



# An Investor Response to the U.S. Chamber's Proposal to Revise SEC Rule 14a-8

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## About this paper

This paper provides an investor perspective on the U.S. Chamber of Commerce proposal to revise SEC Rule 14a-8. It was prepared by Ceres investor program staff with major contributions from numerous investor members of the Ceres, ICCR and US SIF investor networks, who have been active in filing shareholder proposals as part of their corporate engagement and asset stewardship efforts. It is intended as a resource to help inform policy discussions about the content of Rule 14a-8 and the impact of shareholder proposals on corporate issuers, shareholder value and the U.S. economy.

## Introduction

During the summer of 2017, The U.S. Chamber of Commerce's Center for Capital Market Competitiveness (CCMC, or the Chamber) proposed seven changes to the rules governing shareholder proposals in the United States.<sup>1</sup> Here we present a response to the CCMC's proposals, demonstrating why the changes are unnecessary and counterproductive to well-functioning capital markets, the interests of long-term investors and the companies they own.

The CCMC's paper calling for reform was issued in the midst of a public policy debate that included an attempt to change the rules governing shareholder proposals via legislation (House of Representatives Financial Choice Act 2017) and rule making. The later effort was spearheaded by the Corporate Governance Coalition for Investor Value (with the support of several U.S business groups / associations)<sup>2</sup>. It focused on reviving a 2014 petition for rulemaking to the U.S. Securities and Exchange Commission (SEC) requesting an increase of the filing thresholds for resubmission of shareholder proposals.

While the CCMC paper is silent on the value of shares needed to file a shareholder proposal, the House-approved Financial CHOICE Act of 2017 did contain a provision to raise the required holding from \$2,000 to 1% of the value of shares outstanding. This would strip retail investors (and nearly all institutional investors) of their right to file a proposal with most companies -- a right held since the 1940's.

The SEC raised the threshold from \$1,000 to \$2,000 in 1998, and declined to raise it further "out of concern that a more significant increase would restrict access to companies' proxy materials by smaller shareholders, who equally with other holders have a strong interest in

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<sup>1</sup> [Shareholder Proposal Reform: The Need to Protect Investors and Promote the Long-Term Value of Public Companies](#), Summer 2017

<sup>2</sup> American Insurance Association, American Petroleum Institute, Biotechnology Innovation Organization, Center On Executive Compensation, Equity Dealers of America, Independent Community Bankers of America, Financial Services Roundtable, National Association of Corporate Directors, National Association of Manufacturers, National Association of Real Estate Investment Trusts, National Black Chamber of Commerce, National Investor Relations Institute, U.S. Chamber of Commerce

maintaining channels of communication with management and fellow shareholders.” Avoiding this disenfranchisement of smaller investors entails maintaining the existing filing threshold or limiting any increase to an adjustment for inflation to \$3,000.<sup>3</sup>

The rules and related SEC guidance governing shareholder proposals have been fine-tuned for decades, resulting in a system that helps to protect the rights and interests of investors, produces profound benefits to issuers and the capital markets, and maintains healthy corporate practices in the United States (examples below).

The CCMC’s proposed changes to Rule 14a-8 under the Securities and Exchange Act, which governs the shareholder proposal process, appear to ignore or misrepresent the benefits of the current system, and are based more on rhetoric than fact.

The shareholder proposal process, as currently regulated by the SEC, taps market forces and uses private ordering to address emerging risks to companies and investor portfolios. Proof that the current process works is illustrated by the following improvements to corporate policies, practices and governance -- widely attributed to shareholder proposals and investor engagement:

- The now standard practice that independent directors constitute a majority of the board
- Clear leadership structures for independent members of public company boards; while shareholder proposals for independent chairs have received mixed support from shareholders over the decades, they led eventually to a consensus that at minimum, the board should designate an independent lead director with certain clear functions, including leading executive sessions of outside directors, seen by many governance experts as critical to good board governance
- The growing prevalence of the annual election of board members; between 1987 and 2012 the average vote on these proposals grew from 16% to 81%
- Majority vote standard in election of directors; today, 90 percent of large-cap U.S. companies elect directors by majority vote, largely as a result of robust shareholder support for majority-voting proposals
- Proxy access bylaws, adopted by at least 450 companies since 2015, due mainly to a shareholder proposal campaign coordinated by the New York City Comptroller’s Office<sup>4</sup>
- “Say-on-pay” votes, which are now legally required under Dodd Frank; the foundation for this reform was stimulated by scores of shareholder resolutions seeking Say On Pay which received substantial votes
- Increased board diversity, which received critical attention and support in the 1990s through shareholder proposals that received less than 10 percent support at the time (some proposals now are winning majority support)

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<sup>3</sup> [https://www.bls.gov/data/inflation\\_calculator.htm](https://www.bls.gov/data/inflation_calculator.htm)

<sup>4</sup> <https://comptroller.nyc.gov/services/financial-matters/boardroom-accountability-project/overview/>

- Better disclosure and oversight of political contributions; more than half of S&P 100 companies are now committed to disclosure and board oversight of their political spending, as documented in the CPA-Zicklin Index<sup>5</sup>
- Improved disclosure on risks related to climate change, long a focus of various shareholder proposals; during the 2017 proxy season, the average vote on 17 proposals requesting scenario analysis of climate risk was 45%. Three of these proposals achieved majority votes,<sup>6</sup> and companies have begun to produce these reports and to mitigate value at risk. Scenario analysis is a core element of the Financial Stability Board's Task Force on Climate-Related Financial Disclosures' recommendations, issued earlier this year.
- Policies committing to non-discrimination on the basis of sexual orientation; again a policy promoted in shareholder proposals initially receiving limited support in the 1990s, and now widely accepted and in place at an overwhelming majority of large U.S. companies.<sup>7</sup> In contrast, management groups successfully quashed use of shareholder proposals to support racial integration in the 1940s and 1950s, notably regarding de-segregating buses at Greyhound in a proposal first introduced in 1948, hampering progress on the issue that did eventually take place through legislation.

These types of beneficial changes to corporate practices have helped strengthen U.S. capital markets plagued by short-termism, systemic risks, and corporate scandals. Shareholders of all sizes are motivated and well-positioned to address these problems and currently do so through the existing proposal process.

For a more complete review of the benefits of the shareholder process as currently regulated by the SEC see: [The Business Case for the Current SEC Shareholder Proposal Process](#) (Ceres, ICCR and US SIF, 2017).

When evaluating the shareholder proposal process, it is important to keep in mind the set of alternative tools that shareholders may use if their ability to file proposals is scaled back. These include tactics that are much more time and resource intensive for both companies and investors such as: vote-no campaigns against directors, books and records requests, and lawsuits. In addition, shareholder proposals offer an alternative to divestment as an approach to addressing social concerns, to the benefit of companies and investors.

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<sup>5</sup> <http://politicalaccountability.net/index>

<sup>6</sup> 67.3% at Occidental Petroleum, 62.1% at Exxonmobil, and 56.8% at PPL Corporation

<sup>7</sup> A [2016 analysis by Credit Suisse](#) found that 270 companies which provide inclusive work environments outperformed global stock markets by 3 percent annually for the previous six years.

## Responses to the Chamber's Claims

The CCMC paper has two main sections: a set of introductory claims about the shareholder proposal process and then seven suggested “reforms.” We address the claims first, which we label claims A-F, and then the proposed “reforms,” labeled 1-7.

**Claim A:** *“For decades... The SEC often took the position that proposals dealing with personal grievances, or those of a social or political nature, were not proper subjects for shareholders to vote on under Rule 14a-8, largely because such proposals sought to advance goals other than running the business more efficiently and profitably.”*

Response: The current rules do not, and should not, allow resolutions dealing with personal grievances. We address this in greater detail in Section 6 below.

Regarding efficiency and profitability, the current rules aim to screen out proposals related to “ordinary business” and those that seek to “micro-manage” the company, while permitting those that focus on “significant policy issues,” because these issues transcend day-to-day business matters. The current process ensures that companies are not overrun with overly specific suggestions from investors about how to directly improve operations or profitability.

The Commission has provided for a “significant policy exception” to the ordinary business rule since 1976.<sup>8</sup> Since that time, significant policy issues, such as climate change and human rights, have dramatically grown in importance for fiduciaries, in recognition of their material systemic and bottom-line implications for issuers and portfolios.

A substantial body of literature shows that companies that have superior sustainability or environmental, social and governance (ESG) performance perform at least as well as, and often better than, less sustainable peers.<sup>9</sup> For example, a 2015 Deutsche Bank meta study of more than 2000 empirical studies documents the link between strong performance on ESG matters and strong financial performance.<sup>10</sup>

It appears that the CCMC is most critical of shareholder proposals related to environmental and social issues, viewing these matters as not significant for investors. In contrast, there is a strong view among a wide range of investors that many environmental and social proposals clearly raise matters significant to them as investors, even where there is disagreement on the merits of particular proposals.

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<sup>8</sup> See Exchange Act Release No. 12999 (Nov. 22, 1976) (41 FR 52994).

<sup>9</sup> [The Business Case for the Current SEC Shareholder Proposal Process](#) (Ceres, ICCR and US SIF, 2017), pg. 12  
MSCI 2016, [“The Tipping Point Women on Boards and Financial Performance”](#)  
Carter, David A., D’Souza, Frank, Simkins, Betty J., and Simpson, W. Gary, [“The Diversity of Corporate Board Committees and Financial Performance,”](#)  
Oklahoma State University, 2007. Also see, Mijntje Lückerath-Rovers, [“Women on Board and Firm Performance,”](#) April 2010.

<sup>10</sup> <http://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917>

For example, there is something approaching a consensus that climate change and efforts to deal with global warming pose significant risks for many companies, and that disclosures by many companies have been inadequate. Investors also tend to believe that workforce practices are important for value creation, and in recent years investor voting support for fair employment practices has been strong. We would note that \$65 trillion in assets are managed by members of the UN-backed Principles for Responsible Investment, which commits signatories to incorporating ESG issues into investment analysis and decision-making processes.

Investor demand for these kinds of metrics was demonstrated by the groundswell of comments favoring improved ESG disclosure during the 2016 concept release on Regulation S-K. As a tool for encouraging balance against the pressures of short-termism, the current arrangement of rights under Rule 14a-8 is appropriate and effective.

Corporations exist within a social, environmental and political context connected to company and shareholder value, making these topics frequently appropriate for shareholder proposals. As BlackRock CEO Larry Fink wrote in his 2016 annual letter to CEOs: “Over the long-term, environmental, social and governance (ESG) issues – ranging from climate change to diversity to board effectiveness – have real and quantifiable financial impacts.”<sup>11</sup>

BlackRock is joined by hundreds of other institutional investors who use various ESG investing and active ownership strategies. **About a fifth of assets under professional management in the US (\$8.72 trillion as of 2016) are engaged in sustainable, responsible or impact investing in the United States.**<sup>12</sup>

**Claim B:** “As a result, proposals dealing with social or political issues and topics that the federal securities laws have long treated as not material are ending up in proxy statements with increasing frequency, even when the proposal’s subject matter is wholly unrelated to a company’s long-term performance. In fact, half of all proposals submitted to Fortune 250 companies during the 2016 proxy season dealt with some type of social or policy-related matter.

Response: The Chamber’s suggestion that “the federal securities laws have long treated” any particular set of topics -- social, political or otherwise -- as *a priori* “immaterial” is erroneous and contrary to the legal concept of materiality. The Commission’s 2010 guidance on climate change is one clear rebuttal to this mechanistic view, demonstrating that social and environmental issues clearly can have important financial implications for companies.<sup>13</sup>

A policy issue’s materiality depends on circumstances related to each individual company or sector. The current rules generally let shareholders, rather than SEC staff, judge the

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<sup>11</sup> <https://www.blackrock.com/corporate/en-us/literature/press-release/2016-larry-fink-ceo-letter.pdf>

<sup>12</sup> US SIF Foundation, *Report on US Sustainable, Responsible and Impact Investing Trends 2016*, pp 5.

<sup>13</sup> <https://www.sec.gov/news/press/2010/2010-15.htm>

materiality or importance to the company of policy issues addressed in shareholder resolutions. The prevailing legal standard for materiality is based on the significance of an issue to a reasonable shareholder.

We address the Commission's specific rule concerning a minimum financial impact threshold for resolutions in section 4 below.

Proposals requesting disclosure of corporate spending on elections or lobbying highlight a myriad of circumstances in which this disclosure can be important to financial performance. Consider a company that has worked hard to establish a reputation as a great place to work where employees and customers are free of discrimination. If this company were to provide financial support for public policies or candidates who appear to promote discrimination, the company could suffer serious reputational damage, making it difficult to compete for high quality employees and offending customers. Given these risks, corporate leaders themselves, working with investors, have helped to define best practice disclosure.<sup>14</sup>

Regarding the frequency of shareholder proposal filings, we provide a chart in the section on “Claim E,” below. According to the ISS Voting Analytics database of Russell 3000 companies, shareholders submitted an average of 836 proposals at 386 companies per year between 2004 and 2017. The number of submitted proposals fluctuated between approximately 800-900 proposals per year, except for a dip to 603 proposals in 2011 and 673 proposals in 2012 after the SEC’s adoption of say-on-pay vote requirements.

The question of whether shareholder proposals should decrease over time as issues are resolved can be answered by a simple analogy to governments and legal systems. Countries need governments and legal systems to adapt on an ongoing basis as societies are dynamic and new issues continually arise. Two of the strengths of the current shareholder proposal process are its adaptability and efficiency. Investors learn from SEC no-action letters and adapt their proposals the next year to be responsive to the concerns raised by companies.

**Claim C:** *“The SEC has previously recognized that the current shareholder proposal system harms investors in key respects. For example, in 1997—under the leadership of Chairman Arthur Levitt—the SEC proposed raising the resubmission thresholds under Rule 14a-8 so that proposals would have to elicit meaningful support before being proposed again. As the SEC stated then: ‘... we believe that a proposal that has not achieved these [proposed] levels of support has been fairly tested and stands no significant chance of obtaining the level of voting support required for approval.’ While the SEC’s rulemaking was never finalized, we believe that reform is needed even more today.”*

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<sup>14</sup> The Conference Board convened a committee of leading companies that has released guidance for corporate disclosure that aims to avoid risks associated with election spending. See <https://www.conference-board.org/politicalspending/>.



Response: The charge that the proposal system ‘harms investors in key respects’ is unsupported. The examples listed in the bullets beginning on page 3 show how the process has benefited investors, issuers, and the capital markets.

After careful consideration of the SEC’s 1997 proposal to raise resubmission thresholds, and a review of extensive public comments on the issue, the SEC decided NOT to change the thresholds.

In 1997, the shareholder proponent community was deeply concerned that the proposed resubmission levels would eliminate a substantial number of proposals. The fact that many of these kinds of proposals today garner votes in the 20-30% range is testament to the Commission’s wisdom in not pursuing its original proposal, and continuing to allow these issues time to gain support among investors. During the 2017 proxy season, we witnessed three majority votes on climate change proposals at ExxonMobil, Occidental Petroleum and PPL -- a key material risk that took decades to gain traction.<sup>15</sup> Nobody can predict which of today’s emerging issues will be tomorrow’s material risk. The current system has stood the test of time.

Further, very few shareholder proposals linger on the proxy after the third year, as we explain in the section on “Claim F” below.

When assessing the number of environmental and social resolutions that fail to achieve majority votes each year, it is critical to note that many of these proposals are withdrawn after the company commits to address the shareholder’s concerns. Many ESG topics, including climate change, experience average withdrawal / commitment rates higher than 30%.<sup>16</sup> The benefits that accrue to investors, companies and the economy from these commitments are a primary benefit of the current shareholder proposal process.

**Claim D:** *“Moreover, a very small subset of investors have come to dominate the shareholder proposal system...”*

Response: Individual investors who file the most resolutions are Chevedden, Steiner and McRitchie. Between 2004 and 2017 these filers accounted for 14.5% of proposals. **The average vote on their resolutions is 40%.**<sup>17</sup> These investors provide an important service for the capital markets because they have a very strong track record of filing proposals on corporate governance issues that have resulted in hundreds of companies adopting policies that are now considered best practice in governance. These filers provide a good example of a point made by Adam Kanzer of Domini Impact Investments: “The quality of one’s ideas is not correlated with the size of one’s investment.”<sup>18</sup>

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<sup>15</sup> Board diversity proposals at Cognex and Hudson Pacific Properties also achieved majority votes.

<sup>16</sup> Analysis of Ceres data found at: [www.ceres.org/resolutions](http://www.ceres.org/resolutions).

<sup>17</sup> Source: Institutional Shareholder Services resolution database.

<sup>18</sup> <https://www.domini.com/why-domini/domini-insights/domini-blog/unreasonable-proposal>

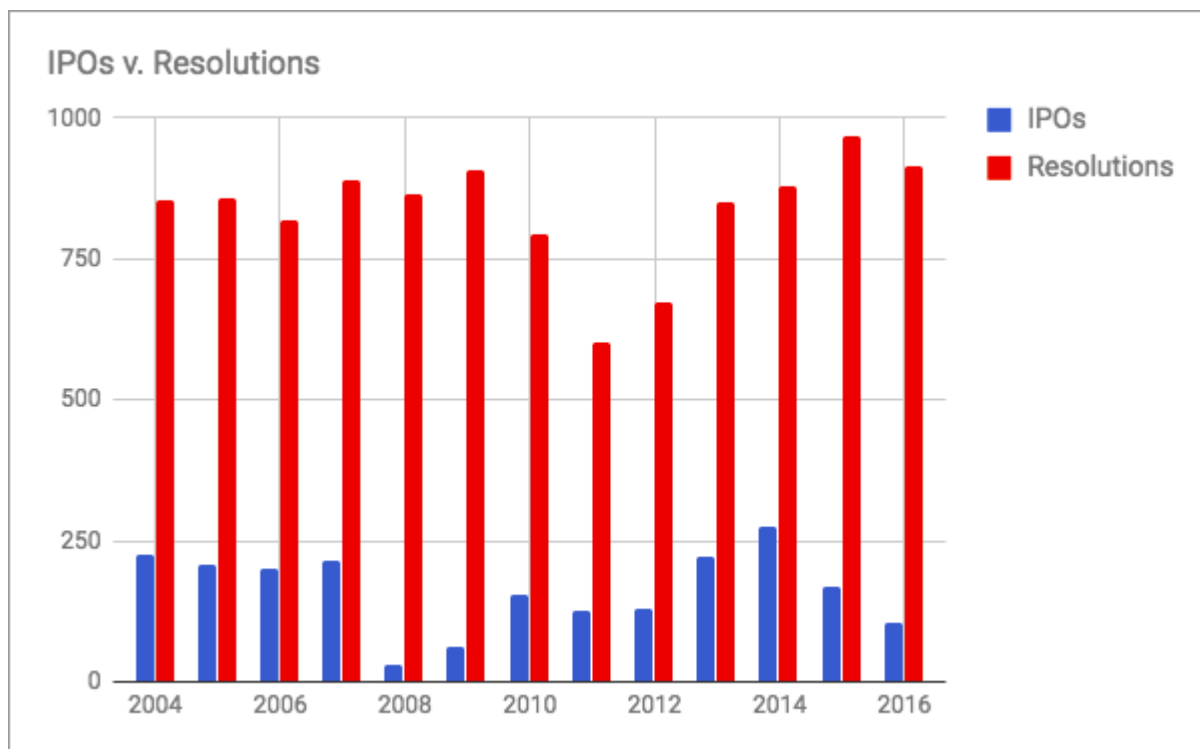
**Claim E:** *“The broken Rule 14a-8 system is yet another burden on companies and their shareholders that only serves to make the public company model less attractive.”*

Response: Can the CCMC identify any company that would not have gone public because of Rule 14a-8, or any company that has been taken private as a result of shareholder resolutions? The claim that shareholder proposals impacts IPO markets seems implausible on its face, and definitely should require some evidence to take seriously. According to data from ISS, only 9% of public companies that have IPO'd since 2004 have ever received a shareholder proposal.

Indeed, most public companies never receive shareholder proposals. On average, 13% of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017, according to the ISS database. Moreover, more than three-quarters of the proposals to Russell 3000 companies in that period were submitted to S&P 500 companies. Less than 4% of shareholder proposals in the ISS database were filed with companies having market caps under \$1 billion.

The median market cap of companies that IPO'd in 2017 through September was less than \$600 million. Two-thirds of these companies have market caps below \$1 billion, and only four have market caps of more than \$5 billion. Smaller, newer companies that fit the profile of IPOs just do not receive many shareholder proposals. It does not seem plausible that other companies that might have gone public chose instead to stay private, or be bought out by other companies notwithstanding financial advantages to going public, were it not for the possibility they might (though probably will not) receive a non-binding shareholder proposal sometime in the next decade or two.

If shareholder proposals make the public company model less attractive in a meaningful way, one would expect to see a correlation between rising numbers of resolutions and falling numbers of IPOs. As shown below, no such correlation exists.



Sources: Institutional Shareholder Services and Renaissance Capital

Recent studies by Credit Suisse<sup>19</sup> and Ernst & Young<sup>20</sup> examined other factors more likely to have reduced the number IPOs in recent years. They point to alternative sources of financing due to dramatic growth in availability of late-stage venture capital, private equity growth capital, and record-low interest rates. Additionally, the Jumpstart Our Business Startups Act (2012) raised the ceiling for the number of shareholders a company can have before having to publicly report to the SEC.

**Claim F:** *“No company wants to go public only to find itself subject to endless politically driven campaigns intended to embarrass an enterprise that was built from scratch by its founders.....In fact, in some cases, even if over 90% of shareholders have rejected a proposal more than once, a proponent is allowed to keep submitting it.”*

This really is the same as Claim E, although stated in even more extreme form. As noted, fewer than 9% of Russell 3000 companies that have had an IPO since 2004 have ever received a shareholder proposal, and only 13% of *all* Russell 3000 companies received a shareholder proposal in a particular year since 2004. For companies that receive a proposal, the median number of proposals is one per year.<sup>21</sup> In other words, **the average Russell 3000**

<sup>19</sup> Mauboussin, Michael J., et al. *The Incredible Shrinking Universe of Stocks: The Causes and Consequences of Fewer U.S. Equities*. Credit Suisse, 22 Mar. 2017.

<sup>20</sup> Brown, D, Grabow, J., Holmes & C., Kelley, J., “Looking Behind the Declining Number of Public Companies”, Ernst & Young, May 2017.

<sup>21</sup> Data sourced from ISS Voting Analytics database.

**company can expect to receive a proposal once every 7.7 years.** Proposals are generally filed at larger, more mature companies.

With regard to “endless” campaigns based on re-submitted proposals, there is no evidence to support this claim. In fact, since, 2010, ISS data shows proponents re-submitted an environmental, social, or sustainability-governance<sup>22</sup> (ESSG) proposal only 40 times (affecting only 31 companies) for a fourth or more times with those fourth or more votes between 11% and 30%. (During this period, there were more than 400 ESSG proposals filed each year according to data from the Sustainable Investments Institute.)

In addition, the concerns raised by investors who file shareholder proposals are overwhelmingly focused on long-term risk management, not “political campaigns intended to embarrass” companies. Proposals that are harmful to companies and their investors receive low votes or are excluded via the SEC’s current resubmission thresholds.

## Responses to the Chamber’s Proposals

So far we have addressed claims made in the introduction of the CCMC paper. Below we assess the Chamber’s seven suggestions for modifying the shareholder proposal process and the harm that would result from each suggested change.

### 1) Resubmission thresholds

*Proposed “reform”: “Amend the SEC’s Resubmission Rule to raise the thresholds for support that proposals must receive in order to be eligible for resubmission.”*

The Chamber presents misleading arguments asserting a need for reform of SEC Rule 14a-8(i)(12) on resubmission thresholds. Currently when a shareholder proposal has garnered 3%, 6% and 10% voting support for the first, second, third and subsequent year of submission, pursuant to Rule 14a-8(i)(12), it can be refiled to appear in a subsequent year on the company’s proxy. The Chamber suggests the SEC consider raising the thresholds to 6%, 15% and 30% for the first, second and third (and subsequent) year of submission.

On its face, the suggested level for resubmission thresholds would do significant damage to the shareholder franchise, if only because circumstances change and that can lead investor views to change. For example, in 2007, a non-binding shareholder proposal to Bank of America for an independent board chair received support from 16.5% of shares voted. In 2009, amidst the financial crisis, perceived poor decisions by bank leadership and a huge government bailout of the bank, shareholders, who had seen a 80%+ loss in share value, approved a binding proposal for an independent board chair. This was an important part of an effort by shareholders to change bank leadership and set it on a better course. This example

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<sup>22</sup> By sustainability-governance proposals we mean those proposals related to both sustainability issues and governance, e.g. proposals requesting the addition of a board member with environmental expertise.

alone suggests that third-year resubmission thresholds should not exceed a requirement for 15% support.

The Chamber report and petition for rulemaking<sup>23</sup> asserts that the resubmission thresholds of Rule 14a-8(i)(12) should be made more restrictive because support levels are higher today than when the rule was originally promulgated. While average support for shareholder proposals has indeed increased over the years, the number of proposals has fluctuated within a fairly stable range, suggesting that there is no problem of companies being flooded with re-submitted proposals.

There is no evidence that shareholders are abusing the rule, that the existing rule is failing to screen out proposals with low investor support, or that proxy statements are clogged with proposals appearing year after year on the proxy despite low investor support. On the contrary, very few proposals appear on corporate proxies for multiple years at levels near the current rule's thresholds, as noted under "Claim F" above.

Further, the Chamber assumes that only proposals on track to winning majority support should appear on the annual proxy. This fails to consider the valuable role of the shareholder proposal process in private ordering and helping investors and companies reach agreements through dialogue. For example, the current thresholds have proven effective at bringing long-term concerns neglected by management to the attention of shareholders and the board. One source of evidence for this can be found in the large numbers of shareholder proposals withdrawn by proponents each year in return for a commitment by the company to address the issue raised by the proposal.

Approximately 37% of climate-related proposals tracked by Ceres between 2011 and 2017 were withdrawn in return for company commitments.<sup>24</sup> In recent years, certain types of governance proposals also have generated high withdrawal rates (e.g., most proxy access proposals in the last two years have been withdrawn when companies agreed to adopt proxy access bylaws).

Based on data from ISS, less than half of all submitted proposals actually go to a vote. Out of the 11,706 proposals that the ISS database tracked between 2004 and 2017, only 5,342 of these shareholder proposals (46%) went to a shareholder vote. The SEC permitted companies to omit 15% of proposals. The remainder were withdrawn after mutually agreeable outcomes with companies or otherwise did not go to a vote.

Private ordering enabled by the rule is of great value to investors, companies, and society and would be undermined by rule changes that prematurely screen out proposals on emerging

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<sup>23</sup> <https://www.sec.gov/rules/petitions/2014/petn4-675.pdf>

<sup>24</sup> Data is published at <http://www.ceres.org/resolutions>

issues. These benefits of the existing rules, which would need to be considered in any cost-benefit analysis, far exceed exaggerated estimates of the cost of shareholder proposals.<sup>25</sup>

To state what may be obvious, it can take time for investor understanding on new issues to build. This is the main rationale for lower first- and second-year thresholds for resubmission. Most new proposals take at least a couple of years to demonstrate staying power. And some issues have taken many years to develop investor support (e.g. board diversity, moving from average 7% in 1993 to high levels of support at present). It is important to respect this ramp-up, and not close off consideration of innovative ideas too early through too-high resubmission threshold requirements. Indeed, one could argue that there is no need for resubmission requirements, as there is a free market for ideas, with investors perfectly capable of rejecting proposals, and they can save time doing so when they have already analyzed the same proposal in an earlier year.

A radical increase in the resubmission thresholds would undermine the ability of shareholders to maintain proposals at a company on emerging issues. It would also deprive larger shareholders of an important tool they use when their private dialogues with companies fail to yield results and they then decide to vote for a proposal on the same issue. This is exactly what happened recently at ExxonMobil and Occidental Petroleum, and led to majority votes on climate risk disclosure resolutions.

Dramatically higher resubmission thresholds are likely to prematurely exclude a large number of proposals. The ISS database tracked 459 shareholder proposals that went to a vote at Russell 3000 companies as of the third quarter of 2017. Of these proposals, 104 (22.7%) received less than 10% of the For/Against vote. In comparison, 252 proposals (54.9%) received less than 30% of the For/Against vote.

The Chamber's approach to resubmissions represents an incomplete and inaccurate understanding of the relationship between the rule's voting metrics and the underlying purpose of the rule in assessing investor interest in the subject matter. The resubmission rule provides an indicator of whether investors are sufficiently interested in the subject matter of a proposal for it to be maintained on the proxy, yet current vote count methods often underestimate and mischaracterize the level of support shown by a firm's active, engaged and independent investors.

Share ownership configurations, including dual class ownership, voting demographics and the role of insider share ownership complicate the interpretation of 3, 6 and 10 percent support. Insiders do not ordinarily vote in favor of shareholder proposals, but instead reflexively follow management's recommendations for or (nearly always) against the proposals. As a result, the proportion of actual "for" votes often understates the proportion of *independent* investors who are "for" the proposal. At a minimum, this would complicate any effort to revise the

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<sup>25</sup> An analysis of cost estimates associated with shareholder proposals is available here: [The Business Case for the Current SEC Shareholder Proposal Process](#) (Ceres, ICCR and US SIF, 2017), pg. 11

resubmission rule in a way that supports the rule's purpose of assessing investor interest in the subject matter of each shareholder proposal.

Modifying Rule 14a-8(i)(12) in a manner that would exclude more proposals would be a costly loss to investors, corporations and society. It would be inconsistent with the SEC's mission of investor protection and maintenance of efficient markets, and would not be in the public interest.

## 2) Management proposals conflicting with shareholder proposals

*Proposed "reform": "Withdraw Staff Legal Bulletin 14H (CF), issued in October 2015 concerning the Rule 14a-8(i)(9) exemption, which allows the exclusion of a proposal if it conflicts with one of the company's own proposals."*

Staff Legal Bulletin 14H (CF) (the "Bulletin"), issued in October 2015, corrected longstanding problems created by what had become an overly broad and subjective interpretation of Rule 14a-8(i)(9) by SEC staff. Far from "restoring certainty," as the Chamber of Commerce contends, withdrawing the Bulletin would merely turn back the clock to a time when those overly broad interpretations inappropriately denied shareholders the ability to present and vote on a wide range of reforms and created the potential for abuse by companies.

Prior to the Bulletin, the interpretative approach taken by SEC staff was to exclude proposals where inclusion could "present alternative and conflicting decisions for shareholders" and "could provide *inconsistent and ambiguous results*" (emphasis added). This approach focused on the potential for shareholder confusion, which went well beyond the intent of Rule 14a-8(i)(9) and resulted in the exclusion of proposals where, by any objective standard, no conflict existed.

For example, prior to the Bulletin, Staff permitted companies to exclude precatory proposals addressing executive pay clawback provisions and change-in-control severance agreements for future equity plans in cases where the company had sought shareholder approval for an executive pay plan on that year's proxy statement. This occurred even though no direct conflict existed: If shareholders approved both proposals, a board could readily understand that shareholders agreed with the broad equity plan provisions as presented on the proxy, but also believed that future plans should incorporate the recommendations of the shareholder proposal.

Concerns with the pre-Bulletin interpretation of Rule 14a-8(i)(9) -- particularly its potential for abuse by companies -- came to a head in the 2015 proxy season, when Whole Foods successfully sought no-action relief to exclude a proxy access proposal, arguing its board intended to put forward its own proxy access proposal with far more restrictive terms that were widely viewed as unworkable. Over the following six weeks, approximately two dozen companies that had also received proxy access shareholder proposals similarly requested no-action relief based on their newfound intent to submit competing proxy access proposals with

more stringent terms than those in the shareholder proposal. Investors widely perceived the companies as playing games on this, using the rules in a manner that could indefinitely block consideration for a reasonable shareholder proposal.

These were the circumstances that prompted Chair White to revoke the Whole Foods no-action letter, temporarily suspend no-action reviews under Rule 14a-8(i)(9) and, ultimately, to issue the Bulletin. The Bulletin properly returned the focus to whether there is a direct conflict between management and shareholder proposals, defined by Staff to include only those circumstances in which “a vote for one proposal is tantamount to a vote against the other proposal.”

Under the standard established in the Bulletin, the Staff does not “view a shareholder proposal as directly conflicting with a management proposal if a reasonable shareholder, although possibly preferring one proposal over the other, could logically vote for both.”<sup>26</sup> In addition to being consistent with the narrow intent of Rule 14a-8(i)(9), this standard provides significant benefits to shareholders and boards alike. Specifically, it enables shareholders to communicate useful information on their preferences to boards, which are then free to consider those preferences as they make policy. The Bulletin properly leaves such determinations to the Board, rather than to SEC staff.

It was worth noting that, during the 2015 proxy season -- when SEC Chair White temporarily suspended no action reviews under the Rule -- at least seven companies put forward proxy access proposals to compete with shareholder proposals requesting proxy access with less restrictive terms. Several of the companies (including AES Corporation, Exelon and Visteon Corporation) that presented board-sponsored, non-binding proxy access proposals said they saw benefits from presenting two proposals on the same topic to gauge investor sentiment on the two different proxy access models proposed.

None of the seven companies subsequently experienced voting results that were “inconsistent and ambiguous.” In all but one case, one proposal or the other got a clear majority vote and in no case did both proposals earn a majority vote. The differing support levels on the two proposals indicate that shareholders were not confused in understanding the different proposals, nor did those seven Boards face ambiguity or difficulty interpreting the voting results. Rather, in each case, they simply got clear and valuable information, typically available by no other means, about what shareholders truly preferred.

Moreover, even where ambiguity may be a possible outcome, the information is not necessarily unimportant or irrelevant. Ambiguous results can suggest to the board a degree of uncertainty that may dictate changes or reconsideration.

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<sup>26</sup> Many investors believe that precatory proposals can never give rise to a conflict, because they are non-binding and can be readily ignored by a board. In its Bulletin, however, the SEC staff opted for a broader definition of a conflicting proposal.



In short, the interpretative framework established in the Bulletin allows for the exclusion of shareowner proposals that objectively and directly conflict with a management proposal, while permitting shareholders the ability to present and vote on proposed reforms. Equally important, it avoids the potential for gamesmanship by issuers seeking to exclude shareholder proposals by proposing more restrictive proposals on the same issue, and also avoids placing SEC staff in the impossible position of assessing motive in cases where gamesmanship appears to be a possibility.

### 3) Disclosure of economic interests and objectives

*Proposed “reform”:* “Offer more transparency to investors by requiring proponents to provide sufficient disclosure regarding their economic interests and objectives.”

A number of points in the Chamber petition seem to be designed to identify ways to make the process of filing a resolution more burdensome for investors. In addition, a number of them do not seem to address a problem needing a solution. This provision is one such example.

The provision is vague and therefore difficult to imagine how to implement. What are the “economic interests” the provision asks to be described? Is it the number of shares held? What is the evidence that investors that short or have derivative positions in a stock, that might in some way be suspect, use the shareholder proposal process? And would not a first step be to require the company to name the proponent(s) in the proxy statement, so that investors could have clarity on who submitted the proposal (many companies exclude this information from proxy statements).

How does it help the company or the investors reading the proxy if the proponent included a description of their investment objectives. And what does this look like for an individual investor? Are they being asked to describe their portfolio size, their net worth or investment strategy? Again the proposal is so vague that it is hard to interpret.

While the proposal is vague, clearly the Chamber would like to call into question the motives of filers, something that the Commission generally seeks to avoid in the implementation of the rule. The only exception is under the personal grievance provisions of Rule 14a-8(i)(4). Creating extensive disclosure of a proponent’s relationships and motivations would open a Pandora’s box -- questioning investor relationships and alliances. This would be an inappropriate and unfortunate development and implementation of the rule.

That said, many investors would welcome a specific checklist along the following lines if the issuer were required to pass the same on to shareholders in the proxy statement:

1. Proponent's name and address and number of shares held in company x used for filing this resolution.
2. On a voluntary basis limited to 100 words not included in the resolution, a description of who the lead proponent is and brief description of any co-filers.

3. On a voluntary basis a brief description of the business case for the request in the resolution.

Such additional information would be welcomed by many investors if the guidance is clear on how to provide the information.

Any disclosure requirements of these kinds needs to consider the added burden placed both on the proponents and on SEC Staff in implementing the requirements, including the possibility of onerous and inappropriate arguments by companies probing investor relationships and motivations.

#### 4) Proposals impacting less than 5% of assets or net earnings

*Proposed "reform": "The Commission should reassert the "relevance rule" under 14a-8(i)(5) by allowing excludability of a proposal if the subject matter impacts less than 5% of a company's total assets and 5% of net earnings."*

Rule 14a-8(i)(5) concerning "relevance" currently permits exclusion of a shareholder proposal: "If the proposal relates to operations which account for less than 5 percent of the company's total assets at the end of its most recent fiscal year, and for less than 5 percent of its net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business."

The CCMC proposes that the Commission amend the relevance exclusion to remove the following clause: "and is not otherwise significantly related to the company's business."

(During final preparation of this paper, the SEC issued Staff Legal Bulletin No. 141, which guides company boards to provide their opinion to the SEC about the relevance to their businesses of proposals for which their companies are seeking no-action letters from the SEC. The Staff also announced that it intends to re-apply a financial test to items that are "otherwise significantly related" to a company's business, consistent with the decision in *Lovenheim v. Iroquois Brands, Ltd.*, 618 F. Supp. 554 (D.D.C. 1985). While the impact of this interpretation on important shareholder proposals remains to be seen, it appears that the Staff action was intended to directly address the underlying issues in this Chamber of Commerce critique. However, in this paper we limit our discussion to the Chamber's proposal itself.)

The Chamber's proposal is unworkable and inconsistent with modern conceptions of risk and investor priorities. It would create substantial confusion, dramatically increase the number and complexity of no-action requests and likely lead to the exclusion of a vast array of shareholder proposals directed towards improved governance and management of long-term risks.

Thousands of companies and investors believe good governance is central to protecting both an issuer and its investors. These benefits, however, are difficult to measure, as they are often

long-term or intangible. A pure economic litmus test could potentially eliminate proposals designed to avoid substantial damage to corporate reputations, among other material risks.

**The Commission considered, and rejected, versions of this idea in 1976<sup>27</sup> and 1997.**

Both rejections were rooted in the insoluble problem of applying a strict financial test to the important forward-looking governance issues raised by most shareholder proposals. For example, how would the test apply to a proposal on proxy access, or to reducing the risk of future reputational damage?

Material risks are not necessarily correlated to revenues or significant ownership. As Commissioner Wallman noted in 1997, for example: "...if a company employs slave labor in a small plant in Asia, a proposal relating to that operation would be excludable under this test, notwithstanding the significant potential costs to the company and its shareholders from the company's pursuing such a policy."<sup>28</sup> Indeed, reputational risks to a company's goodwill value are very hard to measure.

Another common example is in the area of corporate political spending. Although many companies argue in response to shareholder proposals seeking full disclosure of corporate political contributions that these contributions are "*de minimis*," there are numerous examples of relatively insignificant contributions leading to public controversies and legal consequences for companies.

**The problems with the CCMC's idea run so deep that the Commission's 1997 proposal included complex provisions limiting the exclusion to "proposals relating to quantifiable matters..."** Further, the Commission provided an "override" mechanism, which would have permitted 3% of shareholders to override the entire no-action process. In the end, the proposal did not receive sufficient support from shareholders or issuers, and was rejected.

Ultimately this proposal also presents intractable practical problems. **A pure economic test puts shareholder proponents – and SEC staff -- in the impossible position of evaluating the magnitude of the economic relevance of any given proposal.** Which assets or operations does it "relate" to? What is the value of those operations? How should governance proposals be treated? How should supply chain proposals be treated involving assets and operations not owned by the company? How should Staff treat proposals that do not appear to relate to any particular set of "operations"?

If adopted, the Chamber's proposal will predictably lead to numerous lengthy and contentious no-action requests as issuers seek to test the boundaries of the new rule and proponents seek

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<sup>27</sup> In 1976, "the Commission considered a purely economic test for determining a proposal's relevance, but rejected the idea largely out of recognition that some matters, such as cumulative voting rights or the ratification of auditors, may be important to the company despite the unavailability of a quantifiable economic value."

<sup>28</sup> <https://www.sec.gov/rules/proposed/34-39093.htm>  
<https://www.sec.gov/rules/proposed/s72597cn.htm>

to convince Staff of the relevance of their proposals. Presumably, SEC staff would be called upon to issue Staff Legal Bulletins to explain where it was drawing the line for numerous categories of proposals. Challenges under this provision, which are currently rare, would become ubiquitous, as it could apply to nearly every type of proposal submitted.

The need for an “otherwise related” clause is even more pronounced today, with significant investor attention being paid to systemic and reputational risks and environmental, social and governance factors.

## 5) Use of Images, Photos or Graphs

*Proposed “reform”: Prohibit the use of images, photos, or graphs as part of proposals, while maintaining the ability of proponents to include a hyperlink for a website they wish to include.*

It is not clear that there is a problem involving images, photos and graphs, which may be useful and efficient communication tools supporting a proposal.

Sometimes a picture is worth a thousand words, yet might only occupy the space of 100 words. Although the rule is silent on whether or not images can be included in a proposal, it seems reasonable to count the number of words in an image as part of the word count of a proposal, and to ensure that the images are not misleading, pursuant to the existing rules against misleading communications in the proxy.

In adopting the 500 word limit, the SEC Commissioners were trying to achieve a balanced and reasonable approach to determining how much space a shareholder proposal can occupy in a company proxy. As they stated, they sought to avoid shareholder proposals “obscur[ing] other material matters in the proxy statements of issuers, thereby reducing the effectiveness of such documents.”

The Division of Corporation Finance has decades of experience working to maintain the balance of 14a-8, and applying 14a-9 protections (concerning materially false or misleading statements in proxy soliciting materials) to shareholder proposals and the proxy as a whole. Clearly, some images can be permitted consistent with 14a-9 and in a manner that does not obscure other parts of the proxy.

If any clarification of these rules is provided, we believe it would be best to do so through a Staff Legal Bulletin rather than rulemaking as the SEC staff has recently done in issuing Staff Legal Bulletin No. 14I.

## 6) Personal claims and grievances

*Proposed “reform”: “The SEC should provide market participants with more certainty regarding its policing of 14a-8(i)(4), which deals with proposals that relate to a redress of a personal claim or grievance.”*

The existing rule on personal grievances is already well enforced by the Staff. Rule 14a-8(i)(4) provides that proposals are excludable if they are intended to address a personal grievance or address an interest not shared with other shareholders at large.

Indeed, Staff Legal Bulletin 14, Issued on July 13, 2001, provided that if an individual were abusing the shareholder proposal process to advance a personal grievance, the staff can even issue “forward-looking relief” which would apply to future proposals by the same individual.

The existing rule has been applied to exclude proposals, even where the “personal grievance” being advanced is that of a third party rather than the proponent. Therefore, when shareholders filed a proposal at Dow Jones & Co. in the midst of a union dispute, the Staff concluded the proposal was excludable. The SEC staff decision in Dow Jones & Co. (Jan. 24, 1994) on two different proposals recommended the adoption of policies tying any increases in CEO pay to proportional increases in compensation of the other employees of the company. There was substantial evidence, including in news releases by the company’s union, that the proposals were drafted and filed by third parties on behalf of the company’s union, which was in a wage dispute with the company. The SEC staff found that in this instance, the filing of the proposal was excludable because it related to the redress of a personal claim or grievance or is designed to result in a benefit to the proponent or to further a personal interest, which benefit or interest is not shared with the other security holders at large. Subsequent SEC staff no action letters have appropriately placed the burden of proof on companies to provide factual evidence that a shareholder’s proposal is motivated by a personal grievance.

## 7) Statements that are materially false or misleading

*Proposed “reform”:* “The SEC must allow for the exclusion of proposals that include materially false or misleading statements.”

The SEC already allows for exclusion of proposals with false or misleading statements. The current rules were clarified in 2004 via Staff Legal Bulletin (SLB) 14B.<sup>29</sup>

The Bulletin was necessary because, as it states, “...many companies have begun to assert deficiencies in virtually every line of a proposal’s supporting statement as a means to justify exclusion of the proposal in its entirety.”

The existing approach in SLB 14B is to allow exclusion of proposals “where [a] company demonstrates objectively that the proposal or statement is materially false or misleading.” In addition, the SEC is likely to concur with company requests to exclude proposals if they impugn character without factual foundation or are so vague that the action requested is undecipherable.

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<sup>29</sup> <https://www.sec.gov/interps/legal/cfslb14b.htm>

For differences of opinion relating to facts in proposals, the Bulletin guides companies to use the opposition statement to the proposal to provide their point of view in the following circumstances:

- “the company objects to factual assertions because they are not supported;
- the company objects to factual assertions that, while not materially false or misleading, may be disputed or countered;
- the company objects to factual assertions because those assertions may be interpreted by shareholders in a manner that is unfavorable to the company, its directors, or its officers; and/or
- the company objects to statements because they represent the opinion of the shareholder proponent or a referenced source, but the statements are not identified specifically as such.”<sup>30</sup>

This approach is functioning well and limits the burden on SEC staff of weighing in on disputes relating to differences of opinion.

## Conclusion

In summary, the CCMC’s suggestions to limit shareholder proposals will diminish the ability of the SEC to fulfill its mission to protect investors in the context of rapidly growing investor concern about the materiality of ESG issues, the prevalence of systemic risks, “the tyranny of short termism,”<sup>31</sup> and the wide scale shift to fiduciary capitalism.

According to John Rogers, the former president and CEO of CFA Institute, “Fiduciary capitalism has several attractive traits. It encourages long-term thinking. As ‘universal owners,’ fiduciaries foster a deeper engagement with companies’ management teams and public policymakers on governance and strategy.”<sup>32</sup> In textbook terms, they seek to minimize negative externalities and reward positive ones.”<sup>33</sup>

The focus on externalities stems from these fiduciaries generally having widely diversified portfolios and wanting to discourage individual firms from creating systemic risks that will harm long-term, portfolio-wide returns. This is a good example of how the interest of these fiduciaries is well-aligned with the SEC’s mission.

Organizations defending the current shareholder proposal process are leading advocates for fiduciary capitalism and long-term value creation that benefits their clients and beneficiaries. In addition to those who prepared this paper, they include the Council of Institutional Investors

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<sup>30</sup> <https://www.sec.gov/interps/legal/cfslb14b.htm>, part 4.

<sup>31</sup> <https://hbr.org/2011/03/capitalism-for-the-long-term>

<sup>32</sup> <http://www.upenn.edu/pennpress/book/13400.html>

<sup>33</sup> <https://blogs.cfainstitute.org/investor/2014/04/28/a-new-era-of-fiduciary-capitalism-lets-hope-so/>

(CII), representing investors managing \$23 trillion (including Associate Members), the Principles for Responsible Investment (PRI) with more than 1,600 investor signatories managing over \$65 trillion globally and CDP, which works with investors managing more than \$100 trillion globally.

The shareholder proposal is among the most important tools used by investors in these groups, and others, to act as watchdogs and advocates for long-term value creation and risk management within the U.S. capital markets. In this sense, they are strong allies of the SEC in achieving its mission; and they do this work voluntarily, through the existing, fine-tuned form of shareholder democracy facilitated by rule 14a-8.

For the reasons described above, the Chambers' proposed "reforms" would undermine the role of the SEC in protecting investors and facilitating well-functioning capital markets that serve the public interest. Notwithstanding the contrary assertions and rhetoric presented by the CCMC's petition, there are no compelling reasons to amend Rule 14a-8 and no evidence that that current shareholder proposal process has been abused or misused to the detriment of corporate issuers.