voting recommendations simply by threatening costly litigation. Even in the absence of those threats, the mere possibility of litigation likely would influence proxy advisors—especially when a registrant questions any aspects of their proposed reports. To minimize litigation risk, proxy advisors will be incentivized to:

- defer to adverse comments by registrants on their draft reports, rather than risk a controversy that could blossom into threatened or actual litigation;
- self-censor to avoid controversy with registrants by either changing their basic voting policies or not applying their voting policies in what they perceive to be sensitive situations; and
- refrain from a case-by-case analysis that could yield discrepancies across reports.

Another unfortunate consequence of the Commission’s focus on the applicability of Rule 14a-9 to proxy voting advice businesses is that registrants and proxy advisors likely will ask the Commission’s staff to

referee the debate. This would resemble the frequent practice of participants in a traditional proxy contest of urging the staff to assert possible Rule 14a-9 violations in their opponents' proxy material. Such a practice of routinely trying to use the Commission and its staff as a forum for "litigating" alleged Rule 14a-9 claims in the context of potentially hundreds of proxy voting advices issued every proxy season would waste the Commission's resources.

We thus believe that the Commission's forceful insistence on the applicability of Rule 14a-9 to proxy voting advice will spawn an *in terrorem* effect on the rendering of proxy voting advice adverse to a registrant's perceived or articulated position. Such a loss of independence for proxy advisors will not ultimately benefit any participant in the proxy voting process—certainly not the shareholders the Commission is charged with protecting.

### *The Commission's Definition of "Solicitation" Under Proposed Rule 14a-1(l) Is Technically Flawed*

We also have technical comments on the Commission's definition of "solicitation" in the Proposing Release and in its August Guidance.

*First*, we disagree with the Commission's statements that proxy advisors engage in "solicitation" by using their voting platforms to vote their clients' shares in accordance with the clients' voting policies, no matter whether they align with those of the proxy advisor.<sup>3</sup> In these situations, the proxy advisor is performing a ministerial service, which the Commission acknowledged in its August Guidance is not a "solicitation."<sup>4</sup>

<sup>3</sup> The only support for such a broad interpretation of the term "solicitation" is a reference to the August Guidance, which offers the same interpretation without further reasoning or citation. *See* August Guidance at 4–5; Proposing Release at 15–16.

<sup>4</sup> The error of a contrary interpretation of the term "solicitation" is highlighted by a well-known episode from the Dell going private transaction. *See* Dell, Inc., Schedule 14A, filed June 18, 2013. T. Rowe Price, a large investment adviser, opposed the transaction and made clear before the shareholder vote that it would vote all of its portfolio shares against the transaction. T. Rowe Price subscribed to ISS's voting platform and provided ISS with custom voting policies, including voting for management-supported merger and acquisition transactions unless T. Rowe Price specifically overrode its default voting policy. Inadvertently,

*Second*, contrary to the Commission’s assertion, proxy advisors do not engage in a “solicitation” when they provide their clients or the public with their general voting guidelines. The term “solicitation” cannot reasonably be read to encompass abstract voting guidance. If it were construed that broadly, every commentator on corporate governance could be “soliciting” proxies every time it took a public position on any ESG policy or other matter that could be the subject of a shareholder vote. That would subject countless academics, law firms, bar associations, business associations like the Business Roundtable and the Conference Board, public interest groups and individuals to the full scope of the solicitation rules when they engage in a discussion of policy concerns. The key to the “solicitation” concept, in our view, must be the existence of a pending proxy vote, not potential shareholder voting on recurring subject matters, such as declassifying corporate boards or adopting majority voting. We therefore urge the Commission to state specifically that providing general guidelines unrelated to specific registrants is excluded from the term “solicitation.”

*Third*, the Proposing Release could be read to provide that if an investor uses a proxy advisor’s voting platform but does not subscribe to the advisor’s voting recommendation service, the casting of the investors vote is a “solicitation.” That situation is clearly beyond what the proposed rule is intended to capture. If the Commission does amend Rule 14a-1(l), we propose a clarification that no “solicitation” has occurred when investors merely use the proxy advice business’s voting platform.

*Proposed Note (e) to Rule 14a-9 is Unnecessary and Amplifies the Threat of Spurious Litigation*

The Commission’s proposal to add Note (e) to Rule 14a-9 would risk a deluge of baseless litigation over quibbles with proxy advisors’ methodology and analyses. As proposed, Note (e) would state explicitly that a Rule 14a-9 violation could be based on a proxy advisor’s “failure

T. Rowe Price did not override its default policy, and ISS voted the shares in favor of the transaction. It cannot be that ISS conducted a “solicitation” related to T. Rowe Price’s shares. Instead, it was simply performing a ministerial function.

to disclose information such as the proxy voting advice business’s methodology . . . .”<sup>5</sup> That note would amplify the litigation risk created by at least fifteen statements in the August Guidance and the Proposing Release to the effect that “inadequate,” “incomplete,” “incorrect” or “insufficiently explained” methodology or analysis can give rise to a Rule 14a-9 violation.<sup>6</sup> We assume these references to methodology and analysis were not intended to open the floodgates to novel Rule 14a-9 claims based on purported flaws in a proxy advisor’s methodology or analysis. But they will have just that effect. The plain language and intent of Rule 14a-9 are clear that the rule covers only misstatements and omissions of material facts. A proxy advisor’s methodology and analysis simply are not facts; they are part of the reasoning underlying its conclusions and opinions.

This distinction is underscored by the principal case the Commission cites for its position that “inadequate” or “inaccurate” methodology or analysis could be the basis of a Rule 14a-9 violation: *Virginia Bankshares, Inc. v. Sandberg*.<sup>7</sup> Nowhere does that decision hold that methodological or analytical flaws give rise to Rule 14a-9 liability. At issue was whether directors’ statements of belief that a proposed merger offered “high” value and a “fair” price to shareholders were actionable. The case turned not on whether the directors expressed those beliefs in reliance on a flawed analysis, but on whether the “directors’ statements of belief and opinion were made “with knowledge that the directors did not hold the beliefs or opinions expressed . . . .”<sup>8</sup> Justice Souter’s majority opinion makes clear that where a statement of the reasons for a belief both “misstate the speaker’s reasons and also mislead about the stated subject matter (*e.g.*, the value of the shares),” it is “open to objection only in the former respect . . . , solely as a misstatement of

<sup>5</sup> Proposing Release at 70.

<sup>6</sup> *See* Annex.

<sup>7</sup> 501 U.S. 1083 (1991).

<sup>8</sup> *Id.* at 1090.

the *psychological fact* of the speaker’s belief in what he says.”<sup>9</sup> The Court cited evidence that the analysis underpinning the directors’ stated beliefs was incomplete and omitted contrary facts—not because analytical flaws are actionable, but because that evidence was probative of the “psychological fact” that the directors did not genuinely believe in the financial fairness of the transaction.

Other courts applying *Virginia Bankshares* confirm that it was not about the quality and completeness of the board’s analysis, but whether the directors’ stated beliefs were genuinely held. In *Fait v. Regions Financial Corp.*, for example, the Second Circuit invoked *Virginia Bankshares* in dismissing a complaint alleging that the defendants “should have reached different conclusions” about goodwill, but not “plausibly alleg[ing] that defendants did not believe the statements regarding goodwill at the time they made them.”<sup>10</sup>

Proposed Note (e) to Rule 14a-9 threatens significant unintended and harmful consequences for registrants and other participants in proxy contests: they could become the target of vexatious litigation by the plaintiffs’ bar, which will be handed a new type of allegation for use against registrants or other authors of proxy statements. The plaintiffs’ bar would be further emboldened by the comment in the August Guidance that Rule 14a-9 “extends to opinions, reasons, recommendations, or beliefs that are disclosed as part of the solicitation, which may be statements of material facts for purposes of the rule,”<sup>11</sup> and other similar statements compiled in the Annex hereto. Just as a registrant could allege a Rule 14a-9 violation against a proxy advisor for alleged inadequate, incomplete or incorrect methodology or analysis, a plaintiffs’ lawyer could lodge a Rule 14a-9 claim against a registrant based on inadequate, incomplete or incorrect methodology or analysis—for example, in selecting its executive-compensation peer group or in its explanation of

<sup>9</sup> *Id.* at 1095 (emphasis added).

<sup>10</sup> 655 F.3d 105, 112 (2d Cir. 2011).

<sup>11</sup> See August Guidance at 11; Annex (compiling statements to similar effect).

why it believes its NEO compensation policies achieve the stated objectives of the board and Compensation Committee.<sup>12</sup>

The Delaware plaintiffs' bar has for years relied on asserted incompleteness, inaccuracy or inadequacy in the description of investment bankers' analyses underlying their fairness opinions in proxy statements as the basis for lawsuits claiming those proxy statements violated directors' fiduciary duty of candor (which is analogous to Rule 14a-9). More recently, plaintiffs' lawyers have adopted the same tactics in lawsuits alleging Rule 14a-9 violations based on asserted incomplete or inaccurate descriptions or methodology of investment bankers' fairness analysis in merger proxy statements. State and federal courts have rejected these claims time and again. Their principal consequence is to motivate participants in the transaction to pay plaintiffs' attorneys a fee as the price of a release or a voluntary suit dismissal. The Delaware judiciary (joined recently by the Court of Appeals for the Seventh Circuit) has taken steps to limit this use of pretextual claims under Rule 14a-9 or its Delaware analogue as the basis for payments to plaintiffs' lawyers.<sup>13</sup> We believe that the Commission's proposed Note (e) to Rule 14a-9 and the rhetoric in the Proposing Release and August Guidance focusing on analysis and methodology will invite spurious litigation by the plaintiffs' bar against registrants based on their proxy-statement explanations of executive compensation.

The threat of Rule 14a-9 litigation could also become a feature of conventional proxy contests, as well as shareholder challenges to votes on merger and acquisition transactions. Historically, the Commission wisely has refrained from intervening in such proxy contests other than to invoke Rule 14a-9 to assure factual accuracy in proxy statements. By adopting proposed Note (e) to Rule 14a-9 and suggesting in the Proposing Release

<sup>12</sup> We note that most of the claims against proxy voting advice businesses for inadequate or flawed methodology occur in the context of Say on Pay voting recommendations. Registrants are likewise vulnerable to similar claims attacking the "Compensation Discussion and Analysis" in proxy statements.

<sup>13</sup> See, e.g., *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718 (7th Cir. 2016); *In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016); Sean Griffith, *Innovation in Disclosure-Based Shareholder Suits*, 69 Case W. Res. L. Rev. 927 (2019).

and August Guidance that Rule 14a-9 reaches beyond the realm of factual accuracy to encompass qualitative aspects of methodology and analysis, the Commission would risk opening a new front for controversy and litigation in both uncontested and contested shareholder votes. In addition to lacking a doctrinal foundation, the proposed rules would do little but encourage unwarranted Rule 14a-9 claims in many contexts.

*Our Recommendations:*

We believe there are several steps the Commission should take to avoid this needless increase in litigation and the resulting chilling effect on objective advice and analysis from proxy advisory firms.

*First*, we urge the Commission to withdraw proposed Rule 14a-1(1) and proposed Note (e) to Rule 14a-9 because they would compromise the independence and integrity of proxy voting advice. In our view, these amendments would cause harm to the quality and credibility of our proxy voting system that far outweighs the asserted benefit of inducing proxy advisors to be more careful with their factual data.

*Second*, if the Commission declines to withdraw its proposed amendment to Rule 14a-1(1), it is imperative that, at the very least, it withdraw Note (e) to Rule 14a-9, particularly its reference to methodology. We also recommend that the Commission specifically state that in its view Rule 14a-9 extends only to factual accuracy and is not intended and should not be used for attacking methodology and analysis based on claims of incompleteness, inadequacy or inaccuracy.

*Third*, if the Commission retains the proposed amendment to Rule 14a-1(1), we recommend providing in any final rule that any confidentiality agreement between a registrant and a proxy voting advice business may be conditioned on mutual waivers of all claims under Rule 14a-9. Doing so would minimize the specter of vexatious private Rule 14a-9 lawsuits and its impact on the quality of proxy voting advice. Yet it would also preserve Rule 14a-9 as a basis for Commission enforcement actions and thereby help assure the accountability of proxy advisors.

*Fourth*, as recommended below in our comments on the proposed addition of Rule 14a-2(b)(9)(ii), we urge the Commission to limit the information proxy advisors must provide registrants to the data in their proposed reports, but not the analysis and recommendation portions of the reports.<sup>14</sup> This would help achieve the Commission’s objective of assuring the accuracy of data used in proxy advisors’ reports without exposing the analysis and conclusions to the specter of Rule 14a-9 claims and thus subtle censorship by registrants.

### **Proposed Amendments to Rule 14a-2(b)(9)**

#### *Proposed Rule 14a-2(b)(9)(ii) Should Be Deleted in Its Entirety or at Least Substantially Revamped*

We strongly disagree with the Commission’s proposed addition of Rule 14a-2(b)(9)(ii), which requires prior review by registrants of both a draft and the final version of proxy voting advice before advisors may send the advice to their clients.

#### **I. Proposed Rule 14a-2(b)(9)(ii) Is Vulnerable to a First Amendment Challenge**

The Commission’s proposed Rule establishing a mandatory registrant review process of proxy voting advice would unconstitutionally regulate the speech of proxy advisory firms. Courts and commentators have forecast that an expansion of securities regulations that turns third-parties’ “expression[s] of opinion concerning a publicly-traded corporation into a regulated proxy solicitation . . . would raise serious questions under the free speech clause of the First Amendment. . . .”<sup>15</sup> The proposed Rule is vulnerable here for three major reasons.

<sup>14</sup> We have been informed by both ISS and Glass Lewis that they could easily separate their proxy voting advice into three sections: data, analysis and voting recommendation. This would allow proposed Rule 14a-2(b)(9)(ii) to apply solely to the data portion of the proposed advice.

<sup>15</sup> *Gas Nat. Inc. v. Osborne*, 624 F. App’x 944, 952 (6th Cir. 2015); see Lani M. Lee, *The Effects of Lowe on the Application of the Investment Advisers Act of 1940 to Impersonal Investment Advisory Publications*, 42 Bus. Law. 507, 551 n.149 (1987) (explaining that while statutory interpretation was used to avoid investment-advice publishers’ First Amendment arguments in *Lowe v. S.E.C.*, 472 U.S. 181 (1985), that

*First*, the proposed Rule is an unconstitutional prior restraint on proxy advisors’ speech. The proposed Rule demands that proxy advisors submit to the registrant both a draft and the final version of proxy voting advice before distributing it to clients. And proxy advisors that ignore registrants’ or soliciting persons’ comments—including comments on what the businesses should not say—do so at the risk of litigation. The resulting *in terrorem* effect would threaten the ability of proxy advisors to render independent advice. By thus impelling proxy voting advice businesses to accept substantive comments before publishing their analysis, the proposed Rule would not only delay speech but also chill and substantively coerce speech. And that amounts to a prior restraint.<sup>16</sup>

This prior restraint would not survive a First Amendment challenge. Because “[p]rior restraints on speech and publication are the most serious and the least tolerable infringement on First Amendment rights,”<sup>17</sup> “[a]ny system of prior restraints of expression comes . . . bear[s] a heavy presumption against its constitutional validity.”<sup>18</sup> The “Government thus carries a heavy burden of showing justification for the imposition of such a restraint.”<sup>19</sup>

It is difficult to see how the Commission could meet its heavy burden to justify the proposed Rule’s prior restraint on proxy advisors. No rule resembling the mandatory two-step review process has any precedent in the securities regulations. Nor is it limited to registrants, their opponents in proxy contests, shareholder groups or other parties with a direct pecuniary stake in the election. Instead, the proposed Rule *only* targets independent, third-party proxy advisors who serve a vital role in

case “may be used as precedent to attack other registration requirements imposed by the federal securities laws”).

<sup>16</sup> See *Dixon v. Kirkpatrick*, 553 F.3d 1294, 1308 (10th Cir. 2009) (explaining that a prior restraint is conduct that restricts, or “chills” speech because of its content before the speech is communicated); see also *Nebraska Press Ass’n v. Stuart*, 427 U.S. 539, 558–59 (1976) (noting that the constitutional violation “is not reduced by the temporary nature of a restraint”).

<sup>17</sup> *Id.* at 559.

<sup>18</sup> *Bantam Books, Inc. v. Sullivan*, 372 U.S. 58, 70 (1963).

<sup>19</sup> *New York Times Co. v. United States*, 403 U.S. 713, 714 (1971).

facilitating institutional investors’ fulfillment of their fiduciary duties on proxy voting.

Second, by mandating the inclusion of a hyperlink to the registrant’s and soliciting person’s responses to the final notice of voting advice, the proposed Rule impermissibly compels speech. The First Amendment guarantees the right to decide both “what to say and what *not* to say.”<sup>20</sup> By requiring inclusion of the hyperlink to a responsive statement and thus “[m]andating speech that a speaker would not otherwise make,” the proposed Rule “necessarily alters the content of the speech.”<sup>21</sup> Yet “[t]he First Amendment mandates that we presume that speakers, not the government, know best both what to say and how to say it.”<sup>22</sup> For the reasons discussed above, we believe that this too is a presumption that the Commission could not overcome.

Third, even if a court were to classify proxy voting advice as less-protected commercial speech and rule that prior-restraint and compelled-speech case law were therefore inapplicable—a doubly incorrect view, we believe<sup>23</sup>—the Rule would still be constitutionally infirm. The Supreme Court applies intermediate scrutiny to restrictions on commercial speech. Under this standard, commercial speech that is not false or deceptive “may be restricted only in the service of a substantial governmental interest, and

<sup>20</sup> *Riley v. Nat’l Fed’n of the Blind*, 487 U.S. 781, 795 (1988).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.* at 790–91.

<sup>23</sup> Proxy advisors offer their independent, third-party assessment of corporate governance issues to inform and benefit shareholders. Commercial speech, by contrast, is “speech which does no more than propose a commercial transaction.” *Bolger v. Youngs Drug Prod. Corp.*, 463 U.S. 60, 66 (1983). Unlike proxy solicitations by companies or investors, proxy advisors typically have no direct pecuniary stake in the outcome of a proxy vote. Thus, proxy advisors’ independent opinions are not directed “solely to the economic interests of the speaker. . . .” *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of New York*, 447 U.S. 557, 563 (1980). And commercial speech “cannot simply be speech on a commercial subject.” *Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 761 (1976). Instead, the bounds of what constitutes commercial speech properly turns on the right of the audience to receive information freely—here, the right of shareholders to receive independent proxy advisors’ opinions. *See Miami Herald Pub. Co. v. Tornillo*, 418 U.S. 241, 257 (1974). What is more, even commercial speech would likely still be entitled to First Amendment protection against prior restraints. *See New York Magazine. Metro. Transp. Auth.*, 136 F.3d 123, 131 (2d Cir. 1998) (holding that the rules against “prior restraints should not be loosened even in the context of commercial speech”).

only through means that directly advance that interest.”<sup>24</sup> To meet its burden under modern First Amendment jurisprudence, the government must “show[] that more limited speech regulation would be ineffective . . . .”<sup>25</sup> For the reasons discussed above, we do not believe it would be realistic for the Commission to show that no more limited regulation than the proposed Rule’s unprecedented restrictions on third-party speech could be effective.

## II. A Mandatory Two-Step Review Process Would Compromise the Independence and Integrity of Proxy Voting Advice

Mandatory registrant review is not just unconstitutional, it is also ill-advised as a matter of policy because it would threaten the integrity and independence of proxy voting advice. The prospect of disputes and even litigation arising from the registrant’s pushback during a two-stage review might well lead proxy advisors to shy away from criticizing the registrant’s corporate governance or executive pay policies and practices or supporting precatory shareholder proposals. And the risk of self-censorship would be more pronounced if registrants have the latitude to attack the advisory business’s methodology, analysis and recommendations. Such attacks on proxy advisors’ draft advice could cause them to alter the conclusions in their final reports to avoid litigation exposure.

## III. Proposed Rule 14a-2(b)(9)(ii) Is an Unwarranted Departure from the Commission’s Well-Settled Principles and Practices

There is no sound justification for imposing restrictions on proxy voting advice that are far more onerous than the rules governing proxy solicitations. One of the Commission’s justifications for an intrusive mandatory two-step review process is that clients of proxy advisors

<sup>24</sup> *Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 638 (1985).

<sup>25</sup> *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of New York*, 447 U.S. 557, 571 (1980) (striking down restrictions on commercial speech for lack of such a showing); *see also 44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 505 (1996) (“[A] commercial speech regulation may not be sustained if it provides only ineffective or remote support for the government’s purpose.”).

cannot rely on advisors' advice unless "the *analysis and research* supporting the advice [are] accurate and complete in all material respects."<sup>26</sup> Putting aside the unmanageability of any standard requiring analysis and research to be "accurate and complete," no such standard applies to proxy solicitations by issuers, insurgents, their advisors or anyone else. The only regulation of the content of proxy materials (other than line-item disclosure requirements) is Rule 14a-9. And as explained above, Rule 14a-9 cannot fairly be read to require that analysis and research be "accurate and complete in all material respects." Imposing higher standards on proxy voting advice is both unwarranted and counterintuitive: if anything, the risk of questionable analysis is greater in the context of proxy solicitations, where the authors have a great interest in the outcome of the vote.<sup>27</sup>

Nor do registrants' purported concerns about the reliability of proxy voting advice justify extraordinary intrusions on proxy advisors that are not imposed on proxy solicitors. In support of the proposed rule, the Commission cites "concerns . . . expressed by a number of commentators, *particularly within the registrant community*" that proxy voting advice *could* suffer from "factual errors, *incompleteness, or methodological weaknesses.*"<sup>28</sup> But the concerns (predictably) expressed by registrants about the reliability of proxy voting advice apply equally to all other information given to voters, including proxy materials from third parties and registrants, which are likewise susceptible to methodological or analytical weaknesses. The proxy system has long functioned efficiently by relying on the parties involved in a solicitation to challenge any purported incompleteness, methodological weakness or other defect in an opponent's voting solicitations. Indeed, for eighty years the Commission

<sup>26</sup> Proposing Release at 38 (emphasis added).

<sup>27</sup> We disagree with the Commission's comment that complete and accurate analysis and research is "especially critical when an investment adviser retains a proxy voting advice business to provide information that will inform the adviser's voting determinations," Proposing Release at 38–39. Whether the advice is given directly to a voter or to the voter's agent should not impact the level of scrutiny applied to the content of the recommendation. Nor does the involvement of an advisor justify treating advice differently from proxy solicitations.

<sup>28</sup> *Id.* at 39 (emphasis added).

wisely has relied on the “marketplace of ideas” to regulate proxy voting solicitations, allowing the parties involved in proxy contests to make their own arguments and counterarguments without regulatory interference, so long as there are no misstatements or omissions of material fact. A mandatory two-step registrant review process would represent a dramatic and unwarranted departure from the Commission’s long-established policies governing proxy voting, particularly since there is not a persuasive track record of errors in the reports of proxy advisory firms that would justify such a dramatic step.

#### IV. The Process Contemplated by Proposed Rule 14a-2(b)(9)(ii) Is Unworkable

Proposed Rule 14a-2(b)(9)(ii) is as impractical as it is unwarranted. The protocol contemplated by the proposed rule could create situations in which, by the time an advisor is permitted to release its final proxy voting advice to its clients, those clients have insufficient time to digest the advice and any contrary input from the registrant. The Commission’s proposed rule mandates not only a five- or three-day review period for draft proxy voting advice, but also a two-day pre-publication review period for the final version. These time periods seem inconsequential in the context of an individual registrant that, as a practical matter, has to engage with no more than a couple of proxy voting advisors. A proxy voting advice business, on the other hand, would need to react to comments from as many as hundreds of registrants each day during the height of a proxy season. Doing so is at best unduly burdensome and likely infeasible. And this crush of work would further threaten the quality and objectivity of advisors’ final reports.

We are, moreover, unaware of any other instance in which the Commission has compelled a party engaged in a proxy solicitation to seek comments from its opponent on a draft advance copy, then submit a final version to the opponent (and other participants), and, if requested, to include a hyperlink to the opponent’s rebuttal. Such a process would be an unprecedented intrusion into proxy voting—and one that far exceeds the Commission’s regulation of conventional proxy contests and disputed

votes on mergers and acquisitions, which are far more fractious and of greater economic significance than the precatory proposals and non-binding Say on Pay votes, the purported impetus for registrants' complaints about proxy voting advice.

*Our Recommendation:*

For all of these reasons, we urge the Commission to withdraw proposed Rule 14a-2(b)(9)(ii) in its entirety. Barring that, we propose the following alternative approaches to addressing perceived concerns about proxy voting advice.

- 1. Requiring Timely Circulation of Proxy Voting Advice to Registrants Would Achieve the Same Objectives as Rule 14a-2(b)(9)(ii) Without Creating the Same Problems*

The Commission could address registrants' purported concerns about proxy voting advice in a far less burdensome way than proposed and in a way that poses far less potential violation of the First Amendment. When it comes to proxy voting advice, the two fundamental aims of registrants are to have (1) an opportunity to respond to what they perceive as factual errors and inappropriate conclusions in voting advice, and (2) enough time to do so before a shareholder meeting. The Commission could give registrants what they seek without abandoning its historical approach to proxy regulation by enacting a rule providing that proxy advisors must provide a copy of their advice to the registrant on the same business day they provide it to their clients.

Like the Commission's current proposal, our suggested approach would reward registrants that maximize the time between the distribution of their definitive proxy statement and the shareholder meeting. What we propose also would assist proxy advisors by incentivizing registrants to maximize the time period between distribution of their definitive proxy materials and their meeting dates so as to provide them with adequate time to furnish their reports well ahead of the meeting dates. As under the Commission's current proposal, those registrants that do not circulate

proxy materials sufficiently before the shareholder meeting might lose their chance to rebut the proxy voting advice, but it would be because of their timing and thus within their control.

Importantly, however, our proposal would not represent an unprecedented departure from the Commission's longtime policy of relying on the free market of ideas to test any questionable voting recommendations.

## *2. Any Registrant Review Should Be Limited to Factual Data*

If the Commission empowers registrants to review proxy voting advice before advisors may furnish it to clients—and, to be clear, we believe doing so would be ill-advised and unconstitutional—the Commission should at least limit that right of review to factual data, not analysis and recommendations too. The Commission should not be in the business of regulating opinion.

Giving registrants the right to review factual data would address what we consider to be the only conceivably legitimate complaint advanced by registrants—that proxy voting advice sometimes contains factual errors. And limiting a registrant's prior review to factual matters would make clear that the Commission is not trying to regulate thought and opinion, which are beyond the purview of Rule 14a-9—not to mention protected by the First Amendment.

Adopting this alternative proposal also would lessen the timing-related burdens on proxy advisors. If registrants were limited to reviewing factual data, there would be no need for a five- or three-day initial review period; twenty-four hours would be more than enough time for a fact-check. Nor would there be any need for a second review period.

## *The Commission Should Modify Proposed Rule 14a-2(b)(9)(i) To Be Truly Principles-Based*

We agree with the Commission's view that meaningful conflict of interest disclosures are important to proxy voting advice. But the highly

detailed, four-part disclosure requirement contemplated by proposed Rule 14a-2(b)(9)(i) is excessive and unprecedented.

The disclosure rule under consideration is unprecedented in its detail and complexity. The Proposing Release does not cite, nor are we aware of, any instance in which the Commission has deviated from general, principles-based standards for conflict-of-interest rules—such as those based on “significant relationships,” “direct or indirect material interests” or “substantial interests.” That the proposed Rule is novel in its detail and complexity appears to be acknowledged in Question 14 of the Proposing Release, which identifies other conflict-of-interest disclosure rules, all of which are general and principles-based, not detailed and prescriptive.<sup>29</sup> There is no reason to depart from the standards that for decades have sufficed in every other context.

Paragraph (D) of proposed Rule 14a-2(b)(9)(i) in particular threatens to impose excessive, unprecedented burdens on proxy voting advice businesses. That provision would require sweeping disclosure of a proxy advisor’s internal decision-making, including a description of “any policies and procedures used to identify, as well as the steps taken to address, any such material conflict of interest . . . .”<sup>30</sup> And that disclosure would need to identify “the persons responsible for administering these policies and procedures.”<sup>31</sup> We are unaware of any comparable rule requiring disclosure of a reporting person’s internal policies and procedures and responsible personnel in a conflict of interest disclosure. There is no principled basis for imposing such onerous and intrusive disclosure requirements on proxy advisors, but not registrants.

The unprecedented disclosure rules under consideration also would create much uncertainty. Paragraph (C) of proposed Rule 14a-2(b)(9)(i), for example, would require disclosure of “any . . . information regarding the interest, transaction, or relationship of the proxy voting advice

<sup>29</sup> Proposing Release at 36.

<sup>30</sup> *Id.* at 138.

<sup>31</sup> *Id.* at 32.

business . . . that is material to assessing the *objectivity* of the proxy voting advice . . . .”<sup>32</sup> Injecting the broad and vague notion of “objectivity” into the disclosure rules would make them unworkable. Such a standard would raise all manner of questions—for example:

- If a proxy voting advice business receives presentations from parties seeking to influence its voting recommendation (such as the registrant), must advisors disclose each presentation? Must the disclosure state the identity of the participants in the meeting and their role in the proxy voting advice process (as proposed paragraph (D) requiring identification of people involved in the process might suggest)? Must the disclosure convey the substance of the meeting or identify the written materials prepared for the meeting?
- If clients comment on an advisor’s forthcoming report, must that be disclosed? If so, in what detail?
- If a proxy voting advice business reshapes its voting-recommendation policies based on feedback from clients or third parties, has there been a disclosable event?

These and other facts could be viewed as materially affecting the objectivity of proxy voting advice. The proposed rule thus would create great uncertainty and litigation risk, and, as a result, could prompt counter-productive overdisclosure.

#### *Our Recommendations:*

If the Commission concludes that there is a need for augmented conflict-of-interest disclosures by proxy advisors, we recommend an approach that is more proportionate to the concerns discussed in the Proposing Release. The Commission cites, for example, a letter criticizing disclosures “in the form of blanket statements that simply note

<sup>32</sup> *Id.* (emphasis added).

that conflicts may generally exist.”<sup>33</sup> The Commission could address such concerns through a principles-based rule requiring disclosure of “significant relationships” and “material interests,” together with a rule that any such disclosures must specifically identify any such relationships or interests. This proposed approach would prevent proxy advisors from giving boilerplate disclosures using “blanket statements” about the potential existence of conflicts of interest without creating unprecedented and excessive burdens.

We also urge the Commission not to require a conflict-of-interest disclosure to be communicated in full in any proxy voting advice delivered through an electronic voting platform, or to require redundant conflict of interest disclosures both in written advice provided to a client and in the electronic medium used by the client for implementation of its voting decision. In our view, those requirements would impose needless and onerous burdens on proxy advisory firms.

\* \* \* \*

We thank you for the opportunity to comment on this important Commission initiative. We would be happy to discuss any aspect of this letter with the Commission staff.

Respectfully submitted,

Rob Collins

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

<sup>33</sup> *Id.* at 30 n.83.

## ANNEX

The August Guidance and the Proposing Release contain the following statements to the effect that “inadequate,” “incomplete” or “incorrect” methodology or analysis can be the basis of a Rule 14a-9 violation.

### **August Guidance**

(1) “Rule 14a-9 also extends to opinions, reasons, recommendations, or beliefs that are disclosed as part of a solicitation, which may be statements of material facts for purposes of the rule.”<sup>34</sup>

(2) “Where such opinions, recommendations, or similar views are provided, disclosure of the underlying facts, assumptions, limitations, and other information may be needed so that these views do not raise Rule 14a-9 concerns.”<sup>35</sup>

(3) “Accordingly, any person engaged in a solicitation through proxy voting advice must not make materially false or misleading statements or omit material facts, such as information underlying the basis of its advice or which would affect its analysis and judgments, that would be required to make the advice not misleading.”<sup>36</sup>

(4) – (6) “For example, the provider of the proxy voting advice should consider whether, depending on the particular statement, it may need to disclose the following types of information in order to avoid a potential violation of Rule 14a-9:

- an explanation of the methodology used to formulate its voting advice on a particular matter (including any material deviations from the provider’s publicly-announced guidelines, policies, or standard methodologies for analyzing such matters) where the

<sup>34</sup> August Guidance, 11.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 11–12.

omission of such information would render the voting advice materially false or misleading;

- to the extent that the proxy voting advice is based on information other than the registrant’s public disclosures, such as third-party information sources, disclosure about these information sources and the extent to which the information from these sources differs from the public disclosures provided by the registrant if such differences are material and the failure to disclose the differences would render the voting advice false or misleading; and
- disclosure about material conflicts of interest that arise in connection with providing the proxy voting advice in reasonably sufficient detail so that the client can assess the relevance of those conflicts.”<sup>37</sup>

(7) “To the extent that the proxy voting advice is materially based on a methodology using a group of peer companies selected by the proxy advisory firm, the disclosure may need to include the identities of the peer group members used as part of its recommendation and the reasons for selecting these peer group members as well as, if material, why its peer group members differ from those selected by the registrant. For example, such disclosure may be needed for a voting recommendation on a registrant’s advisory vote on an executive compensation proposal that is based on a comparison of the registrant’s executive compensation policies to those of other companies selected by the proxy advisory firm.”<sup>38</sup>

## **Proposing Release**

(1) “Given proxy voting advice businesses’ potential to influence the voting decisions of investment advisers and other institutional investors, who often vote on behalf of others, we are concerned about the risk of proxy voting advice businesses providing inaccurate or incomplete voting advice (including the failure to disclose material conflicts of interest) that

<sup>37</sup> *Id.* at 12–13.

<sup>38</sup> *Id.* at 12, n.34.

could be relied upon to the detriment of investors. In light of these concerns, we are proposing amendments to the federal proxy rules that are designed to enhance the accuracy, transparency of process, and material completeness of the information provided to clients of proxy voting advice businesses when they cast their votes, as well as amendments to enhance disclosures of conflicts of interest that may materially affect the proxy voting advice businesses' voting advice.”<sup>39</sup>

(2) “For the clients of proxy voting advice businesses to be able to rely on the voting advice they receive to make informed voting decisions, the analysis and research supporting the advice must be accurate and complete in all material respects.”<sup>40</sup>

(3) “However, in recent years concerns have been expressed by a number of commentators, particularly within the registrant community, that there could be factual errors, incompleteness, or methodological weaknesses in proxy voting advice businesses' analysis and information underlying their voting advice that could materially affect the reliability of their voting recommendations and could affect voting outcomes, and that processes currently in place to mitigate these risks are insufficient.”<sup>41</sup>

(4) “Any person engaged in a solicitation through proxy voting advice must not make materially false or misleading statements or omit material facts, such as information underlying the basis of its advice or which would affect its analysis and judgments, that would be required to make the advice not misleading.”<sup>42</sup>

(5) “The types of information a proxy voting advice business may need to disclose could include the methodology used to formulate the proxy voting advice, sources of information on which the advice is based, or

<sup>39</sup> Proposing Release, 11.

<sup>40</sup> *Id.* at 38.

<sup>41</sup> *Id.* at 39.

<sup>42</sup> *Id.* at 68–69 (*quoting* Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Release No. 34-86721 (Aug. 21, 2019) [84 FR 47416 (Sept. 10, 2019)], 12).

material conflicts of interest that arise in connection with providing the advice, without which the proxy voting advice may be misleading.”<sup>43</sup>

(6) “Thus, the amended rule would list failure to disclose information such as the proxy voting advice business’s methodology, sources of information and conflicts of interest as an example of what may be misleading within the meaning of the rule.”<sup>44</sup>

(7) “Finally, we are proposing to amend the list of examples in Exchange Act Rule 14a-9 to add as an example of a potentially material misstatement or omission within the meaning of the rule, depending upon particular facts and circumstances, the failure to disclose information such as the proxy voting advice business’s methodology, sources of information, conflicts of interest, or the use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.”<sup>45</sup>

(8) “Finally, we are proposing to amend Rule 14a-9 to add as an example of what could be misleading, if omitted, certain disclosures that are relevant to proxy voting advice, specifically disclosures related to the proxy voting advice business’s methodology, sources of information, conflicts of interest or the use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.”<sup>46</sup>



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Rob Collins

Executive Director

Council for Investor Rights and Corporate Accountability (CIRCA)

<sup>43</sup> *Id.* at 69.

<sup>44</sup> *Id.* at 70.

<sup>45</sup> *Id.* at 77.

<sup>46</sup> *Id.* at 103.

