February 3, 2020

Vanessa Countryman
Secretary
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 Secretary Countryman,

On behalf of the CtW Investment Group, I am writing to provide comments on the U.S. Securities and Exchange Commission ("SEC" or "Commission")'s proposed amendments to Rule 14a-8 on shareholder proposals (File No. S7-23-19). The CtW Investment Group works with union-sponsored pension funds to enhance long-term stockholder value through active ownership. These funds have over $250 billion in assets under management and many of these pension plans submit Rule 14a-8 shareholder proposals as part of their shareholder engagement activities to promote corporate accountability.

We also file shareholder proposals and strongly oppose the changes to Rule 14a-8 proposed by the Commission. We urge the Commission to promptly withdraw its proposed amendments, address the significant concerns with the proxy voting process described by the Commission's Investor Advisory Committee, and commit to taking no action with respect to Rule 14a-8 until the SEC's Office of Inspector General has fully investigated the fraudulent "investor comments" submitted to the SEC, and determined how those fraudulent comments found their way into public statements by Chairman Jay Clayton.

Benefits of Shareholder Resolutions

The existing shareholder resolution process has not only enabled issuers to learn what matters concern their shareholders with much greater timeliness and accuracy that alternative communications methods, such as periodic analyst calls or presentations to brokerage clients, but it has also delivered large benefits to shareholders as a result of improved governance. A seminal academic study from 2003 found that companies with the most shareholder friendly governance outperformed those with the least shareholder friendly polices by 8.5% per year, while a later study attributed this governance effect to the absence practices that entrench incumbent directors, such as the classified or staggered board.[1] In 2003, a majority of S&P 500 companies maintained such a practice – meaning that directors only stood for election once every three years – as did a larger majority of publicly traded companies overall. Academic research indicated that classified boards reduced shareholder value: one well regarded 2005 study estimated that classified boards reduced market capitalization relative to the replacement value of company assets by more than 10%.[2]

[1] Paul Gompers et. al., "Corporate Governance and Equity Prices," Quantitative Journal of Economics, 118(1), 107-155 (February 2003); Lucian Bebchuk et. al., "What Matters in Corporate Governance," Review of Financial Studies, Vol. 22 No. 2, 783-827 (February 2009).

[2] Lucian A. Bebchuk and Alma Cohen. The Costs of Entrenched Boards. 2005. Journal of Financial Economics.

Other studies found that classified boards directly reduced the frequency of mergers, increased managerial entrenchment, and reduced the alignment between executive pay and company performance.[3] Conversely, when announcing a plan to move to annual elections, companies were found to experience an immediate 1% increase in share price.[4]

We raise the example of classified boards because, perhaps more than any other issue, they represent the positive impact that small shareholders –whether institutional or individual – can have on the value of all shareholders' investments through the existing shareholder resolution process. By 2010, only 41% of S&P 500 companies retained a classified board, and by 2019 a mere 13% of companies in this large capitalization index failed to hold annual elections.[5] Given the estimates noted above, even the most conservative assumptions would lead to the conclusion the shareholder proponents of board declassification have contributed over $100 billion in value, gains that accrued primarily to the investing public at large.[6] But if the proposed amendments had been in place 20 years ago, few if any of the proponents of declassification resolutions would have been able to file them, and many fewer companies would have subsequently adopted annual director elections, depriving the investing public of substantial gains.

Moreover, while the case of classified board resolutions suggests impressive progress, in fact smaller companies have been much slower to implement annual board elections: as of 2017 nearly 40% of mid cap companies and 50% of small cap companies maintained staggered boards.[7] One reason for their slow embrace of value enhancing governance changes has no doubt been the much lower frequency with which shareholder resolutions are filed at smaller companies: in recent years, about 40% of large cap companies received at least one shareholder resolution, compared to only 10% of mid-cap companies and 4% of small-cap issuers.[8] Given the considerable work still to be done just on the issue of annual director elections – let alone all of the other beneficial governance changes that small proponents have advanced, including majority vote standards for director elections, access to the proxy for shareholder-nominated director candidates, and shareholder approval of poison pills – we would have hoped that the SEC would be devoting its energies to enhancing this important contributor to investor protection, rather than seeking to short-circuit it.

Costs of Shareholder Resolutions to Issuers

Of course, this hope has been disappointed by the amendments the SEC has proposed. Not only has the SEC failed to consider the benefits to shareholders of the existing 14a-8 process, but it has

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[3] Lucian A. Bebchuk, John C. Coates IV, and Guhan Subramanian. The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy. 2002. Stanford Law Review.; Olubunmi Faleye. Classified Boards, Firm Value, and Managerial Entrenchment. 2007. Journal of Financial Economics.

[4] Re-Jin Guo, Timothy A. Kruse, and Tom Nohel. Undoing the Powerful Antitakeover Force of Staggered Boards. 2008. Journal of Corporate Finance

[5] Papadopoulos et. al., "US Board Study" ISS, April 17, 2018 pg. 5.

[6] The total market capitalization of the S&P500 in 2003 was approximately $1.7 trillion. Roughly 40% of the index transitioned from staggered to annual elections over the following decade and a half, during which time the index's total market capitalization rose to $27 trillion. Using only the 2003 figure, 40% of total market cap would equal nearly $700 billion, 10% of which would be $70 billion. Since most of the changes to board elections took place after 2003, when the S&P had a considerably higher value, $100 billion seems a conservative estimate. (https://etfdb.com/history-of-the-s-and-p-500/#2003); (https://ycharts.com/indicators/sp_500_market_cap)

[7] Papadopoulus et. al., Ibid.

[8] Papadopoulus et. al., pg. 4.

arrived at implausible and poorly evidenced estimates of the costs of the current rules for issuers: for the entire Russell 3000, taking into account both increased ownership thresholds for submission and increased vote thresholds for re-submission, the Commission estimates savings for issuers of between $4.5 million and $79.5 million per year. First, as should have been obvious to commission members, these purported savings are nowhere close to the standard of materiality that either the Commission or its Division of Corporation Finance would apply in any circumstance of which we are aware. Russell 3000 companies over the past 12 months have reported revenue of $16.2 trillion and net income of $1.3 trillion.[9] The savings estimated by the Commission amount to a scant 0.0005% of revenue and 0.006% of net income, vastly below any materiality threshold employed by the Commission.

Amazingly, even these paltry savings appear to be both poorly evidenced and exaggerated. Despite its ample powers to request or even subpoena documentary evidence from issuers, the Commission neglected to do so when it considered the costs of shareholder proposals. Instead, it relied solely on figures cited by comments on the Statement announcing the SEC Staff Roundtable on the Proxy Process. The Commission relied on four such comments, which reported costs per proposal at $87,000 (two commenters), $100,000, and $150,000. However, subsequent research has shown that the two commenters reporting an $87,000 cost were relying on an 11-year old study commissioned by the U.S. Chamber of Commerce, and which did not itself collect any data from companies, relying instead on a 1997 survey undertaken by the SEC.[10] Again, the Commission has considerable power and resources to determine the real costs to issuers of receiving, opposing, negotiating, and implementing shareholder resolutions, and should have no reason to rely on third-hand reports of its own 22-year old data. Given the substantial reduction in communications costs since 1997 – proxy materials distributor Broadridge estimated that recent changes technological changes “saved corporate issuers and mutual funds over $1.7 trillion in paper, printing, and postage” just in 2019[11] - it seems very likely to us that, had the Commission required issuers to submit clear documentation of costs related to shareholder resolutions, those costs would be substantially below the 1997 survey estimate.

But those two commenters were if anything better able to defend their estimates than the two commenters citing costs at $100,000 and $150,000 per resolution. The second of these estimates was provided by a securities industry trade association, and did not even purport to represent information provided by its members: instead, the association cited a report published by the House Financial Services Committee, but which fails to identify any source at all for that particular cost estimate.[12] The remaining estimate, of $100,000 per resolution, was provided by Exxon Mobil Corporation. Curiously, Exxon Mobil claims that there is no cost difference between new proposals and resubmitted proposals, even when the resubmitted proposal is identical to a prior proposal, and even when management’s statement in opposition is identical to the statement from the year before.[13] We strongly suspect that, had it approached the question of the costs of shareholder resolutions with any investigatory rigor whatsoever, the Commission would have

[9] Data from Capital IQ.
[10] Josh Zinner, Interfaith Center for Corporate Responsibility, Comment letter submitted January 27, 2020.
[11] Cited in Zinner, Ibid.
[12] Zinner, Ibid.
[13] Zinner, Ibid.

quickly discovered that a great many issuers are able to manage the process, particularly for re-submitted proposals, at considerably less expense that Exxon Mobil claims.

Over and above the deeply flawed process the Commission undertook to estimate the costs of the current regulatory regime governing shareholder resolutions, it is worth pointing out that even the costs typically cited by issuers are voluntary responses to shareholder resolutions, not mandatory expenses triggered by such resolutions. Companies receiving a resolution have no obligation to pay any attorney to determine if it might be excludable, no obligation to seek No Action relief, no obligation to include a statement of opposition or any assessment at all of the resolution by the board, no obligation to engage in any proxy solicitation in opposition to the proposal, and no obligation to implement a proposal regardless of its level of support. Instead, issuers incur these expenses because they choose to dissuade their shareholders from supporting the efforts of resolution proponents. Since issuers can effectively minimize such expenses simply by making different decisions at no cost to themselves, the Commission has little basis on which to premise its proposed amendments.

Alternatives to Shareholder Resolutions, and the Consequent Cost to Issuers

Beyond failing to consider the large and well-documented gains to all shareholders from shareholder resolutions filed by proponents with small holdings, and accepting implausible and likely exaggerated estimates of the costs of shareholder resolutions for issuers, the Commission has entirely failed to consider how affected shareholders will respond to its proposed amendments, and how those responses will affect issuer expenses. In particular, the Commission seems strangely silent on the *other* process by which shareholders may bring resolutions before an annual meeting –the "a4" process - or the other mechanisms by which shareholders may attempt to hold directors and executives accountable, including efforts to deny directors re-election, to nominate director candidates to appear on the issuer's proxy, or to disapprove of an issuer's executive pay practices. These alternatives to the a8 resolution do not all require the issuer to alter their planned proxy statement, but when shareholders avail themselves of such means, issuers almost always choose to respond through multiple written, verbal, and electronic communications to shareholders, usually under the guidance of a professional proxy solicitation firm.

For instance, when investor activists such as hedge funds or private equity firms pursuing a hostile acquisition or run a slate of directors for election to an issuer's board, they typically do so by distributing their own proxy materials to shareholders. Few issuers will fail to respond to such efforts, and issuer expenses in such cases (which are documented and disclosed) far exceed the exaggerated and implausible costs cited by the Commission with respect to a8 resolutions. For instance, in 2017, Proctor and Gamble reported spending $35 million in an effort to defeat a dissident slate promoted by Trian Fund, and ADP spent $24 million opposing directors nominated by Pershing Square. Overall, the median cost of a proxy fight to issuers rose from $350,000 in 2010 to $1 million in 2016.[14] The frequency of such challenges to issuers has already been rising over the past decade. Given that the proposed amendments seek to limit the ability of small holders to combine their stakes for the purposes of meeting the new ownership thresholds, but that such limits have no bearing on the a4 process, the Commission should have anticipated a further increase in such expensive proxy fights for issuers as a consequence of adopting the proposed amendments, and incorporated such increased costs into its cost-benefit analysis.

[14] https://insight.factset.com/2017-proxy-fights-high-cost-low-volume

While full-fledged proxy fights such as those waged by Trian or Pershing Square are expensive for proponents as well (Trian spent an estimated $25 million, though Pershing Square spent only $2 million), the combination of successful past private ordering – principally majority vote and proxy access bylaws – enable shareholders to both challenge the re-election of incumbent directors and to nominate their own directors at little-to-no expense to themselves. Obviously, unless the issuer is content to leave such challenges unanswered, the costs to issuers are considerably higher. Finally, while direct cost estimates for the shareholder communications and engagements that issuers undertake in order to secure acceptable levels of support for their executive pay practices are not available, it seems likely that such costs exceed those associated with a8 shareholder resolutions, given issuers' extensive engagement with shareholders, compensation consultants, and legal advisors either after or in anticipation of a low rate of shareholder support.[15] It is worth pointing out that, despite the introduction of (mostly) annual say-on-pay votes after 2010, shareholders continue to identify problematic pay practices via a8 resolutions, suggesting that the say-on-pay vote is not currently the exclusive or even primary site for expressing concerns over a company's pay practices. Again, the Commission should have expected that constraining the ability of such shareholders to continue addressing their concerns through the a8 process would lead to increased public activity around say-on-pay votes, with consequent increases in costs for issuers.

No Action Until the OIG Initiates and Completes Investigation into Tainted Rule Making Process

As frustrated as we have been by the Commission's failure to undertake a good-faith process to arrive at realistic and well-evidenced estimates of the costs and benefits of the current shareholder resolution process, as well as the costs and benefits of its proposed amendments and the likely response to them from affected shareholders, all of this pales in comparison to our concern over the corruption of the public comment process through the submission of false comments. As has been reported by *Bloomberg*, many of the letters received by the SEC in support of changing the proxy process in order to reduce the ability of shareholders with small holdings to file resolutions, including those cited specifically by Chairman Jay Clayton at a Commission meeting in November - appear to have been fraudulent.[16] Many of the supposed signatories denied any knowledge of the letter they supposedly submitted, while others claimed to have signed a letter written by someone else. Many of these letters appear to have been signed by staff or relatives at advocacy groups that receive funding from corporations or trade associations which have actively sought to reduce executive accountability to shareholders. Not only was this discovery embarrassing for the SEC, and in particular for Chairman Clayton, but his decision to cite the supposed opinions of small investors as motivation for the proposed amendments reveals that his and the Commission's deliberations on these amendments were irredeemable tainted by false or misleading evidence.

The SEC must determine how these fraudulent comments were submitted, and if possible identify individuals or organizations submitting them for possible enforcement actions. The appropriate first step would be for the SEC's Office of Inspector General to begin an investigation, if it has not done so already. Until that investigation has been completed, the SEC cannot take any action on these proposed amendments in good faith, as they cannot be confident that the false comments so

[15] See for instance: https://www.davispolk.com/files/2018-11-29-a_say-on-pay_update_plus_strategies.pdf

[16] https://www.bloomberg.com/news/articles/2019-11-19/sec-chairman-cites-fishy-letters-in-support-of-policy-change

far discovered are the only fraudulent evidence submitted by the perpetrators. Only after the OIG completes its investigation should the SEC begin its process of considering changes to the proxy voting process anew, with an eye toward ensuring that only well-evidenced claims and legitimate comment enter into its decision making. The SEC's failure to implement appropriate controls to ensure the staff and Commissioners are not exposed to false, misleading, or even fraudulent comments and other submissions fatally compromises its work on these proposed amendments to date. As a consequence, the proposed amendments should be promptly withdrawn.

We appreciate this opportunity to provide our views to the Commission on this important matter. Please feel free to contact me with any questions.

Sincerely,

Dieter Waizenegger
Executive Director, CtW Investment Group