January 28, 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Electronic address: rule-comments@sec.gov

Re: File No. S7-23-19: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8

Dear Ms. Countryman:

These comments are submitted in response to the Commission's request for comments in the above-referenced rule-making proceeding.

I am a retiree benefitting from long-term pension and retirement funds and a political scientist who has published for decades on regulatory policy and the uses and limitations of benefit-cost analysis.

I am also the founder of a shareholder advocacy organization that has engaged scores of companies constructively without the need for filing resolutions but which has also participated in scores of such filings. Resolutions frequently were filed when companies failed to respond to two rounds of inquiry letters advancing the business case (financial opportunities and risks) for issues we raised. These letters always requested dialogue, which in too many cases did not begin until after filing of shareholder resolutions prompted corporate response. Cover letters accompanying our filings generally expressed our preference for constructive dialogue and noted the resolutions were being filed to preserve our right of access to the proxy statement.

My four core points:

1. The benefit-cost analysis underlying the proposal is thin. As acknowledged implicitly or explicitly by the Commission's request for comments, the Commission has relied on nonmeaningful and badly dated aggregate statistics on the costs to companies of addressing shareholder resolutions. In striking contrast, the Commission has made no effort to assess the benefits to companies and their shareholders accruing from shareholder resolutions, in particular resolutions in past years that would have been excluded from the proxy under the Commission's proposed rules. *The skewed consideration of costs and benefits appears to come nowhere close to implementing the Commission's 2012 "Current Guidance on Economic Analysis in SEC Rulemakings", whose*

intent is to allow the Commission "to meaningfully compare the proposed action with reasonable alternatives, including the alternative of not adopting a rule."[1]

2. Statistics of shareholder resolutions filed and withdrawn through the years do not illustrate a growing problem demanding regulatory response. *As others have commented in this and related Commission proceedings, the Commission is proposing a draconian solution to a non-problem*.
3. The proposed regulation throws a monkey wrench in an existing system of shareholder engagement, including shareholder resolutions, that has functioned well through the years. These engagements have led to broadly supported improvements in corporate governance, many of which were first advanced via shareholder resolutions of smaller investors that gained support over time.

   From my own experience, shareholder resolutions and related engagement practices provide the following management benefits.[2] First, they serve as "canaries in the coal mine", signaling emerging issues of potentially great significance that need to be understood and addressed sooner rather than later. Second, they are a useful antidote to senior management groupthink. Groupthink can cause senior management to fool both themselves and less engaged investors, to the detriment of both. Third, Investor engagement can raise management issues that cut across departments and supply chains, prompting senior management to bring together individuals from diverse corporate departments who should be discussing emerging issues with one another but are not. Fourth, investors bring to the table—*at no cost to the company*--information about emerging science and pertinent innovative risk management practices both within and beyond the sector in which a company is operating.

   These investor interventions can prompt senior management to gain "first mover", reputation-protecting, top- and bottom-line advantages in addressing emerging issues, through product innovation and risk-reduction measures.
4. In the absence of a more robust decision-making record, the Commission seems to be taking sides in a "corporate culture war" rather than engaging in factually well-supported decision-making. This conflict pits campaigners such as The Chamber of Commerce, supporting insular and insulated corporate governance, on one side, against investors who have constructively used shareholder resolutions and other engagement methods to enhance corporate environmental, social and governance practices beneficial to both companies and society. *Further insulating corporate executives and boards from concerned shareholders—reducing corporate accountability-- is contrary to the Commission's charge to protect the investing public and is not in the public interest.*

<u>The Proposal Fails to Describe in Sufficient Detail the Existing Filing and Response Process, Omitting Details Critical to Assessing its Costs and Benefits and the Consequences of Proposed Changes</u>

[1] https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf

[2] I founded the Investor Environmental Health Network (www.iehn.org. IEHN is filing separate comments that include case studies of specific investor resolution filings and related engagements that provided benefits to companies.

The Commission has gathered readily available but truly skeletal data on the costs to companies of responding to shareholder resolutions. The data are too gross and dated to provide a meaningful basis for decision-making, as would seem to be indicated by the Commission's own questions to commentators on how costs vary depending on how companies respond to resolutions.

The proposal fails to capture the rich variety of resolution topics and requests and corporate responses, which will influence whether a company incurs sizeable or negligible response costs. For example, a company whose default response to any resolution is relying on expensive outside counsel to file a no-action letter at the SEC is likely to incur significantly higher costs than a company that convenes a dialogue with filers, consults relevant subject matter staff experts, releases hitherto internal data to filers, and commits to making the data available to all shareholders via future corporate reports.

Similarly, the nature of filers' resolution requests will influence both the demand on corporate resources and the size and timing of the costs and benefits from responding in good faith to the filing. For example, a resolution requesting planning to reduce energy use, lower fresh water consumption or reduce generation of waste may require sizeable upfront planning and capital investments, but will yield longer-term cost reductions, i.e., benefits that are not captured in any benefit-cost analysis that focuses on short term costs and benefits. Reducing such operating costs can improve performance on traditional financial indicators such as operating margins and profit. These longer-term benefits especially serve the investment goals of pension funds that must invest for the long-term to serve their participants' retirement needs.

This failure to gather pertinent data, especially on the benefits attributable to filings of shareholder resolutions, means the Commission has failed to create a sufficient administrative record to assess the costs and benefits of retaining the existing system of regulations governing the filing of shareholder resolutions and the positive and negative consequences of proposed changes.

<u>The Proposal Does Not Comply with the Commission's Internal Guidance for Conducting Benefit-Cost Analysis</u>

The Commission's internal guidance for conducting economic analysis, as cited and noted above, calls for use of best available information to inform decision making. The guidance states four basic components of a good regulatory economic analysis, all of which are consistent with broader economic analysis requirements contained in presidential Executive Orders and implementing guidance from the Office of Management and Budget. First, a statement of the need for the proposed action. Second, the definition of a baseline against which to measure the likely economic consequences of the proposed regulation. Third, identification of alternative regulatory approaches. Fourth an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis.

The guidance further declares that the economic impacts of proposed regulations are measured as the differences between the current situation and a scenario based on the regulatory proposal including "both the economic attributes of the relevant market and the existing regulatory structure, including (where relevant) state law."

The guidance recognizes that quantitative information may be limited, so it provides an "off-ramp" allowing rule-writing staff to explain why costs and benefits cannot reasonably be quantified and encouraging staff to use the public comment process to solicit additional quantitative information.

Perhaps most importantly for this rulemaking, rule-writers are called upon to "frame costs and benefits neutrally and consistently." Costs and benefits should be evaluated "even-handedly and candidly, acknowledging any limitations in the data or quantifiable information." While recognizing that data-gathering is a continuing process, at the "proposing stage" of a regulation, "the proposed release should include a substantially complete analysis of the most likely economic consequences of the rule proposal."

The analysis of costs to companies of shareholder resolutions dwarfs in length assessment of the benefits companies and their shareholders derive from shareholder resolutions. The proposal alludes in passing to the literature on the financial benefits of the ESG issues advanced in resolutions but makes no concerted effort to analyze the benefits of the issues such resolutions advance. Rather than framing costs and benefits neutrally and consistently, the Commission seems to have taken sides in the corporate culture war, appearing to assume that shareholder resolutions, especially those filed by smaller shareholders, have adverse effects on companies. In so doing, the Commission has inappropriately shifted to outside commentators the burden of proving the benefits of such resolutions.

<u>Specific Shortcomings of the Commission Analysis</u>

1. <u>The Commission has failed to make a compelling case that the current system governing filing of shareholder proposals needs adjustment.</u>
   a. The commission's data show no significant increase in shareholder resolutions that needs to be addressed. The Commission's analysis of shareholder proposals at Russell 3000 companies going to a vote, omitted following a no-action determination, and withdrawn, between 2004 and 2008, "has largely remained stable during [this] period."[3] The Commission's further analysis of all submitted proposals (rather than focusing on just voted, omitted or withdrawn proposals) shows that the average number of proposals submitted to S&P companies declined

[3] Securities and Exchange Commission, "Procedural Requirements and Resubmission Thresholds Under Exchange Act Rul3 14a-8, Federal Register Vol. 84, No. 233, December 4, 2019, p. 6647, hereafter cited as "Proposal".

by 33 percent between 2004 and 2018, and the number of such proposals submitted to Russell 3000 companies decreased by 26 percent.[4]

b. The Commission's data further show that just over half (56 percent) of resolutions filed went to a vote, 15 percent were omitted following issuance of Commission "no action" letters, and just under one-third (29 percent) were withdrawn. These percentages remained stable during the period of analysis.

c. The Commission's data on voting results show either stable or rising percentages of shareholder voting support for resolutions voted between 2004 and 2018. Support for governance proposals has averaged 42.1 percent, while support for environmental proposals increased from a low of 11.8 percent in 2004 in 2018, with an average during that period of 21.9 percent. Similarly, average support for social proposals during the period rose from a low of 9.3 percent in 2005 to a high of 24.6 percent. *The stable and rising levels of support for voted resolutions are a compelling indication that the resolutions proceeding to a vote are tapping growing shareholder concern about corporate management of ESG issues. These data may be a further indicator that this rule-making is triggered by the Commission taking sides in a corporate culture war--corporate managements may simply prefer not to deal with outside intrusions on existing internal power relationships and established corporate agendas, even if positive responses to such interventions may contribute to increased long-term value and reduced risk.*

2. <u>The Commission's estimates of the costs to companies of responding to resolutions are based on poorly documented and anecdotal assertions.</u>
    a. The Commission's high-end estimate of the annual savings to Russell 3000 companies from adopting proposed changes to Rule 14a-8(b) and 14a-8(c) is $70.6 million. This high-end estimate is based on a communication from the American Securities Association that the cost of responding to an individual proposal is $150,000.[5] Based on my own experience engaging scores of companies, which included withdrawing 50 percent of our filings because of constructive engagement, this figure is ludicrous.[6]
    b. The Commission highlights the high-end estimate above in the main text of its proposal but, curiously, gives less prominence (by relegation to a footnote) to a significantly smaller low-end estimate. This low-end estimate is annual savings of $1.4 million, based on anecdotal evidence offered in congressional testimony in 2016.[7]
    c. The Commission gives similarly uneven treatment to the high- and low-end estimates of cost savings from changes to Rule 14a-8(i)(12). The high-end

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[4] Proposal, p. 66473.

[5] Proposal, p. 66502. For other rough estimates, see p. 66496.

[6] For a thorough debunking of high-end estimates of the cost of responding to proposals, See Adam Kanzer, "The Dangerous 'Promise" of Market Reform': No Shareholder Proposals", Harvard Law School Forum on Corporate Governance", cited briefly but without elaboration in Proposal, footnote 104.

[7] Proposal, footnotes 230 and 272, re testimony of Darla Stuckey, President and CEO, Society for Corporate Governance

estimate in the text is $8.9 million and low-end estimate in an accompanying footnote is $3.1 million.[8]

3. <u>The Commission explicitly declined to make a quantitative effort to estimate the benefits to shareholders from the resolution process, a striking contrast to its extended analysis of companies' costs to respond to resolutions</u>.
    a. "Our economic analysis does not speak to whether any particular shareholder proposal or type of proposals are value enhancing, whether the proposed amendments would exclude value-enhancing proposals, or whether the proposed amendments would have a disproportionate effect on proposals that are more or less value enhancing."[9]

    In text preceding this statement, the Commission correctly notes that a shareholder proposal may or may not be value-enhancing. That said, the Commission could and should have, for example, selected a sample of shareholder resolutions and gathered estimates of their financial benefits and reduced risks to companies and shareholders. Instead, the Commission has defaulted to outside commentators to offer such examples or to otherwise conduct analysis that the Commission should have conducted in the first instance.

    For one example of such an exercise, see the December 17, 2019 comments submitted by Tom Shaffner.[10] Shaffner, while acknowledging that his analysis is "extremely simplistic", concludes that the proposed regulations restricting resolution filings will cost shareholders and companies net foregone benefits (value enhancements) from such proposals of between $129 and $144 million annually.

    The Shareholder Rights Group, in its January 6, 2020 comments, has offered specific examples of past resolutions raising issues of poor governance that would have been precluded by the proposed regulation.[11] At Wells Fargo & Co., investor efforts to reform a costly, reputation-damaging predatory corporate culture would have been obstructed by the proposed rule change. At Boeing, shareholder concern about the company's lobbying overreach (which may have led to lax regulation contributing to the 737 MAX financial disaster) would have been obstructed by the proposed rules.

    It is evident just from these few examples that not only do the benefits of shareholder resolutions dwarf the costs calculated by the Commission to respond to resolutions, but the Commission's indifference to assessing the benefits of

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[8] Proposal, p. 66503

[9] Proposal. p. 66494.

[10] https://www.sec.gov/comments/s7-23-19/s72319-6562349-200995.pdf, pp. 8-10. While acknowledging that his analysis is "extremely simplistic", Shaffner concludes that the proposed regulations restricting resolution filings will cost shareholders and companies net foregone benefits (value enhancements) from such proposals of between $129 and $144 million annually.

[11] https://www.sec.gov/comments/s7-22-19/s72219-6610717-202929.pdf

shareholder resolutions to companies and their shareholders has created a far from neutral, imbalanced administrative record for decision.

4. <u>The Commission has failed to give weight to the growing body of evidence that corporate application of the ESG values embodied in shareholder resolutions enhances value and reduces risk.</u>

Shareholder proposals are key drivers of enhanced environmental, social, and governance performance and the financial rewards thereof. A 2016 meta-study aggregating the results of more than 2,000 empirical studies found that in around 90 percent of the cases, the relationship between ESG ratings and financial performance was either positive or zero—meaning that companies that did better on sustainability indicators performed *at least* as well as their peers financially, or better, 90% of the time.[12] Investor engagements through dialogue and if necessary shareholder resolutions are built on this foundation: more sustainable companies are better at creating long-term durable value.

Based on the above analysis and many more similar assessments, focus on ESG—commonly labeled "sustainable investing"—is rapidly being mainstreamed in US investment circles, following in the footsteps of European investors. This increased interest may also be a contributing factor to the rise in support for shareholder resolutions, especially those addressing environmental and social issues.

When the *Harvard Business Review* released its annual ranking of the world's 100 best-performing CEOs in 2015, for the first time it allocated a 20 percent weighting to the ESG performance of a CEO's company, complementing an 80 percent weighting to long-term financial performance.[13] ESG performance was raised to a 30 percent weighting in 2019.[14] BlackRock, the world's largest investment management firm with $7 trillion assets under management, has stated that ESG "is not just about saving the planet or feeling good. We view ESG excellence as a mark of operational and management quality."[15] S&P Global Ratings, the world's leading provider of independent credit risk research, has created a new ESG assessment framework for issues of corporate debt, whose goal is to assess sustainability risks over the medium to long-term.[16]

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[12] G. Friede et al, "ESG and financial performance: aggregated evidence from more than 2000 empirical studies", *Journal of Sustainable Finance & Investment*, 2016, http://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917.

[13] https://hbr.org/2015/11/the-best-performing-ceos-in-the-world.

[14] "The 35 best CEOs in the world, according to Harvard Business Review", *Business Insider*, 2019m https://www.businessinsider.com/best-ceos-in-world-harvard-business-review-excludes-jeff-bezos-2019-10.

[15] BlackRock, Inc., "The price of climate change: Global warming's impact on portfolios", 2015, p. 2, https://www.blackrock.com/investing/literature/whitepaper/bii-pricing-climate-risk-us.pdf.

[16] S&P Global Ratings press release, "New green bond and ESG evaluation tools proposed by S&P global ratings", 2016, http://www.prnewswire.com/news-releases/new-green-bond-and-esg-evaluation-tools-proposed-by-sp-global-ratings-300324419.html; "ESG Evaluation", https://www.spglobal.com/_assets/documents/ratings/esg_evals_digital_brochure.pdf

A September 23, 2019 Bank of America Merrill Lynch publication, "10 Reasons You Should Care About ESG" recites specific data demonstrating the rewards to corporations and their shareholders of enhanced ESG performance.[17] For example:

1. "A strategy of buying stocks that rank well on ESG metrics would have outperformed the market by up to 3 percentage points per year over the last five years."
2. "Intangible assets—assets tied to reputation, brand and intellectual property—has reached record highs for the S&P 500 companies. Analyzing financial metrics alone simply won't suffice anymore…."
3. "Traditional financial metrics, such as earnings quality, leverage and profitability don't come close to ESG as a signal of future earnings volatility or bottom-line risk."
4. "ESG could have helped avoid 90% of bankruptcies. 15 out of 17 (90%) of bankruptcies in the S&P 500 were of companies with poor Environmental and Social scores five years prior to the bankruptcies."
5. "'Good' companies enjoy a lower cost of capital. … The cost of debt for "good" versus "bad" companies based on ESG scores can be nearly 2 percentage points lower."
6. "ESG 'controversies' have cost investors a lot. Major ESG-related controversies during the past six years were accompanied by peak-to-trough market capitalization losses of $534 billion for large US companies. Loss avoidance is key for portfolio returns over time."

Conclusion

The Commission:

1. has failed to demonstrate that the current set of rules governing shareholder proposals is broken.
2. has failed to quantify the benefits of the existing set of rules.
3. has failed to quantify the benefits companies and shareholders would forego if the current proposal is adopted.
4. has generated what appear to be gross overstatements of the estimated costs to companies of responding to shareholder proposals.

For these reasons, the Commission should not adopt the proposal nor should it consider any further tweaks of refiling thresholds, holding periods, and the like, except perhaps adjusting for inflation the $2,000 minimum holding requirement.

Adoption of the proposed regulations would severely compromise an engagement vehicle that has proven to be beneficial to companies and their shareholders alike. The Commission should not attempt to fix a system that is not broken.

Respectfully submitted, Richard A Liroff, Ph.D.

[17] https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID19_1119/esg_matters.pdf