AFL-CIO

AMERICA'S UNIONS

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February 3, 2020

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

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

Dear Ms. Countryman:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to provide comments on the U.S. Securities and Exchange Commission's proposed amendments to Rule 14a-8 on shareholder proposals (File No. S7-23-19). The AFL-CIO is a voluntary federation of 55 national and international labor unions that represent 12.5 million working people. Union members participate in the capital markets as individual investors as well as participants in pension and employee benefit plans. Many of these pension and employee benefit plans submit Rule 14a-8 shareholder proposals as part of their shareholder engagement activities to promote corporate accountability.

Simply stated, the Commission has not provided any factual evidence to support the need for this proposed rulemaking. As described below, the Commission's proposed rulemaking violates the economic cost-benefit analysis requirements of the Administrative Procedure Act, the paperwork burden estimate requirements of the Paperwork Reduction Act, the small entity regulatory relief requirements of the Regulatory Flexibility Act, and the major rule requirements of the Small Business Regulatory Enforcement Fairness Act. Moreover, given the magnitude of the required corrections, the Commission cannot address these deficiencies without first re-proposing a revised rulemaking for notice and comment. We respectfully request that the Commission withdraw the proposed rulemaking in its entirety.

Shareholder proposals are an integral part of shareholder democracy in the United States. Over the past several decades, shareholder proposals have facilitated the private ordering of companies on a variety of environmental, social and governance issues. Rule 14a-8 is a remarkably cost-effective mechanism to elevate shareholder concerns to boards of directors and corporate management. Given the low costs and extraordinarily high benefits of this process, it is hard to imagine how any restrictive changes to the shareholder proposal rule could satisfy a comprehensive cost-benefit analysis. Yet the Commission's proposed amendments to Rule 14a-8 will effectively disenfranchise many shareholders from placing proposals on corporate ballots.

Union members' pension and employee benefit plans have a proud history of submitting shareholder proposals to promote corporate accountability for the benefit of the marketplace. Consistent with their fiduciary duties under the Employee Retirement Income Security Act of 1974 ("ERISA"), pension and employee benefit plans have submitted shareholder proposals to improve the long-term financial performance of the companies in which they invest.[1] Over the past two decades, these plans have collectively submitted thousands of shareholder proposals. Many of today's legal and regulatory standards for public companies were pioneered by the shareholder proposals of union members' pension and employee plans, including:

- Stock option expensing,
- Director independence requirements,
- Executive compensation clawbacks,
- Advisory votes on executive compensation, and
- Limits on auditors providing non-audit services.

Other shareholder proposals submitted by union members' pension and employee benefit plans have resulted in companies adopting the following corporate governance best practices:

- Annual elections of directors,
- Majority voting for directors,
- Equal access to the proxy,
- Shareholder approval of poison pills, and
- Independent board chairs.

The shareholder proposals of union members' pension and employee benefit plans have also helped establish the following widely-adopted reforms of executive compensation:

- Bans on executive tax gross-ups,
- Executive stockholding requirements,
- Limits on cash golden parachutes,
- Limits on accelerated vesting of equity, and
- Limits on supplemental executive retirement plans.

Finally, union members' pension and employee benefit plans have submitted shareholder proposals on a variety of corporate responsibility issues that are now considered best practices:

[1] *See* Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, including Proxy Voting Policies or Guidelines, U.S. Department of Labor, No. 2016-01, 29 C.F.R. §2509.2016-01. *See also* Field Assistance Bulletin No. 2018-01, U.S. Department of Labor, April 23, 2018.

- Reporting on political spending and lobbying,
- Reporting on safety management,
- Reporting on equal employment opportunity,
- Board diversity, and
- International labor rights standards.

Academic studies have found that the shareholder proposals of union members' pension and employee benefit plans create long-term value.[2] We are not aware of any credible peer-reviewed academic studies that conclude otherwise. As a result, the retirement security of working people has been enhanced by these corporate reforms. We vigorously oppose the Commission's proposed rulemaking that will make the submission of shareholder proposals more difficult for union members' pension and employee benefit plans. For the reasons discussed below, we strongly urge the Commission to withdraw and reconsider its proposed rulemaking. The narrow self-interest of corporate CEOs who oppose the shareholder proposal process should not come before the value for investors that shareholder proposals create.

Rule 14a-8(b) Eligibility Requirements (Questions 1-16)

Since its creation in 1942, the Commission's shareholder proposal rule has facilitated the ability of small investors to submit proposals for a vote at company shareholder meetings. For the first four decades of the shareholder proposal rule, there was no stockholding requirement. The Commission first adopted a $1,000 stockholding requirement in 1983[3], and later increased the stockholding requirement to $2,000 in 1998 to adjust for inflation.[4] To preserve the longstanding right of small investors to submit shareholder proposals, any increase in the one-year Rule 14a-8(b) stockholding requirements should not exceed $3,000 to adjust for inflation since 1998.

Good ideas are not limited to investors with large pocketbooks. Since its inception, the shareholder proposal rule has facilitated the ability of small investors to submit proposals to a vote at company shareholder meetings. Shareholder proposals help reduce agency costs that stem from the separation of ownership and control in public companies.[5] The submission of shareholder proposals to increase management accountability conveys a benefit on all shareholders. But because the benefits of shareholder proposals do not accrue entirely to the sponsor of the proposal, the number of proposals is too low relative to the public good they create. Accordingly, the Commission should seek to expand the number of shareholders who file proposals, not reduce them as the Commission has proposed in its amendments to Rule 14a-8.

Shareholder proposals that are submitted by individual investors arguably provide a public good that is disproportionate to their share ownership. According to the ISS Voting Analytics database

[2] Andrew Prevost, et.al., "Labor Unions as Shareholder Activists: Champions or Detractors?" Financial Review, Vol. 47, Issue 2, May 2012, pp. 219-421; Luc Rennebooga and Peter Szilagyi, "The Role of Shareholder Proposals in Corporate Governance," Journal of Corporate Finance, Vol. 17, Issue 1, February 2011, pp. 167-188.
[3] Exchange Act Release No. 20091 (Aug. 16, 1983) (48 FR 38218).
[4] Exchange Act Release No. 34-40018; (May 21, 1998) (63 FR 29106).
[5] *See* Lucian Bebchuk, "The Case for Increasing Shareholder Power," Harvard Law Review, Vol. 118, No. 3, pp. 833-914, January 2005.

of shareholder proposals that were submitted at Russell 3000 companies, the average vote for shareholder proposals was 33 percent in 2019. In comparison, the average vote on shareholder proposals that were submitted by an individual or family trust was 39 percent in 2019 (excluding proposals that were co-filed by an institutional investor or an organization).[6] This higher level of shareholder support for proposals by individual investors indicates that all investors benefit from the opportunity to vote on shareholder proposals that are submitted by individual investors.

Stockholding Requirements

The Commission has stated a number of times in recent years its desire to promote the interests of small "Main Street" investors. Yet this proposed rulemaking aims to disenfranchise these same small investors. The Commission's proposed increase in the Rule 14a-8(b) stockholding requirement to $25,000 after one year or $15,000 after two years is excessive relative to the size of Main Street individual investor portfolios. According to U.S. Census Bureau data, 59 percent of working age individuals do not own any retirement account assets. In other words, the median retirement account balance is zero. For workers who are fortunate to own assets in a retirement account, the median account balance is approximately $40,000.[7] The Commission's proposed $15,000 to $25,000 stockholding requirements are the equivalent of 37.5 percent to 62.5 percent of the median retirement account balance. The Commission's rules should not encourage Main Street individual investors to hold such a large concentration of shares in one security.

The Commission's proposed elimination of the ability for individual investors to aggregate their shares to meet the proposed stockholding requirements is arbitrary. Institutional investors such as mutual funds and pension plans represent the aggregated holdings of many individual investors and plan participants. Preventing individuals from co-filing proposals for the purpose of meeting the Rule 14a-8(b) stockholding requirements elevates legal form over substance. Will the Commission also prohibit individuals who wish to aggregate their shares from forming a partnership or an unincorporated association for this purpose? Why treat individual investors differently from mutual fund investors or pension plan participants?

Holding Periods

While encouraging long-termism is a laudable goal, extending the Rule 14a-8(b) stockholding requirement of $2,000 from one year to three years is not the appropriate way for the Commission to do so. The proposed three-year time extension will disproportionately impact the ability of employee-owners to submit shareholder proposals. Employees who receive equity compensation typically are granted stock options or restricted stock that may not be exercised or vest for several years. Requiring these employees to hold their shares for an additional three years to meet the $2,000 stockholding requirement is not justified given that they have already demonstrated their long-term economic interest in the company that employs them.

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[6] AFL-CIO analysis of ISS Voting Analytics database of shareholder proposals.

[7], Diane Oakley, Jennifer Erin Brown, and Joelle Saad-Lessler, "Retirement in America: Out of Reach for Working Americans?," National Institute on Retirement Security, September 2018.

Nor does the Commission's proposed extension of the Rule 14a-8(b) $2,000 ownership threshold from one year to three years consider the length of time that individual and institutional investors typically hold shares. According to one study, individual accounts at a U.S. discount brokerage had an average annual portfolio turnover of 75 percent which is the equivalent holding period of 16 months.[8] Another study found the average holding period of all categories of mutual funds between 2005 and 2015 (including index funds) ranged between 15 to 17 months.[9] These average holding periods suggest that the existing Rule 14a-8(b) stockholding requirement of 12 months is an appropriate length of time relative to the typical investor's portfolio turnover.

Finally, the Commission's proposed Rule 14a-8(b) ownership thresholds are unnecessarily complicated and confusing. Rule 14a-8 has been written in plain English in order to facilitate the enfranchisement of small investors who may lack the necessary legal expertise to decipher complicated securities regulations. Adding multiple criteria for Rule 14a-8(b) ownership thresholds will create additional complexity for shareholder-proponents who are required to provide a proof of ownership letter from their bank or broker when they submit a shareholder proposal. Under the Commission's proposal, shareholders will need to track their share ownership for one-, two-, and three-year intervals to determine which Rule 14a-8(b) ownership threshold they satisfy. Obtaining a satisfactory proof of ownership letter may be particularly challenging for investors who change their bank or broker during this lookback period.

For these reasons, the Commission should maintain the existing Rule 14a-8(b) ownership requirement of $2,000 for establishing an investor's eligibility to submit a shareholder proposal. If the Commission feels that the Rule 14a-8(b) ownership requirement must be "modernized" due to the passage of time, the only warranted modernization that is consistent with the long history of the shareholder proposal rule is an increase in the stockholding requirement to $3,000 to adjust for inflation. Nor should the Rule 14a-8(b) time holding requirement of one year be extended given the typical investor's rate of portfolio turnover. A holding period of more than one year will likely limit use of the shareholder proposal rule to investors who only maintain their stock ownership for the sole purpose of being able to file a shareholder proposal.

Proposals Submitted on Behalf of Shareholders (Questions 17-21)

The Commission's proposed new requirements for shareholders to appoint a representative to submit a proposal are unnecessary. Given the complexity of the shareholder proposal rule, investors who submit proposals often choose to be represented by someone who is more experienced with the Rule 14a-8 process. In Staff Legal Bulletin No. 14I, the staff of the Division of Corporation Finance clarified the documentation expectations for shareholders who submit proposals through representatives. Proposals that do not meet these requirements risk being excluded from company proxy statements by the issuance of a "no action letter." In our view, the procedural expectations described in Staff Legal Bulletin No. 14I eliminated any need for a formal rulemaking regarding the appointment of shareholder-representatives.

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[8] Brad Barber and Terrance Odean, "Trading Is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors," The Journal of Finance, April 2000.
[9] Anne Tucker, "The Long and The Short: Portfolio Turnover Ratios & Mutual Fund Investment Time Horizons," The Journal of Corporation Law, 2018.

Moreover, the Commission's proposed rulemaking creates an additional burdensome requirement that was not contained in Staff Legal Bulletin No. 14I. Specifically, the proposed rulemaking requires that the documentation appointing a representative must now include the shareholder's statement supporting the proposal. In other words, shareholders will need to provide the full text of their 500-word proposal and its supporting statement. This additional procedural requirement will interfere with the ability of shareholders to use their chosen representatives as subject matter experts to draft their proposal's supporting statement. Does the Commission have any examples of abuse of Rule 14a-8 that justify the need for such a rulemaking to "help safeguard the integrity of the shareholder-proposal process"?

The proposed rulemaking also interferes with state agency law by requiring that shareholders provide express and specific authorization of the designated representative to submit a shareholder proposal. The representation of shareholders by a representative is a matter of state law. Under the legal doctrine of agency, an agent may act under the express, implied or apparent authority of their principal. In all cases, the principal is bound by their agent's actions even if the agent lacked actual authority. Moreover, as a matter of state law, all agency relationships are fiduciary relationships. Therefore, it is irrelevant whether the representative of a shareholder is a registered investment advisor, an ERISA fiduciary, an attorney or simply a trusted friend or family member. For these reasons, the Commission's proposed amendments are an unwarranted and problematic intrusion into agency relationships that are properly governed by state law.

We are concerned that the proposed rulemaking will have unintended consequences for institutional investors. Institutional investors such as mutual funds and pension plans are not natural persons and therefore must act through agents. Moreover, ERISA encourages pension plans to enlist the advice of prudent experts. The Commission's proposed rulemaking is inexplicably silent on the fact that institutional investors necessarily rely on agents to conduct all business including the submission of shareholder proposals. The proposed rulemaking does not clarify whether these documentation requirements will apply to the agents of institutional investors. For example, will a pension plan administrator no longer be able to submit a proposal without the specific authorization of the board of trustees? Such a restriction conflicts with the lawful ability of pension plan trustees to delegate their fiduciary responsibilities under ERISA.

The Role of Shareholder Proposals in Shareholder Engagement (Questions 22-28)

The Commission's proposed rule requiring that shareholders make themselves available to companies is asymmetrically arbitrary. As the Commission's proposed rulemaking notes, company engagement with shareholders who submit proposals has increased in recent years and shareholders frequently withdraw their proposals as a result of this dialogue. As a general matter, shareholders submit proposals to bring issues of concern to corporate management, boards of directors, and their fellow shareholders. The goal of shareholder-proponents is to improve the policies and practices of the companies that they invest in, not to simply take proposals to a vote. The increased willingness of companies and shareholders to reach withdrawal agreements indicates that Rule 14a-8 is working better than ever to facilitate this private ordering process.

However, the Commission's rationale for requiring that shareholders make themselves available to companies for dialogue at a specific time and date is contradictory to our experience as a sponsor of shareholder proposals. All too often, it is the company that refuses to dialogue with the shareholder who has submitted a proposal. For example, in our experience, companies often request no action relief from the Division of Corporation Finance staff without contacting us to first discuss the proposal. In other cases, the only communication that we receive from companies is the opposition statement to the shareholder proposal that is required to be sent under Rule 14a-8(m)(3). In such situations, our shareholder proposal and the company's opposition statement are the only communications—despite our willingness to dialogue.

If the Commission believes that there is insufficient dialogue between companies and shareholders who submit proposals, the Commission should propose a symmetrical obligation on all parties. The one-sided nature of the Commission's proposed rulemaking places all the burden on shareholders without considering the fact that in many cases, it is the company that is reluctant to dialogue. Most public companies have well-staffed corporate secretaries and investor relations departments that could easily accommodate a required phone call with shareholder-proponents. For example, the Commission could require that companies engage in dialogue with shareholder-proponents before allowing companies to solicit votes against shareholder proposals. Why does the Commission's proposed rulemaking arbitrarily assume (without providing any evidence) that it is shareholders and not companies who need to be required to dialogue?

One Proposal Limit (Questions 29-36)

The Commission's proposed amendment to limit the submission of one proposal to "each person" rather than "each shareholder" will have unintended consequences for shareholders who wish to avail themselves of expertise from lawyers, investment advisors, and others. Institutional investors in particular are likely to be restricted in their choice of representatives given that institutional investors are not natural persons and therefore must act through a natural person. For example, several pension plans may use the same registered investment advisor or pension plan administrator for the purpose of submitting shareholder proposals. Limiting representatives to one proposal per company will create a burdensome "first to file" constraint for their clients.

Moreover, the Commission's proposed rulemaking is vague and ambiguous regarding exactly what types of dual representation will be prohibited under the amended rule. For example, Rule 14a-8(h) explicitly permits shareholders to designate a representative to present shareholder proposals at shareholder meetings. Under the proposed rulemaking, will multiple shareholders be able to have their proposals introduced inside the annual meeting by one person? If such dual representation is now to be prohibited, will these amended Rule 14a-8 provisions be in conflict with state law that allows principals to select the agents of their own choosing?

The questions asked by the Commission's proposed rulemaking suggest a concern that certain shareholders or certain representatives of shareholders are filing "too many" proposals. We question this underlying assumption. Why does it matter if certain shareholders and their representatives file a significant percentage of proposals? The activity of these investors should be encouraged to the extent that their proposals provide a public good for the benefit of all shareholders. Active shareholder engagement with companies – which is facilitated by the shareholder proposal rule – has helped make the U.S. capital markets the deepest and most liquid in the world. If anything, the Commission's rules should be amended to make it easier for other shareholders to submit proposals so that the promotion of good corporate governance through the shareholder proposal process does not fall on a small group of Good Samaritans.

Resubmissions (Questions 37 – 44)

The Commission's proposed rulemaking asserts that "public interest in revisiting the resubmission has grown." However, in support of this assertion, the Commission cites letters from trade associations that represent corporate management such as the Business Roundtable whose members consist of CEOs, not investors who the Commission is charged with protecting. The Commission also cites a February 4, 2019, letter from NASDAQ that was signed by 319 companies urging an increase in the resubmission thresholds. However, a review of the ISS Voting Analytics database of shareholder proposals reveals that only a tiny fraction of these NASDAQ companies has ever received a shareholder proposal, and even fewer have received a resubmitted proposal. Such letters should not be given greater weight than letters from investors.

The Rule 14a-8 vote requirements for the resubmission of shareholder proposals should be maintained at the existing levels of 3, 6, and 10 percent after the first, second, and third years. The history of Rule 14a-8 shows that it takes time for consensus to emerge regarding best practices in corporate governance. The shareholder proposals described at the beginning of this letter took years to gain traction in the marketplace. For example, shareholder support for proposals to eliminate classified boards and hold annual director elections took decades to reach majority vote status.[10] The results of these resubmitted proposals have been remarkable. Twenty years ago, more than 60 percent of S&P 500 companies maintained a classified board structure. Today, less than 20 percent of S&P 500 companies still have classified boards.[11]

The Commission's proposed amendments to the vote resubmission thresholds assumes that proposals need to eventually receive majority levels of support to merit resubmission. This assumption is unsound based on current practices in corporate governance. Today's boards of directors are highly motivated to implement a shareholder proposal that is expected to receive a majority vote. As observed by Ernst & Young's Center for Board Matters, "at 50% support, if the board is deemed to take insufficient action in response, many investors will consider voting against incumbent directors at the next annual meeting."[12] The willingness of boards to implement proposals that a majority of shareholders will support means that the total universe of majority vote proposals is unobservable. Accordingly, the 6.5 percent of resubmitted proposals that go on to receive majority support is the wrong baseline for consideration.

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[10] Noam Noked, "Activism and the Move toward Annual Director Elections," Harvard Law School Forum on Corporate Governance and Financial Regulation, January 15, 2012. *Available at* https://corpgov.law.harvard.edu/2012/01/15/activism-and-the-move-toward-annual-director-elections/

[11] Lucian Bebchuk et. al, "Towards the Declassification of S&P 500 Boards," Harvard Business Law Review, Vol. 3, No. 1, 2013, pp.157-184.

[12] "Five takeaways from the 2019 proxy season," EY Center for Board Matters, July 2019, p. 7. *Available at* https://assets.ey.com/content/dam/ey-sites/ey-com/en_us/topics/cbm/ey-cbm-2019-proxy-season-preview.pdf

A proper baseline for meritorious shareholder proposals would consider all shareholder proposals that are implemented by companies. Boards of directors owe a fiduciary duty to all their shareholders, not to the majority of shareholders. To be responsive to minority stockholder views, companies frequently act on shareholder proposals that fail to receive majority levels of support. As noted by Ernst & Young's Center for Board Matters, "[t]hirty-percent support is the level at which many boards take note of a proposal topic"[13] and that more than 70 percent of observed shareholder proposal withdraws during a recent proxy season were in connection with companies and investors reaching agreement.[14] A proper rulemaking analysis needs to consider whether changes to the resubmission thresholds will negatively impact the resubmission of all proposals that may be implemented by companies, not just majority vote proposals.

Nor is the fact that 90 percent of shareholder proposals are eligible for resubmission under the current thresholds the proper baseline for analysis of Rule 14a-8(i)(12). Shareholder-proponents are aware of their shareholder proposal vote results and the vote resubmission requirements. Accordingly, shareholders are unlikely to resubmit proposals that garner low levels of support. Rather, shareholders modify proposal language to improve shareholder support. For this reason, it is not surprising that few proposals are excluded under the current Rule 14a-8(i)(12) thresholds. This does not mean, however, that the existing resubmission thresholds are not weeding out low-vote proposals. The number of low-vote proposals that are deterred from resubmission by the Rule 14a-8(i)(12) thresholds is not directly observable.

The Commission does not adequately consider the impact of the proposed Rule 14a-8(i)(12) thresholds on shareholders at dual-class companies. Under dual-class capital structures, public investors typically receive one vote per share (the "Class A" shares), and company insiders typically receive 10 or more votes per share (the "Class B" shares). These Class B shares enjoy voting power that is disproportionate to their ownership interest. As a result, dual-class capital structures entrench corporate managers and increase agency costs. While shareholder proposals at such companies may never receive a majority vote of all shareholders, they can still encourage reform. However, the Commission's proposed higher vote resubmission thresholds will make it nearly impossible for Class A shareholders to reintroduce proposals after the first year. If higher vote resubmission thresholds are to be adopted, the Commission should exclude classes of shares with disproportionate voting power from the Rule 14a-8(i)(12) vote tabulation methodology.

To do a proper rulemaking analysis, the Commission should first survey companies to determine how many proposals are implemented and withdrawn before a vote takes place. The Commission should also survey shareholders to determine how the existing Rule 14a-8(i)(12) resubmission thresholds affect their decision to not resubmit or amend their proposals. Finally, the Commission should obtain actual data on the costs of resubmitted shareholder proposals. Resubmitted proposals are less costly than first time proposals in terms of legal expenses or staff time. In our experience, companies are far less likely to seek to exclude resubmitted proposals because a second attempt to exclude a proposal is likely to be futile. A resubmitted proposal also

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[13] *Id.*
[14] "2015 shareholder proposal landscape," EY Center for Board Matters, April 2015, p. 1. *Available at* https://www.ey.com/Publication/vwLUAssets/EY-shareholder-proposal-landscape/$FILE/EY-shareholder-proposal-landscape.pdf

requires fewer hours of staff time for reconsideration by the board of directors. Nor do company opposition statements to resubmitted proposals change significantly from year to year.

Momentum Requirement for Proposals (Question 45-51)

We also object to the Commission's proposed amendment to create a 10 percent "momentum" requirement for proposals that receive between a 25 percent and a 50 percent vote. Under this proposed rule change, a proposal that has a vote decline from 45 percent to 40 percent would not be eligible for resubmission. This result is perplexing given that proposals that receive a lower vote but have not lost "momentum" could still be reintroduced. On what rational basis should the Commission exclude a shareholder proposal that receives a 40 percent vote that has lost "momentum," but still permit resubmission of a less popular shareholder proposal that has received a steady 30 percent vote? Shouldn't the higher level of shareholder support be a sufficient basis for resubmission of such a proposal notwithstanding its "momentum"?

Not only is this "momentum" vote requirement needlessly complex, but the Commission does not consider that the proxy plumbing system has many unresolved vote accuracy problems. The shareholder vote accuracy problem was extensively discussed during the first panel of the Commission's Roundtable on the Proxy Process.[15] While the current proxy plumbing system may be able to correct for under-voting and over-voting in high stakes proxy contests, vote tabulations at annual shareholder meetings lack a high degree of precision or accuracy. How can the Commission reasonably promulgate a rule that will exclude the resubmission of shareholder proposals on minor vote changes as small as 3 percent (i.e., 10 percent of 30 percent), when the Commission has not yet adopted any safeguards to ensure the accuracy of shareholder votes?

Economic Analysis

The Commission's proposed rulemaking fails to provide an adequate economic analysis as called for by guidance to the Commission staff that was prepared by the Commission's Division of Economic and Risk Analysis and the Office of the General Counsel. This internal staff guidance for rulemaking identifies the following requirements for good economic analysis:

> "(1) a statement of the need for the proposed action;
> (2) the definition of a baseline against which to measure the likely economic consequences of the proposed regulation;
> (3) the identification of alternative regulatory approaches; and
> (4) an evaluation of the benefits and costs—both quantitative and qualitative—of the proposed action and the main alternatives identified by the analysis."[16]

[15] Transcript, Roundtable on the Proxy Process, U.S. Securities and Exchange Commission November 15, 2018. Available at https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf.
[16] "Current Guidance on Economic Analysis in SEC Rulemaking," Memorandum by the Division of Economic and Risk Analysis and the Office of the General Counsel, U.S. Securities and Exchange Commission, March 16, 2012. *Available at* https://www.sec.gov/page/dera_economicanalysis.

The economic analysis contained in the proposed rulemaking is deficient in these required areas. Accordingly, the Commission should withdraw the proposed rulemaking to conduct a proper economic analysis. Moreover, the Commission must allow an adequate opportunity for the public to comment on its revised economic analysis before adopting any changes to Rule 14a-8.

The Commission's proposed rulemaking does not articulate a well-reasoned statement for the need of the proposed action. What exactly is the Commission trying to accomplish with the proposed amendments? The underlying assumption of proposed rulemaking is that there are "too many" shareholder proposals being submitted by relatively few shareholders including a handful of individual investors. However, the Commission's economic analysis underestimates the benefits of shareholder proposals and overestimates the costs of shareholder proposals. Given that the economic benefits of shareholder proposals far outweigh their costs, the proper question is: Why are shareholders submitting too few proposals, and how should the Commission amend Rule 14a-8 to facilitate the ability of shareholders to submit even more proposals?

Notably, the proposed rulemaking's economic analysis of the trends in the submission of shareholder proposals is contradictory. On page 70, the proposed rulemaking states, "[o]ur analysis shows no discernible trend in the number of submitted shareholder proposals in the 1997 to 2018 period." However, the analysis notes that the source of the data is incomplete prior to 2004. According to the summary statistics presented by the proposed rulemaking on page 74:

> "The average number of proposals submitted to S&P 500 companies has decreased from 1.85 in 2004 to 1.24 in 2018, representing a 33 percent decrease during our sample period, and the average number of proposals submitted to Russell 3000 companies has decreased from 0.38 in 2004 to 0.28 in 2018, representing a 26 percent decrease during our sample period."

In other words, the number of shareholder proposals has been steadily declining, suggesting that any benefits from reducing the number of shareholder proposals is lower today than in 1997.

The Commission's economic analysis completely ignores the fact that shareholder proposals are value-enhancing.[17] The proposed rulemaking only briefly discusses various event studies including an authoritative literature review of 73 academic studies that found shareholder proposals are associated with an average 0.06 percent increase in valuation.[18] While this percentage increase in valuation that is associated with shareholder proposals may sound modest, the dollar value of such increases is substantial when considered in aggregate. The proposed rulemaking observes that shareholders are far more likely to file proposals at S&P 500 index companies. The median stock market capitalization of the S&P 500 index is $23.6 billion. A 0.06 percent (6 basis point) increase in the median market capitalization of an S&P 500 index

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[17] The proposed rulemaking states that "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," p. 112.

[18] Matthew Denes, et. al., "Thirty Years of Shareholder Activism: A Survey of Empirical Research," Journal of Corporate Finance, Vol. 44, June 2017, pp. 405-424.

company equals $14.2 million per shareholder proposal. The ISS Voting Analytics database tracked 814 shareholder proposals in 2019. This suggests that shareholder proposals are associated with an estimated $11.5 billion increase in shareholder value in 2019 alone.

The cited literature review of academic studies that found the average 0.06 percent increase in valuation was focused on short-term improvements. Another academic study not considered by the Commission shows that shareholder proposals are associated with greater long-term increases in stock price. A comparative study of the impact of shareholder proposals on firm performance in the United States and the United Kingdom found that U.S. shareholder proposals were associated with a statistically significant 1.23 percent increase in stock performance after two years.[19] Moreover, event studies of shareholder proposals ignore the significant positive externalities that are generated by shareholder proposals. Shareholder proposals have successfully encouraged the adoption of market standards across all public companies. For example, many public companies have adopted majority vote director elections and equal access to the proxy without having ever received a proposal on those topics.

Not only does the Commission's proposed rulemaking ignore the substantial economic benefits of shareholder proposals, but its economic analysis dramatically exaggerates the estimated costs of shareholder proposals. The Commission last surveyed companies on the costs of shareholder proposals in a 1996 questionnaire that estimated the printing costs to be $50,000 per shareholder proposal. Instead of conducting a new survey, the proposed rulemaking's economic analysis applies an inflation adjustment to these dated estimates. Given the development of the Internet and other technological advances since 1996, the marginal cost of including a shareholder proposal in a company proxy statement is far lower today. We question the reliability of such dated cost estimates particularly given the Commission's subsequent authorization in 2007 of "notice and access" e-proxy rules that permit the electronic dissemination of proxy materials to shareholders. We also note that anecdotal cost estimates provided by industry trade associations that favor restricting shareholder proposals are highly suspect and prone to exaggeration.

Nor are the opportunity costs associated with shareholder proposals in terms of management time and attention significant. If a corporation determines that a shareholder proposal lacks merit, the board of directors and management can simply ignore it. The board of directors and management are not even obligated to make a recommendation to shareholders on how to vote. Even if a shareholder proposal receives majority support, the vast majority of proposals are advisory and have no legally binding effect. At most, the presentation of shareholder proposals at annual meetings may take one or two minutes per shareholder proposal. Even this small opportunity cost is a function of the state law right of shareholders to make proposals inside annual meetings and is not a consequence of the Commission's shareholder proposal rule.

Finally, the proposed rulemaking's economic analysis inaccurately suggests that shareholders could benefit from a decrease in shareholder proposals. Shareholder proposals account for less than 2 percent of all proxy votes cast by shareholders each year. The 447 shareholder proposals

[19] Bonnie Buchanan, et. al., "Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom," American Business Law Journal, Volume 49, Issue 4, pp. 739-803, Winter 2012. Table 11, Panel B (adjusted for industry median).

that went to a vote in 2018 represent a trivial number of voting decisions compared to the tens of thousands of votes cast on director elections, executive compensation plans, “say-on-pay” advisory votes, and auditor ratification votes. The vast majority of shareholder proposals are easy for shareholders to vote on because they follow standard templates and are on routine topics that are already addressed by many investors’ proxy voting guidelines. Moreover, shareholders have no legal obligation to vote on shareholder proposals and in fact many investors choose to cast an “abstain” vote on shareholder proposals that they do not wish to vote on.

Paperwork Reduction Act

The Commission’s Paperwork Reduction Act analysis does not adequately estimate the additional paperwork burdens on investors if the proposed amendments are adopted. For example, shareholders’ recordkeeping requirements under Rule 14a-8(b)(1)(i) will triple from one year to three years to determine whether they meet the $2,000 stock ownership requirement. Documenting this longer stock ownership paperwork requirement may be particularly challenging for shareholders that change banks or brokers during the requisite stock ownership period. Shareholder-proponents will also have additional recordkeeping requirements to keep track of the Rule 14a-8(i)(12) “momentum” resubmission eligibility requirement and their use of representatives under the proposed Rule 14a-8(c) one proposal per person rule.

Moreover, certain shareholders will respond to the proposed amendments to Rule 14a-8 by increasing their use of independent proxy solicitations in order to avoid the more restrictive requirements of the amended shareholder proposal rule. The paperwork costs associated with such independent proxy solicitations include expenditures for printing, postage, legal and related expenses that far exceed the marginal costs to companies of including a 500-word shareholder proposal in company proxy statements. All shareholders who vote in such proxy contests will have additional paperwork burdens in evaluating the dissident and management proxy statements. While the paperwork burden of conducting an independent solicitation is substantially higher than submitting a shareholder proposal under Rule 14a-8, at least some shareholders will be willing to incur these additional expenses.

Regulatory Flexibility Act

The Commission’s proposed amendments will have a significant adverse impact on “small entities” as defined by the Regulatory Flexibility Act. The shareholder proposal rule is particularly beneficial to small entities that otherwise lack the resources to communicate with their fellow shareholders or get the attention of corporate management. Small entities who file shareholder proposals include nonprofit organizations, labor unions, and faith groups who have less than $5 million in total assets. The Commission should provide small entities with regulatory relief from the proposed amendments. For example, the Commission should exempt small entities from the enhanced Rule 14a-8(b) stockholding requirements of $25,000 for one year or $15,000 for two years. The existing $2,000 requirement for one year is appropriate given that small entities by definition have small investment portfolios of less than $5 million.

Small Business Regulatory Enforcement Fairness Act

The Commission's proposed amendments are a "major rule" for purposes of the Small Business Regulatory Enforcement Fairness Act. Shareholder proposals provide substantial economic benefits to the U.S. economy by reducing agency costs and thereby enhancing investor protection and capital formation. [20] As discussed above, we estimate the economic benefit from each shareholder proposal at an S&P 500 index company to be $14.2 million.[21] The proposed rulemaking's Paperwork Reduction Act analysis estimates a combined 37.2 percent decrease in the number of shareholder proposal submissions as a result of the proposed amendments. Applying this estimated percentage reduction to the 814 proposals that were submitted in 2019 according to ISS Voting Analytics equals 303 fewer proposals. Accordingly, the Commission's projected reduction in the submission of shareholder proposals will have an estimated $4.3 billion negative annual effect on stock market valuations and the U.S. economy.

Conclusion

For the above reasons, the Commission's proposed rulemaking violates the economic cost-benefit analysis requirements of the Administrative Procedure Act, the paperwork burden estimate requirements of the Paperwork Reduction Act, the small entity regulatory relief requirements of the Regulatory Flexibility Act, and the major rule requirements of the Small Business Regulatory Enforcement Fairness Act. Moreover, given the magnitude of the required corrections, the Commission cannot address these deficiencies in a final rule without first re-proposing a revised rulemaking for notice and comment.

We strongly oppose the Commission's proposed amendments to Rule 14a-8 that will disenfranchise many investors from the ability to file shareholder proposals. The shareholder proposal rule has been part of the fabric of shareholder democracy in the United States since World War II. Such a rule should not be tinkered with lightly. We respectfully request that the Commission withdraw the proposed rulemaking in its entirety. If the AFL-CIO can be of further assistance, please contact me at (202) 637-5152 or brees@aflcio.org.

Sincerely,

Brandon J. Rees
Deputy Director, Corporations and Capital Markets

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[20] *See* Bonnie Buchanan et.al., " Shareholder Proposal Rules and Practice: Evidence from a Comparison of the United States and United Kingdom," American Business Law Journal, Vol. 49, No. 4, 2012; Luc Rennebooga and Peter Szilagyi, "The Role of Shareholder Proposals in Corporate Governance," Journal of Corporate Finance, Vol. 17, Issue 1, February 2011, Pages 167-188; Lucian Bebchuk, "The Case for Increasing Shareholder Power," Harvard Law Review, Vol. 118, No. 3, pp. 833-914, January 2005.

[21] *See* Matthew Denes, et. al., "Thirty Years of Shareholder Activism: A Survey of Empirical Research," Journal of Corporate Finance, Vol. 44, June 2017, pp. 405-424, (finding that shareholder proposals are associated with a 0.06 percent increase in valuation).