

February 2, 2020

Submitted via Email

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

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

Dear Chairman Clayton:

The undersigned are professors are members of fourteen different law schools¹ across the country, each with a specialized focus on, and expertise in, issues of corporate law or the federal securities laws. In this letter, we raise a variety of issues regarding amendments to Rule 14a-8 that are proposed in Securities Exchange Act Release No. 87458. Even though each of us may not share the below concerns with the same intensity with respect as to each of the items discussed, we do share the genuine belief that each of the following merits deep reflection by the SEC in moving forward in its consideration of the proposed amendments.

An Inconvenient Point in History

We are at a unique time in the history of American corporate and securities law. In the summer of 2019, headlines around the country trumpeted the Business Roundtable's "Statement of Purpose of the Corporation." The Statement signed by 181 executives from the largest America companies announced they believed the mission of corporate executives in today's world extended to a broad range of corporate stakeholders, not solely a goal of shareholder-centric wealth maximization. The Statement is an important shift from the North Star of shareholder primacy that for decades has guided the path of CEOs and corporate boards. This development reflects the not just growing but stampeding of interests across investors in Environmental, Social and Governance (ESG) factors in the companies in which they invest and divest. Indeed, the organization you head, the SEC, has repeatedly emphasized the importance of disclosures bearing on the sustainability of the corporation's operations amidst a variety of forces that can buffet the corporation's performance and position. *See e.g.*, SEC Concept Release,

¹ Each signer does so individually and his or her institutional identification is provided solely for informational purposes and does not reflect the position of an institution.

Business and Financial Disclosure Required by Regulation S-K, Part F 205-210, Securities Act Rel. No. 10064 (Apr. 22, 2016). Whether investing in or managing a public company there is a consciousness today of the necessity to consider a range of fast moving and rapidly developing changes in social forces. It therefore is surprising that the SEC is leaning against these winds to substantially retard an important mechanism by which corporate boardrooms can receive and thereby reflect on the significance of emerging investor concerns.

Current Rule 14a-8 serves many purposes. As recent history reflects, it was the fulcrum for introducing greater democratic features to the American corporation. Rule 14a-8 has been the galvanizing mechanism for the broad movement toward annual election of directors, conditioning election of a director on the director garnering at least a majority of the votes cast (imagine now how unreasonable is the alternative to this rule), and causing so many public companies to discontinue their poison pill. In an earlier era, the shareholder proposal rule set the table for the national revulsion of apartheid practices in South Africa as well as the more contemporary concerns surrounding business in Darfur. Each of these initiatives bore fruit not through acclimation upon first being proposed but through the communicative power of the shareholder proposal process. Indeed, these resolutions rarely garnered majority support at the outset. However, the steady persistent efforts of their proponents shined a bright light on a particular problem that needed fixing. Ultimately the problem was fixed. Like so many worthwhile ideas, reflection over time, not instant acceptance, leads to enduring change. We can appreciate that Rule 14a-8 has been the means for introducing change that makes governance practices more in line not just with their owners, but with social norms.

Equally important is the role Rule 14a-8 plays in raising and broadening the consciousness of the company's board and its executives. Boards and executive ranks are necessarily small relative to the body of stockholders. Moreover, the perspective of board members, though elected by the shareholders, is not a microcosm of the shareholders and even less likely to be a microcosm of society as a whole. Well-crafted shareholder proposals that seek reports, procedures or other actions on a matter already determined to be a proper subject of shareholder action under applicable state law at a minimum invite, and likely cause, the directors and executives to reflect on an issue not otherwise considered. Thus, we see that Rule 14a-8 is not just a means by which concerned shareholders can gain some attention within the boardroom and executive suite on a matter; proposals can and often introduce a fresh perspective for consideration. The fruits of this perspective cannot be fully measured *ex ante*; history now reflects that important changes have been brought about in significant measure by shareholder proposals such as occurred with proposals focused on majority vote resolutions, South Africa and now climate change.

Therefore, at a time when investors clearly have historically high concern regarding ESG related proposals,² and especially as they relate to corporate sustainability, it is hardly a time for

² In 2018, the percentage of such proposals securing majority support doubled. Kellie Huennekens and Jamie Smith, *2018 Proxy Season Review*, 2018 Proxy Season Review (Aug. 8, 2018), *retrieved from* Harvard Law School Forum on Corporate Governance and Financial Regulation, <https://corpgov.law.harvard.edu/2018/08/08/2018-proxy-season-review-3/>. "Nineteen percent of [ESG-oriented] resolutions secured at least 40% support [in 2019], up from 12% [in 2018], and 41% attained at least 30% support, up from 29% in 2017." Veena Ramani & Hannah Saltman, CERES, *Running the Risk: How Corporate Boards Can Oversee Environmental Social and Governance (ESG)*

the SEC to weaken the mechanism whereby conscience-raising resolutions can be proposed by the firm's investors.

An Inappropriate Metric for Measuring Success

The success of Rule 14a-8, and for that matter assessing its benefits versus its costs, should not be measured in terms of how many proposals garner majority approval, or even substantial minority support, from the shareholders. Such a focus is incomplete and is itself misleading. First, looking at only the “win-loss” record of Rule 14a-8 proposals overlooks the fact that many firms alter their practices in the wake of experiences created by a proposal. Consider here evidence regarding say-on-pay resolutions (even though mandated by Dodd-Frank say-on-pay is nonetheless deeply analogous to Rule 14a-8 with respect to being an information intermediary). Very few resolutions fail to garner overwhelming majority support; however, the discussions with institutions and proxy advisory firms that precede the proposal shape pay packages with a goal of addressing investor concerns regarding executive compensation. *See* James F. Cotter, Alan R. Malmiter & Randall S. Thomas, *The First Year of Say-on-Pay Under Dodd-Frank: An Empirical Analysis and Look Forward*, 81 *Geo. Wash. L. Rev.* 967 (2013). *See also*, Jill Fisch, Darius Palia & Steven Davidoff Solomon, *Is Say on Pay All About Pay? The Impact of Firm Performance*, 8 *Harv. Bus. L. Rev.* 107 (2018).

Second, in many instances, the formal Rule 14a-8 mechanism is but the first step in private (i.e., non-public) agreements between the proponent and the firm whereby the issuer agrees to address issues central to the proposal. *See e.g.*, Sarah C. Haan, *Shareholder Proposals and the Private Ordering of Private Elections*, 126 *Yale L. J.* 282 (2016); Bauer, et. al., *Who Withdraws Shareholder Proposals and Does It Matter? An Analysis of Sponsor Identity and Pay Practices*, 23 *Corp. Governance* 472 (2015). Therefore, any assessment that is focused on “wins” (i.e., benefits) versus losses requires a much more inclusive meaning of “wins” than is set forth in the proposing release. There needs to be a tally of changes induced by the proposal such as through settlement with the proponent or operational changes or other steps the company takes following receipt of the proposal. The SEC's proposed calculus in its requests for comments is not so broadly focused and thus likely attributes too few benefits to the shareholder proposal rule.

Third, as discussed above, Rule 14a-8 offers a mechanism for raising issues to be considered within the firm's boardroom and executive suite that otherwise may not be focused upon. The shareholder proposal rule thereby enriches the information environment in which management operates and by which the board fulfills its oversight of management's stewardship. The latter is especially important contribution in an era in which ESG is enjoying such an important role among investors. Evaluating Rule 14a-8 only in terms of a percentage of proposals that garner majority approval unnecessarily trivializes the provision's multiple contributions. Focusing only on whether proposals garner majority support ignores the other ways whereby proposals yield results such as stimulating changes in operating practices within

Issues, Nov. 2019, available at https://www.ceres.org/sites/default/files/reports/2020-01/Running%20the%20Risk_Ceres_2020.pdf.

the firm or simply keeping firms grounded in on-going developments that are of concern to shareholders.

Proposal Introduces Costly Inefficiency and Will be Seen as Anti-Small Investor

The release asked for comments on further limiting the single proposal rule to “each person” whereas previously “each shareholder” could submit but a single proposal. The change from “shareholder” to “person” reduces the role of proposal intermediaries since, if adopted, the change limits intermediaries to assisting in only one proposal per issuer and thereby forecloses individuals from representing other shareholders in that firm. To be sure, this change will tend to affect the very small retail customer more than others as such a proponent is likely to seek the experience of others in preparing and ushering the proposal through the regulatory thicket. From this perspective, the proposal can easily be seen as directed to a very specific group of individuals and organizations. As such, it is not befitting of the rich history the SEC has of even-handed treatment of diverse investors. At the same time, the proposed change may well not have any effect. For example, if two holders in the same company wish to submit two different proposals, they each likely can locate just as easily separate advisor to assist in their efforts or locate the same advisor but in the end make the advised-submission in the shareholder’s own name. That is, this restriction can be circumvented. Thus, as the SEC considers whether to move forward with this proposal, the question it needs to address is just what is achieved by this proposed change other than the SEC appearing to be against the interests of small investor and without having any impact on the operation of Rule 14a-8?

The one proposal per “person” may well cause a proponent not to seek experienced advisors and submit their proposals herself or himself. If this is the effect – driving individuals to eschew experienced counselors to prepare, submit and defend the proposal – it can be expected to lead to lower proposal quality and likely to an increase in proposals eligible for exclusion. This scenario can hardly be a defensible regulatory objective.

Moreover, the SEC in considering this proposal must consider its impact on the practice of a large law firm whose representation of multiple clients can portend only one of those clients being able to invoke the law firm’s services in submitting a proposal. Moreover, we cannot ignore the one-dimensional quality of this proposal: A single law firm representing Company A can request no-action relief to omit unrelated proposals from X and Y, but that law firm can only represent X or Y when submitting proposals to Company A. This example invites a wide range of problems surrounding the authority of the SEC to regulate the practice of the law.

The Marginal Cost of Repetition

As the SEC’s release carefully details, for decades the SEC has considered raising the resubmission thresholds for Rule 14a-8. Unquestionably, a firm confronted in the current proxy season with a proposal that was considered before can only view the matter as nettlesome or worse. That belief is underscored by the weak support the proposal earlier enjoyed and the weak success rate resubmitted proposals garner. However, the staff should consider carefully the cost estimated in addressing such resubmissions. Certainly, no responsible general counsel should believe the time, effort and ultimate costs set forth by outside counsel in advising the company

regarding a resubmitted proposal are on a level equal with charges incurred in addressing a newly minted proposal. Indeed, the resubmitted proposal can likely be handled within the office of the general counsel so that variable costs to the firm related to the resubmitted proposal will be both miniscule and hard to isolate. It therefore seems that resubmission levels need to be considered on some basis other than their cost since it is likely the cost of addressing a resubmitted proposal is not material. Simply stated, it is difficult to believe changing the metrics for resubmitted proposals can be justified by variable cost considerations.

Where to Draw Lines

The release sets forth helpful statistics regarding the high percentage of yearly Rule 14a-8 proposals that involve resubmissions. It appears that roughly one-third of all proposals are resubmissions. In designing resubmission levels it would be useful to have descriptive statistics on the number of first-time proposals that garner 3 (the current) or 5 (proposed) percent levels to merit resubmission and likewise for the other two incremental levels. This data could be useful in assessing the argument that the current levels need to be increased to reduce the overall level of resubmissions. That is, if we find that very few proposals on their second attempt achieve 15 percent support there is much less of a case for the third level being raised to 25 percent. The same could be said if few proposals receive 5 percent support on their first consideration then there is less reason to raise the next level triple that level.

In the background of tinkering with levels of support is the observation made earlier that a value of Rule 14a-8 is the communication mechanism it enables whereby shareholders can communicate the breadth of concerns on specific topics to the board and the executives. That value for the current rule exists regardless of the shareholder support level in the first year but definitely increases with there being evidence of increasing support for the proposal over time. This is now captured in the current three tiers of the resubmission rule. Further data is needed, as suggested above, to determine just what those tiers may better be. However, the proposed momentum rule whereby a proposal that has achieved substantial support can nonetheless be omitted in the following year if that support declined by ten percent is at least at odds with viewing Rule 14a-8 having the above-described information function. Using the example in the release, where the proposal received 26 percent support on a third appearance which was below the 30 percent approval on the prior submission, ignores the significance of the shareholder vote. The fact that should be important is that one out of four shares were vote to express approval for the proposal; in a public company, this expression of opinion, albeit a minority, is not inconsequential to a director considering management's stewardship or the overall direction of the company.

Non Aggregation Rule

A well-established fixture of corporate and securities laws is aggregation of ownership among similarly situated individuals. Aggregation is even mandated when it furthers the regulatory objectives, for example in the case of Section 13(d)(3) of the Securities Exchange Act. Aggregation is also expressly recognized under state law. For example, state law that confers shareholder inspection rights on holding a particular percentage of the company's outstanding shares. *See e.g.*, Cal. Corp. Code § 1600(a) or excusing the bond requirement to maintain a

derivative suit. *See* N.Y. Bus. L. § 627(a). Aggregation of holding is also a means for a group of investors to be identified as the most adequate plaintiff in a securities class action based on their aggregate loss being larger than those of a competing petitioner with a smaller loss than the group but larger than any claim of any individual within the group. *See e.g.*, *Netsky v. Capstead Mortgage Corp.*, 2000 U.S. Dist. LEXIS 9941 (N.D. Tex. 2000).

It therefore is puzzling that the SEC proposes preventing aggregation among individuals who have united to support a resolution that otherwise is not objectionable under Rule 14a-8. Consider that California permits shareholders in corporations organized in that state to aggregate their share ownership so as to meet the state's 5 percent ownership requirement to gain access to corporate records without the necessity to establish a proper purpose for that request. Cal. Corp. Code § 1600(a). On what reasonable basis can the SEC take a contrary course with respect to that same group of shareholders seeking to circulate a proposal pursuant to Rule 14a-8? On what basis does the SEC wish to justify its actions being less inclusive than provided by states in an analogous situation?

Moreover, if the SEC does raise the standing requirements as it proposes, it would appear both prudent and logical to allow experiences under the new regime that imposes higher standing thresholds to inform the staff and the commissioners whether the aggregation of owner should be addressed. Simply stated, it is premature to address aggregation among proponents of a single resolution.

In sum, the proposals submitted for comment in the release are poorly conceived largely because of failing to accord to Rule 14a-8 proposals the important communication role the provision has served for generations. Had the SEC started from this basis the focus of the proposals would likely be in better agreement with the contemporary setting in which public owners function.

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