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"Reforming the Proxy Process to Safeguard Investor Interests"
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Good morning, Chairman Wagner, Ranking Member Sherman, and members of the committee. My name is Jonathan Berry, and I am the managing partner of the law and public policy strategy firm Boyden Gray PLLC, where I provide strategic counsel and litigate on issues in the emerging field of bureaucratic overlap in government, corporate America, and capital markets, especially in matters relating to environmental, social, and governance (ESG) issues. I was previously the Acting Assistant Secretary for Policy at the U.S Department of Labor during the Trump Administration. Thank you for inviting me to testify today on the important subject of how the proxy process can better safeguard investor interests.

I currently represent the National Center for Public Policy Research and other shareholder clients in litigation against the SEC regarding its shareholder proposal rule, Rule 14a-8. While my views on the subject of today's hearing are informed by my representation of clients in this and other matters, I do not appear here today on behalf of any client, and the views I present are my own.

Background

In concept, the proxy process is supposed to provide an effective means by which public company investors can represent their interests. The proxy process derives its name from the legal fact that the many financial intermediaries who compose it possess their powers to act "by proxy." That is, the asset managers and proxy advisers who make up the proxy system act *on behalf of* the Americans whose savings they (or their clients) manage in trust. Symbolically, the "proxy process" is supposed to replicate, in modern and virtual form, the traditional stockholder meeting that existed in early American capitalism, where Americans with real skin in the game would attend to corporate affairs and ensure their financial interests were well represented. While scholars still debate the extent to which this traditional model of corporate governance in English and American history was myth or reality, at least in the eyes of the law, this is the backdrop from which the proxy process emerged.

Today, the proxy process falls far short of this ideal. Enabled by intrusive regulations and an overly concentrated and captured financial sector, the proxy process has unfortunately become dominated by activists who use it instead to advance political, social, and environmental agendas that are often contrary to the interests of the very shareholders the process is meant to serve.

We would expect that a well-functioning proxy process would represent the views of investors. What are those views? Research confirms the intuitive fact that retail investors are primarily interested in securing returns on their investments. In a recent survey by Consumers' Research, 70% of retail investors indicated that the primary use of their investment income is to save for retirement or supplement their income. [1] By contrast, only 3% and 2% indicated they sought to advance sustainability or social change, respectively.[2] A survey of 1,128 retail investors conducted by the National Opinion Research Center at the University of Chicago (an independent, non-partisan research institution) and the FINRA Investor Education Foundation similarly found that individual investors prioritize return on investment and other financial factors in their investment decision-making more than any other factor, and identify the environmental aspects of a potential investment as the least important consideration.[3] Reflecting this intuition, the law as well assumes a baseline that investors will seek financial interests, whether in Justice Marshall's classic definition of the "reasonable investor," or the securities laws' inclusion of "expectation of profit" as an element of a security.[4] Deeper still, the essential structure of corporate law that shareholders buy into when they invest in public companies vests discretion in companies' boards of directors to manage the corporation for the best *financial* interests of the corporation and its shareholders.[5]

For these reasons, a reasonable proxy process would fairly reflect the fact that retail investors are primarily interested in securing returns on their investments. Yet today, the interests the proxy process *actually* reflects are nearly the opposite. Today, "environmental and social" proposals consistently comprise a majority of all shareholder proposals submitted to companies each proxy season as a result of the proxy process.[6] And these proposals are sometimes backed and often supported by a proxy-process infrastructure that has become dominated by large firms that themselves have publicly committed to advance environmental and social goals with companies.

With this testimony, I would like to survey for the Committee a key aspect and cause of this misuse of the proxy process: shareholder proposals under the SEC's Rule 14a-8. While there are several important problems with the current proxy system that members of this committee have highlighted, I believe shareholder proposals under Rule 14a-8 provide an excellent starting point for comprehension because they demonstrate the pervasive and insidious problems with the process.

To briefly summarize: Politically motivated shareholder proposals are a main entry point by which activists and financial intermediary firms that have adopted ESG-focused approaches

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[1] Comment of Consumers' Research on The Enhancement and Standardization of Climate-Related Disclosures for Investors, https://www.sec.gov/comments/s7-10-22/s71022-20132345-302910.pdf.
[2] *Id*.
[3] FINRA Investor Educ. Found. & Nat'l Op. Res. Ctr. at the U. of Chi., Mar. 2022 https://www.finrafoundation.org/sites/finrafoundation/files/Consumer-Insights-Money-and-Investing.pdf
[4] *See* SEC Commissioner Elad L. Roisman, *Can the SEC Make ESG Rules that are Sustainable?*, June 22, 2021, https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.
[5] *See, e.g.*, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986); *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end.").
[6] *See infra* Part II.B.

influence public companies to adopt their agendas. First, under Rule 14a-8, the SEC compels companies to provide activists with a platform for their agendas by requiring that companies include certain shareholder proposals in the proxy statements they send to all shareholders. In so doing, the SEC has made public companies the battlegrounds for contentious and polarizing issues that are properly the jurisdiction of our political branches of government. Moreover, through layers of regulatory and sub-regulatory guidance and an opaque process of administrative review, the SEC has virtually ensured shareholder proposals that represent *pro-*ESG viewpoints will make it onto companies' proxy statements, while so-called "anti-ESG" proposals are regularly denied access to the same. This skews the range of shareholder perspectives represented on the corporate ballot to overrepresent pro-ESG perspectives in the eyes of both shareholders and, importantly, managements and boards of directors.

With this beachhead position on the corporate proxy ballot secured, the rest of the market actors in the proxy process—proxy advisory firms, asset managers, and others—are empowered to drive corporate decisions by advising and recommending to clients how they should vote, or voting directly themselves on these select issues. And for market actors that themselves have pro-ESG agendas and investment methodologies (or who are concerned with the "optics" of these issues), votes on pro-ESG shareholder proposals present an opportunity to engage with and influence companies to adopt ESG-oriented goals rather than focus their limited resources on actually delivering returns to the investors who have entrusted them with their own limited capital.

Because this process chronologically begins with Rule 14a-8, I will discuss the rule's history and highly questionable validity, its misuse by the SEC over decades, and how the proxy-process infrastructure today uses Rule 14a-8 shareholder proposals to advance agendas that are contrary to the financial interests of companies and their shareholders. I will conclude with a brief discussion of recently proposed solutions.

I. The History of Shareholder Proposals and Rule 14a-8

I would like to begin by discussing the history of the SEC's shareholder proposal rule, Exchange Act Rule 14a-8. Rule 14a-8 requires publicly traded companies to include certain shareholder-submitted proposals in their proxy solicitations made to shareholders. Once included, shareholders (or, for most shareholders, their financial intermediaries) thereby can vote on those proposals by returning their proxies and affect the outcome for whether the company's shareholders elect to adopt the proposal.

While Rule 14a-8 has been with us for a long time, it has a questionable history that has often gone under-examined by policymakers. With the benefit of hindsight, I think I can safely say that a review of the rule's history makes it appear predestined to cause some of the abuses that we see today.

A. Like corporations, shareholder proposals arise strictly under state law.

To best understand the history of Rule 14a-8, we must look to where the concept of shareholder proposals comes from. The right of a shareholder to submit a shareholder proposal comes from state corporate law. Almost universally, corporations are chartered under state law because, in our system, states possess the primary power to grant corporate privileges and there is no general federal corporation law. As the Supreme Court has recognized, "[c]orporations are creatures of state law."[7] Like these other fundamentals of corporate governance, shareholder proposals then too are originally creatures of state law.

Historically, state law focused on whether a given shareholder proposal was a "proper subject."[8] Under this rule, shareholders could only consider shareholder proposals that presented a "proper subject" for action by the corporation's shareholders. Whether a proposal was a proper subject for action by shareholders depended on the scope of shareholders' powers under state corporate law. For example, some states permitted shareholders to remove directors at will, or required the unanimous consent of shareholders "for the institution of certain broad[] corporate policies."[9] Shareholder proposals that related to these valid exercises of shareholder powers were proper subjects and could be presented by a shareholder at a meeting of the corporation's shareholders. By contrast, a shareholder proposal that exceeded the shareholders' powers to act was not a proper subject and could not be validly considered. For example, a study contemporary to the SEC's proposal of Rule 14a-8 reported that under state law, "if a board of directors has the right to initiate the reduction of capital and a stockholder writes in and states that he proposes to make a motion that the capital be reduced, it would seem that such a motion may properly be declared out of order."[10]

Rule 14a-8 did not invent the shareholder proposal. To the contrary, prior to Rule 14a-8 there existed—and still exists—a robust system of state corporate law with which to evaluate shareholder-proposed items of corporate business. Many states still use the "proper subject" requirement or something like it.[11]

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[7] *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 479 (1977).
[8] *See* David C. Bayne, *The Basic Rationale of Proper Subject*, 34 U. DET. L. J. 575 (1957).
[9] *Id*. at 582.
[10] Arthur H. Dean, *Non-Compliance with Proxy Regulations Effect on Ability of Corporation to Hold Valid Meeting*, 24 CORNELL L. REV. 483, 516 (1939).
[11] *See, e.g.*, Mich. Comp. Laws § 450.2404; N.C. Gen. Stat. § 55-7-01; 8 Del. Code § 109 (reserving to shareholders the power to amend corporate bylaws "relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees"). Under modern state laws, as under the historical common law approach, a proposal is a proper subject for action by stockholders if it is within the scope or reach of the stockholders' power to adopt. *See CA, Inc. v. AFSCME Emps. Pension Plan*, 953 A.2d 227, 232 (Del. 2008). A proposal that does not properly relate to shareholders' powers cannot be validly considered. For example, shareholders do not have the power to adopt proposals that would cause the board of directors to breach its fiduciary duties. *See Paramount Commc'ns Inc. v. Time Inc.,* 1989 WL 79880, at *30 (Del. Ch. July 14, 1989),
(footnote continues on the following page)

While state corporate law for over a century governed shareholder proposals, in general state law envisioned that shareholder proposals were business that would be transacted in person at companies' annual meetings. Originally, shareholder meetings were quite different from what we see today. Prior to the advent of large, vertically integrated corporations and the trading of corporate shares in public capital markets, corporations had relatively few shareholders, and shareholder meetings were conducted mainly in person.[12] The shareholders were often local and were active investors in the corporation. Shareholder proposals were most frequently referred to as "resolutions," and they were usually items of business, like amendments to the corporation's bylaws, or transactions.[13] The ability for a shareholder to submit resolutions was not a distinct or independent capacity, but arose from the more general common-law right of shareholders to attend the corporation's annual meeting or special meetings of shareholders. Presence at these meetings carried the right to propose items of business, such as nominating candidates for the corporation's board of directors, but also presenting shareholder proposals.[14]

As the structure of the conventional business corporation evolved away from trusts or small businesses with few or highly concentrated and active shareholders to publicly traded companies with many dispersed and largely passive shareholders, state corporate law changed with it. For a company to conduct its necessary business at an annual meeting, the company needed to obtain a quorum of shareholder votes present. But with the number and geographic distance of shareholders growing precipitously, obtaining enough shareholders to attend the meeting in person to achieve a quorum was more difficult than before. Instead, state corporate law developed the ability of shareholders to "attend" the annual meeting by proxy—in other words, by submitting written instructions to the company as to how the shareholder wished to vote on the business matters the company planned to consider. "Proxies" were forms by which a shareholder authorizes another person—usually a representative of the corporation—to vote his or her shares at the annual meeting. And that, of course, is where we get the phrase "proxy process" from.

<u>B.</u> <u>With Rule 14a-8, the New Deal-era SEC overtook state law's authority over shareholder proposals.</u>

It was against this state-law background that the SEC adopted Rule 14a-8 (originally enumerated "Rule X-14a-7") in 1942 under the auspices of Section 14(a) of the Securities Exchange Act of 1934.

Section 14(a) of the Exchange Act prohibits anyone from "solicit[ing] any proxy" "in contravention of such rules and regulations as the Commission may prescribe as necessary or

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aff'd, 571 A.2d 1140, (Del. 1990) ("The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares.").
[12] *See* ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 47–64, 139 (1933).
[13] *See* Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1136 (1993).
[14] *Id*.

appropriate in the public interest or for the protection of investors."[15] As the D.C. Circuit has interpreted, while the statute uses "broad[]" language, "it is not seriously disputed that Congress's central concern [in enacting § 14(a)] was with disclosure."[16] In enacting the Exchange Act, Congress expressly rejected a "federal corporation law" that would replace existing state law with a grant of authority to the SEC to regulate corporate governance.[17] Instead, Congress empowered the SEC to require that public companies disclose relevant information to investors. As the Senate report for the Exchange Act provides, the purpose of Section 14(a) was to ensure that investors had "adequate knowledge" about the "financial condition of the corporation . . . [and] the major questions of policy, which are decided at stockholders' meetings."[18] By contrast, while Section 14(a) gave the Commission authority to compel disclosures of existing information, Congress left the substantive regulation of stockholder meetings to the "firmly established" state-law jurisdiction over corporate governance.[19]

Though the language of Section 14(a) of the Exchange Act is a "vague 'public interest' standard . . . the Exchange Act cannot be understood to authorize the regulation of" "the substantive allocation of powers" in matters of "corporate governance traditionally left to the states."[20] The reach of its authority has a clear limit against state law. Section 14(a) does not authorize the Commission to impose upon matters of corporate governance traditionally governed by state law.

But that is precisely what Rule 14a-8 did. At first, the SEC treated its Section 14(a) authority, even as it related to shareholder proposals, as regarding disclosure. As recently as two years before finalizing Rule 14a-8, the SEC exercised its Section 14(a) authority to require that solicitation materials *disclose* "any matters which the persons making the solicitations are informed other persons intend to present for action at such meeting."[21] But just two years later, the SEC ratcheted its approach up further with Rule 14a-8. Purportedly exercising its authority under Section 14(a) of the Exchange Act to issue regulations for the public interest and the protection of investors, the SEC issued Rule 14a-8 in 1942. At the time the SEC proposed Rule 14a-8, state law did not require companies to include shareholder proposals in their proxy statements.[22] While under state law, shareholders possessed the right to present shareholder business at the corporation's annual meeting, state law did not require corporations to include shareholder proposals in their *own* proxy statements ahead of the meeting, sent to company shareholders. Instead, shareholders were free to solicit the proxies of other shareholders on their

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[15] 15 U.S.C. § 78n(a)(1).
[16] *Bus. Roundtable v. SEC*, 905 F.2d 410 (D.C. Cir. 1990).
[17] See Stephen M. Bainbridge, *The Scope of the SEC's Authority Over Shareholder Voting Rights*, UCLA Res. Paper No. 07-16, https://www.sec.gov/comments/4-537/4537-17.pdf.
[18] S. Rep. No. 792, at 12 (1934).
[19] *Bus. Roundtable*, 905 F.2d at 411, 413 (internal citation omitted).
[20] *Id*. 407, 413 (internal citation omitted).
[21] SEC Release No. 2376, 1940 WL 7144 (Jan. 12, 1940).
[22] Susan W. Liebeler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425, 457–458 (1984).

own initiative in favor of a particular shareholder proposal they intended to present at the annual meeting. Rule 14a-8 upended this arrangement, first by compelling companies to include shareholder proposals, and over time by contorting the law governing the *substance* of shareholder proposals in ways far removed from shareholders' rights under state law.

C. Rule 14a-8 shareholder proposals have long provided social activists with a mechanism to influence companies.

From Rule 14a-8's earliest years, activists sought to use the rule to advance their political and social agendas at companies. While nowhere near the volume of shareholder proposals that companies face today, social activists ran a number of prominent issue campaigns at companies utilizing Rule 14a-8. "[S]ocial shareholder activism began as a tactic used by left-leaning social movements," from community organizing, to protests over napalm use in Vietnam, to Greyhound bus boycotts, anti-tobacco, and the "Make General Motors Responsible Campaign."[23] The left-wing activist Saul Alinsky even devoted an entire chapter of his book *Rules for Radicals* to organizing social movements to engineer change at large corporations. It was titled "Proxies for the People."[24]

When the rule was first adopted, Congress even anticipated that the rule would risk allowing shareholders to advance political agendas. In a 1943 hearing before the House Committee on Interstate and Foreign Commerce, Oklahoma Congressman Lyle Boren pressed SEC Chairman Ganson Purcell on whether a "Communist" activist could, "by the mere device of buying one share of stock" send a "propaganda statement" to "the mailing list of all the stockholders" of a company.[25] Congressman Boren could "see nothing [in Rule 14a-8] to prevent that statement from having some propaganda element in it," and Chairman Purcell agreed, saying that, assuming the Communist "otherwise complied with the rules, he could place a statement before all of the stockholders in the corporation."[26] To be sure, Chairman Purcell added that if a shareholder "were going to use the corporate proxy machinery for making a stump speech for some political party, that is obviously without the spirit of the rule," but addressing it might require that the SEC "make such appropriate changes as might seem necessary."[27]

Following from this concern, the SEC originally tried to close the floodgates of such social-agenda proposals that it had opened with Rule 14a-8. In a release published just three years after Rule 14a-8 was adopted, the SEC interpreted the rule to provide that "proposals which deal with general political, social or economic matters are not, within the meaning of the

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[23] Leslie King & Elisabeth Gish, *Marketizing Social Change: Social Shareholder Activism and Responsible Investing*, 58 Sociological Perspectives 711, 714 (2015).
[24] Dan Willett, *Alinsky's Last Passion*, COUNTERPUNCH (Aug. 24, 2017), https://www.counterpunch.org/2017/08/24/alinskys-last-passion/.
[25] *H.R. 1493, H.R. 1821, and H.R. 2019, Hearing Before the H. Comm. on Interstate and Foreign Commerce* 163, 78th Cong. (1943), *available at* https://play.google.com/books/reader?id=7RaCMxk2dH8C&pg=GBS.PP4&hl=en.
[26] *Id*.
[27] *Id*.

rule, proper subjects for action by security holders."[28] A subsequent version of Rule 14a-8 allowed companies to exclude proposals made "primarily for the purpose of promoting general economic, political, racial, religious, social or similar causes."[29] Nonetheless, shareholder activists continued to run campaigns on various issues and seek the inclusion of their proposals, building pressure for future rule changes.

II. The SEC's Blatant Viewpoint Discrimination Against So-Called "Anti-ESG" Proposals and Politically Conservative Shareholders

By implementing Rule 14a-8, the SEC compelled companies to include certain shareholder proposals in their proxy statements. Given the large number of shareholder proposals the rule invited, over the decades, the SEC developed a system of administrative review called the "no-action process" to review whether shareholder proposals complied with Rule 14a-8 such that they must be included in proxy statements. However, the process is highly opaque and unaccountable, and through it the SEC has come to privilege ESG-focused proposals' access to corporate proxies over other perspectives.

A. In the 1990s, the SEC developed the "significant social policy" exception and allowed social activists a path onto corporate proxy statements.

In 1976, the SEC amended the predecessor version of Rule 14a-8 discussed *supra* to remove its reference to the excludability of general economic, political, racial, and social causes.[30] At the same time, the SEC adopted what today is referred to as the "ordinary business" exclusion. In the same amendments, the SEC adopted the text of the ordinary business exclusion that remains essentially unchanged today: a proposal is excludable if it "deals with a matter relating to the conduct of the ordinary business operations of the issuer."[31]

At first, the SEC applied the ordinary business exclusion to permit the exclusion of proposals focusing on social issues. In 1992, in the landmark no-action response *Cracker Barrel Old Country Store, Inc.*, the SEC's Division of Corporation Finance stated its view that the exclusion allowed the company to block a proposal that requested the company "implement non-discriminatory policies relating to sexual orientation and to add explicit prohibitions against such discrimination to their corporate employment policy statement."[32] The Division noted that, in several previous cases, the Division had departed from the "general view that employment matters . . . are excludable as matters involving the conduct of day-to-day business" and made "exceptions" for certain "'social policy' concerns."[33] With *Cracker Barrel*, the Division clarified

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[28] Op. of Baldwin B. Bane, Director, Division of Corporation Finance, Release No. 34-3638, 1945 WL 27415 (Jan. 3, 1945).
[29] *Amendments to Proxy Rules*, Release No. 34-4775, 1952 WL 5254 (Dec. 11, 1952).
[30] *Adoption of Amendments Relating to Proposals by Security Holders*, SEC, Release No. 12, 999, 1976 WL 160347, at *10 (Nov. 22, 1976); *see Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 338 (3d Cir. 2015) (tracing history of the ordinary business exclusion).
[31] 1976 Amendments, 1976 WL 160347, at *10.
[32] 1992 WL 289095, at *6 (Oct. 13, 1992).
[33] *Id*. at *1.

that under the ordinary business exclusion, a proposal's focus on a "social issue" did not "remov[e] the proposal from the realm of ordinary business operations."[34]

After *Cracker Barrel*, some SEC Commissioners and activist groups criticized the SEC's decision to allow companies to exclude social-issue proposals related to employment and pushed for changes in the SEC's interpretation of the ordinary business exclusion in order to permit greater proxy inclusion for social-issue proposals.[35] In a New York Times article titled *Equality Is More Than "Ordinary Business,"* Democrat Commissioner Steven Wallman called on the SEC to "remove any last barrier to getting employment nondiscrimination proposals back on the ballot."[36]

In 1998, the SEC responded to that pressure and reversed course. Noting "changing societal views" and that "the relative importance of *certain* social issues relating to employment matters has reemerged as a consistent topic of widespread public debate," the SEC reconsidered its approach adopted in *Cracker Barrel* by enacting the 1998 Amendments to Rule 14a-8. The SEC adopted changes to "reverse the *Cracker Barrel*" decision and narrow the ordinary business exclusion in order to prevent companies from excluding proposals that "focus[] on sufficiently significant social policy issues."[37] This became known as the "significant social policy" exception to the ordinary business exclusion.

B. Recent SEC guidance has opened the floodgates for a wave of social-activist proposals.

In the years following the adoption of the significant social policy exception, the number of shareholder proposals focusing on social and political issues have increased significantly. As the SEC recounted in a recent proposed rulemaking, from 2004 to 2018, proposals focusing on environmental issues grew from 5 percent to 16 percent of all shareholder proposals, and social-issue proposals from 25 percent to 39 percent.[38] Today, "shareholder proposals are now a central tool for shareholders seeking to advance social change."[39] Each proxy season, shareholder activists now submit hundreds of shareholder proposals on topics ranging from climate change to abortion and LGBT rights.

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[34] *Id*.
[35] *See, e.g.*, *Proxies: SEC Should Reexamine Position on Shareholder Proposals, Wallman Says*, 28 Sec. Reg. L. Rep. (BNA) 1134 (Sept. 20, 1996); *Group Petitions SEC for Change on Proxy Resolutions about Employment*, 27 Sec. Reg. & L. Rep. (BNA) 1366 (Aug. 18, 1995) (petition of 30 institutional investors).
[36] Steven Wallman, *Equality Is More Than "Ordinary Business,"* N.Y. TIMES (Mar. 30, 1997), https://www.nytimes.com/1997/03/30/business/equality-is-more-than-ordinary-business.html.
[37] *Id*.
[38] Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, 84 Fed. Reg. 66458, 66479 (Dec. 4, 2019).
[39] HEIDI WELSH, SUSTAINABLE INV. INST., & MICHAEL PASSOFF, PROXY IMPACT, 2023 PROXY PREVIEW 5 (noting "at least 542 shareholder proposals on environmental, social and related sustainable governance issues for the 2023 proxy season," which is "on track to match or exceed last year's unprecedented final total of 627").

In 2021, the SEC signaled it would allow even more social-issue proposals to be included in proxy materials. The Division issued Staff Legal Bulletin No. 14L ("SLB 14-L"), which explained even more forcefully that the significant social-policy exception does not "focus on . . . the nexus between a policy issue and the company, but will instead focus on the social policy significance of the issue that is the subject of the shareholder proposal," and thus turns on "whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company."[40] SLB-14L further re-emphasized the 1998 Amendments' direction that "[m]atters related to employment discrimination" are an example of proposals that "may rise to the level of transcending the company's ordinary business operations."[41] Since SLB-14L was adopted, pro-ESG proposals have skyrocketed. The number of environmental and social proposals now represent a majority of all shareholder proposals received by Russell 3000 companies, comprising 58% of proposals in 2022 compared to 51% in 2021.[42]

With the development of the significant social policy exception and SLB-14L, Rule 14a-8 has gone a significant step beyond even its prior excess, as it now actively distorts, on an ideological basis, the substantive topics that companies and the shareholders consider through the proxy process. By the SEC's own interpretation of its own overreaching rule, the SEC has arrogated to itself the authority to define and decide what constitutes a "significant social policy" in our country.

As I will discuss next, the SEC now uses the significant social policy exception to further abuse the Exchange Act's neutral "disclosure" purpose by tilting the playing field in favor of shareholder proposals with certain content—namely, left-wing content. Under the current interpretation of Rule 14a-8, proposals that focus on certain kinds of discrimination—like racial quotas—must be considered, while proposals that focus on the other kinds of socially significant discrimination may be excluded from corporate proxy statements. None of this has anything to do with the shareholder value interests that underlie our system of corporate and securities law.

C. At the same time, the SEC arbitrarily sifts out conservative, independent, and other so-called "anti-ESG" proposals.

There has always been a sense that the SEC has catered to political progressives when it comes to proxy proposals. But of late the politicization of the SEC's own conduct has taken on a new and troubling life. The principal proof for this agenda is the SEC's arbitrary discrimination against proposals that express viewpoints that are not aligned with the current ESG dogma.

Recognizing that the SEC's changes to Rule 14a-8 over the years have opened corporate America to political influence by ideologically motivated shareholders, several individual

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[40] Division of Corporation Finance, *SLB-14L* (Nov. 3, 2021), https://www.sec.gov/corpfin/staff-legal-bulletin-14l-shareholder-proposals.
[41] *Id.* at n.5.
[42] Daniel Litowitz et al., *Trends in E&S Proposals in the 2022 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 28, 2022), https://corpgov.law.harvard.edu/2022/11/28/trends-in-es-proposals-in-the-2022-proxy-season/.

activist and politically conservative nonprofits have recently begun to submit their own shareholder proposals under Rule 14a-8. One of these entities is the National Center for Public Policy Research (the "National Center"), which I currently represent in litigation against the SEC. The National Center bills itself as "the nation's leading program for confronting liberal shareholder activism," and it uses shareholder engagement "to create the incentives for corporations to stay focused on their missions" and oppose the "liberal shareholder activism" that "continue[s] to exert undue influence over corporate America."[43]

Some describe proposals submitted by the National Center (and other shareholders who seek to counter pro-ESG proposals' influence) as focusing on ideologically conservative political issues. But in general, when these shareholder activists raise issues like abortion or 2nd Amendment rights, they do so to highlight *companies' own* political activism on a particular side of these issues—which itself is often driven by the influence of politicized actors in the proxy process. Many of these "conservative" activists' proposals are old-fashioned, good-governance reinforcements of fiduciary duty. For example, one proposal submitted by a leading wealth management investor this year called on a company to conduct an "evaluation . . . on the risks created by Company business practices that prioritize non-pecuniary factors when it comes to establishing, rejecting, or failing to continue business relationships."[44] Nonetheless, several media commentators and opposing activists derisively refer to these proposals as "anti-ESG."[45]

While so-called "anti-ESG" proposals have risen, the SEC has blocked many of them from consideration on company proxy statements via its no-action process, by which it affords relief to companies who seek to exclude purportedly non-complaint Rule 14a-8 proposals. The Society for Corporate Governance observed in a recent comment submitted to the Commission that in the 2022 proxy season, the SEC granted no-action relief in 50 percent of the instances where relief was requested on "anti-ESG" proposals—like the National Center's—compared with 38 percent across all proposals. The gap further widened when considering only social/political proposals, where the SEC granted relief at a 50-percent rate for proposals from "anti-ESG" proponents, as compared with 31 percent across all social/political proposals and 24% of environmental proposals considered by the SEC. These rates suggest "uneven grants of no-action relief . . . along ideological lines."[46] A comprehensive study by Consumers' Research

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[43] *Free Enterprise Project*, Nat'l Ctr. for Pub. Pol'y Res., https://nationalcenter.org/programs/free-enterprise-project/ (last accessed May 25, 2023).
[44] *MetLife, Inc*. (SEC No-Action Letter, Apr. 24, 2023) at 3, https://www.sec.gov/files/corpfin/no-action/14a-8/bahnsenmetlife042423-14a8.pdf.
[45] Emile Hallez, *Anti-ESG shareholder proposals rise sharply*, INV. NEWS (June 2, 2023), https://www.investmentnews.com/anti-esg-shareholder-proposals-rise-sharply-238306; *see also* Scott Shepard & Stefan Padfield, *The Pro-Fiduciary-Duty Movement Is Winning*, Nat'l Ctr. for Pub. Pol'y Res. (June 28, 2023), https://nationalcenter.org/ncppr/2023/06/28/scott-shepard-stefan-padfield-the-pro-fiduciary-duty-movement-is-winning/ ("Advocates for Environmental, Social and Governance (ESG) policies label opponents as "anti-ESG." But what we really are is pro-fiduciary-duty.").
[46] *See* Letter from C. Edward Allen, Vice President, Soc'y for Corp. Governance, to Vanessa A. Countryman, Secretary, SEC, Sept. 13, 2022, https://www.sec.gov/comments/s7-20-22/s72022-20142742-308679.pdf.

confirms the SEC's viewpoint bias. For the 2018 through the 2022 proxy seasons, the SEC granted no-action relief under the ordinary business exclusion on 46% of all requests for liberal-aligned proposals in which it was raised, but 72% of all conservative-aligned proposals.[47]

While these aggregate disparities suggest a trend, the proof of discrimination is evident in comparing the proposals themselves. To illustrate, the following are proposals made by the National Center that companies sought to exclude under the ordinary business exclusion and that tracked very similar liberal-aligned proposals for which the SEC had previously denied no-action relief. Yet the SEC *granted* no-action relief against every single one of the proposals in the left-hand column:

Conservative-Aligned Proposal SEC Determined Excludable	**Liberal-Aligned Proposal SEC Determined Non-Excludable**
Report on "the potential risks associated with omitting 'viewpoint' and 'ideology' from its written equal employment opportunity (EEO) policy."[48]	Report on "the potential risks associated with omitting 'sexual orientation' and 'gender identity' from its written equal employment opportunity (EEO) policy."[49]
Report describing "if and how the Company intends to reduce the risk associated with tracking, collecting, or shaping information regarding the processing of payments involving its cards and/or electronic payment system services for the sale and purchase of firearms."[50]	Report describing "if and how the company intends to reduce the risk associated with the processing of payments involving its cards and/or electronic payment system services for the sale and purchase of untraceable firearms, including 'Buy, Build, Shoot' firearm kits, components and/or accessories used to assemble privately made

[47] *Consumers' Research SEC No-Action Audit 2018–2022* (May 4, 2023), https://consumersresearch.org/secnoactionaudit. These figures include proposals withdrawn by the shareholder proponent prior to the SEC issuing a no-action decision. If withdrawn proposals were subtracted, the disparity in no-action rates between liberal and conservative proposals would be even higher given that more liberal proposals are withdrawn (ordinarily after company settlement) than conservative proposals.
[48] *The Kroger Co.*, 2023 WL 2060072 (SEC No-Action Letter, Apr. 12, 2023).
[49] *CorVel Corp.*, 2019 WL 1640021 (SEC No-Action Letter, June 5, 2019).
[50] *American Express Co.*, 2023 WL 2524429 (SEC No-Action Letter, Mar. 9, 2023).

	firearms known as 'Ghost Guns.'"[51]
Report on "prioritization of non-pecuniary factors when it comes to establishing, rejecting, or failing to continue network relationships on its [Company] platform." Supporting Statement notes the company "shutdown [a] conservative news network" "following a concerted campaign by liberal activists" who claimed the company was "consistently giving airtime to conspiracy and misinformation" such as "conservative conspiracy theories ... that the 2020 presidential election was stolen."[52]	Report on "human rights impacts of [Company] content management policies to address misinformation and disinformation across its platforms." Supporting Statement cites to policies designed to prevent "attempt[s] to interfere with elections or civic processes."[53]
Report "on the risks created by Company business practices that prioritize non-pecuniary factors when it comes to establishing, rejecting, or failing to continue client relationships." Supporting Statement notes "[d]ebanking customers based on political, religious, or any other opinion or characteristic other than pecuniary advantage places the Company at great reputational, financial, and legislative and related risk" and "violates the Company's fiduciary duty to its shareholders."[54]	Request that the "Board of Directors take steps necessary to amend our certificate of incorporation ... to become a public benefit corporation." Supporting Statement notes that the proposal would "balance [the] interests of shareholders [and] stakeholders ... allowing the corporation to protect communities, even when it reduces financial return to shareholders in the long run."[55]

[51] *Mastercard, Inc.*, 2022 WL 392206 (SEC No-Action Letter, Apr. 22, 2022).
[52] *AT&T Inc.*, 2023 WL 108213 (SEC No-Action Letter, Mar. 15, 2023).
[53] *Alphabet Inc. (W. Andrew Mims Trust)*, 2022 WL 392221 (SEC No-Action Letter, Apr. 12, 2022).
[54] *JPMorgan Chase & Co.* (SEC No-Action Letter, Mar. 21, 2023).
[55] *Alphabet Inc.*, 2021 WL 389302 (SEC No-Action Letter, Feb. 23, 2021).

Requesting that companies publish their "diversity, equity or related employee-training materials" after they "adopt 'anti-racism' programs" that "distribut[e] pay and authority on the basis of race ... rather than by merit."[56]	Requesting that the company publish a "publicly disclosed" audit analyzing its "impacts on civil rights, equity, diversity and inclusion."[57]

The National Center's litigation against the SEC centers on the first proposal in the above list, which relates to viewpoint discrimination in employment. The proposal sought to ensure transparent oversight by Kroger of the risks associated with failing to prevent discrimination against its employees on the basis of viewpoint or ideology.

The National Center modeled its Kroger proposal on an earlier proposal on an ESG issue that the SEC had previously said was *not* excludable because of the significant social policy exception. A 2019 proposal in *CorVel Corp.* requested that the company "issue a public report detailing the potential risks associated with omitting 'sexual orientation' and 'gender identity' from its written equal employment opportunity (EEO) policy."[58] The Division determined that the company could not exclude the proposal under the exception because it "transcend[ed] ordinary business."[59] This outcome was consistent with the Division's longstanding position, post-1998 Amendments, that proposals focusing on issues relating to employment discrimination on the basis of sexual orientation and gender identity are not excludable under the significant social policy exception.

The National Center's Kroger proposal was identical to the proposal in *CorVel Corp*, except it substituted "viewpoint" and "ideology" for "sexual orientation" and "gender identity." In its briefings before the SEC, the National Center cited extensive statistics about the existence of viewpoint and ideological discrimination in corporate America and at Kroger, as well as the social significance and public debate over that issue. The National Center argued that viewpoint discrimination, the rise of "woke" capital, and its effect of discriminating against Americans based on their political viewpoints are issues that concern millions of Americans and are among the most hotly debated subjects in politics today, comparable to the sexual-orientation discrimination issue raised by other proposals.

Why did the Division grant Kroger no-action relief while denying it to CorVel for a nearly identical proposal that focused on progressive concerns in employment discrimination? The SEC's pattern of disfavoring conservative proposals is the only rational explanation. Both

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[56] *See, e.g.*, *Verizon Communications Inc.*, 2022 WL 110304 (Mar. 17, 2022).
[57] *Amazon.com, Inc. (N.Y. State Common Ret. Fund)* (SEC No-Action Letter, Apr. 7, 2021), https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2021/nyscrfamazon040721-14a8.pdf.
[58] *CorVel Corp.*, 2019 WL 1640021 at *1 (SEC No-Action Letter, June 5, 2019).
[59] *Id*.

issues involved discrimination, which the SEC itself has said is the prototypical issue that transcends ordinary business operations, and both issues are the subject of intense public debate.

The National Center's litigation with the SEC provides a prime example of the SEC's discrimination, which ensures that pro-ESG viewpoints are overrepresented in the proxy process.

III. Rule 14a-8 Shareholder Proposals: The Raw Material of the ESG-Focused Proxy Machinery

The problems that Rule 14a-8 presents are not limited to viewpoint discrimination by the SEC against conservative and other so-called "anti-ESG" shareholder proposals. That is only the starting point. Once the SEC has deemed that a company must include a pro-ESG shareholder proposal on its proxy statement (and sometimes even before then), the rest of the proxy process takes over to use the proposal as an opportunity to influence companies to adopt ESG goals related to the proposal, regardless of whether those goals are in the economic interests of shareholders. To use a metaphor, the shareholder proposal is the raw material that the machinery of the proxy process converts into the finished product of corporate commitments to various environmental, social, and political goals.

A. Proxy advisers, asset managers, and other component actors in the proxy process use Rule 14a-8 shareholder proposals as leverage with companies to urge the adoption of ESG-oriented goals.

Shareholder proposals are one of the main entry points for ESG agenda items to make it onto *companies*' agendas. To paraphrase SEC Commissioner Hester Peirce, shareholder proposals "introduce new pressure points that activists—or stake-holders as some prefer to call them—can use to strong-arm uncooperative funds [and companies] into instituting policies more conducive to the activists' agendas or punish funds [and companies] that fail to fall in line."[60] I

To understand how this happens, I will first provide a brief overview of other actors in the proxy process, and then describe how those actors use Rule 14a-8 shareholder proposals to effect corporate commitments to their agendas.[61]

i. Key actors in the proxy process.

First, in addition to shareholder activists, there are a range of other non-shareholder activist entities who coordinate shareholder-proposal activism on social and environmental issues. For example, the group Climate Action 100+ coordinates the investment strategies of over 700 investors with over $68 trillion in assets toward the stated goal "to ensure the world's largest

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[60] SEC Commissioner Hester Peirce, *Statement on Environmental, Social, and Governance Disclosures for Investment Advisers and Investment Companies*, May 25, 2022, https://www.sec.gov/news/statement/peirce-state-ment-esg-052522.

[61] The remainder of this section borrows heavily from the report published by Consumers' Research discussed *infra* note 78.

corporate greenhouse gas emitters take necessary action on climate change."[62] Notable investor signatories to the network include asset managers like BlackRock, State Street, Goldman Sachs, and J.P. Morgan Asset Management, as well as institutional investors like the California Public Employees' Retirement System ("CalPERS"), the California State Teachers Retirement System ("CalSTRS"), the New York State Common Retirement Fund and Teachers' Retirement Fund and the Harvard University Endowment.[63] Climate Action 100+ organizes its investors to engage with "focus companies" and "seek commitments on the initiative's key asks" of taking "action to reduce greenhouse gas emissions across the value chain."[64] If investors engage with companies on an individual basis, they "are required to share information with the engagement working group and the coordinating investor network" and "liaise with relevant network staff and/or lead investors to ensure engagement priorities and ambition are aligned with the goals of the initiative, as well as with the overall collaborative approach."[65] Other coordinating entities like Climate Action 100+ serve to organize shareholder proposal campaigns against targeted companies.

Second, proxy advisers, the largest of which are Institutional Shareholder Services ("ISS") and Glass Lewis, who control upward of 90 percent of the relevant market, advise many funds on how to vote on shareholder proposals. For example, ISS recommends voting against directors of companies "on the current Climate Action 100+ Focus List" unless the company has issued "[d]etailed disclosure[s] of [its] climate-related risks" and implemented "Net-Zero-by-2050 [green-house gas emissions] reduction targets."[66] Pursuant to that guideline, ISS recommends its clients vote in favor of shareholder proposals that would require companies set these goals. In 2021, Glass Lewis recommended voting in favor of shareholder proposals recommending "racial equity audits" at least seven companies.[67] The proxy voting recommendations of these proxy advisers, both of which are foreign-owned, are incredibly influential, driving vote outcomes and impacting the financial well-being of millions of retail investors each year, while effectively setting energy and social policy for the United States through corporate governance.

Third, the asset managers BlackRock, Vanguard, and State Street Global Advisors together manage over $20 trillion in assets and cast an average of 25 percent of the votes at S&P

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[62] *About*, CLIMATE ACTION 100+, https://www.climateaction100.org/about/ (last accessed July 11, 2023).
[63] *Who is Involved, Investors*, CLIMATE ACTION 100+, https://www.climateaction100.org/whos-involved/investors/ (last accessed July 11, 2023).
[64] *Approach*, *How We Work*, CLIMATE ACTION 100+, https://www.climateaction100.org/approach/how-we-work/ (last accessed May 28, 2023).
[65] *Id.*
[66] Institutional S'holder Servs., *U.S. Proxy Voting Guidelines 2022*, ISS GOVERNANCE at 17 (Dec. 13, 2022).
[67] Ron S. Berenblat et al., *Racial Equity Audits: A New ESG Initiative,* HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 30, 2021), https://corpgov.law.harvard.edu/2021/10/30/racial-equity-audits-a-new-esg-initiative/.

500 companies.[68] These asset managers often engage in favor of pro-ESG priorities yet do not provide evidence that their votes or perspectives are in the best economic interest of the shareholders on behalf of whom they vote and engage. BlackRock's 2021 voting guidelines exhorted, for example, that "boards should aspire to 30% diversity of membership and encourage companies to have at least two directors on their board who identify as female and at least one who identifies as a member of an underrepresented group."[69] State Street similarly has adopted voting guidelines that would require boards to adopt race and sex-based quotas.[70] And on environmental issues, for instance, BlackRock voted against the re-election of the board chair at TransDigm, a U.S. aviation manufacturer, for failure to "to adopt quantitative greenhouse gas emissions goals."[71]

ii. How proxy-process market actors use shareholder proposals to influence companies to make ESG commitments.

Proxy-process market actors use shareholder proposals in a variety of ways as leverage with companies.

In its most prominent form of influence, a shareholder proposal that successfully makes it onto the corporate proxy ballot and earns a majority vote of shareholders is considered "adopted" and creates immense pressure for management to implement its aims. Contrary to claims that dismissing shareholder proposals as non-binding, "[e]very proposal carries the implied threat to directors that their failure to respond to that proposal in the desired fashion will result in a coordinated effort to have those directors removed."[72] Both ISS and Glass Lewis caution in their voting guidelines that they will strongly consider voting against directors at companies that fail to respond to shareholder proposals that receive broad shareholder support.[73] As a result,

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[68] *See* Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 736 (2019); Shaun Bisman & Felipe Cambeiro, *Big Three Institutional Investor Updates*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 13, 2022), https://corpgov.law.harvard.edu/2022/04/13/.

[69] BlackRock Inv. Stewardship, *Proxy voting guidelines for U.S. securities*, BLACKROCK (Jan. 2021).

[70] State Street, Guidance on Diversity Disclosures and Practices, at 2–3 (Jan. 2022), https://www.ssga.com/library-content/pdfs/asset-stewardship/racial-diversity-guidance-article.pdf.

[71] BlackRock Inv. Stewardship, *Our Approach to Sustainability*, BLACKROCK at 11 (2020), https://www.blackrock.com/corporate/literature/publication/our-commitment-to-sustainability-full-report.pdf.

[72] Letter from Austin Knudsen, Attorney General of Montana and 20 other state attorneys general, to BlackRock, JPMorgan, Goldman Saches, and 50 other asset managers (Mar. 30, 2023), https://attorneygeneral.utah.gov/wp-content/uploads/2023/03/2023-03-30-Asset-Manager-letter-Press-FINAL.pdf.

[73] Glass Lewis, *2023 Policy Guidelines*, GLASS, LEWIS & CO. at 18 (2022), https://www.glasslewis.com/wp-content/uploads/2022/11/US-Voting-Guidelines-2023-GL.pdf?hsCtaTracking=45ff0e63-7af7-4e28-ba3c-7985d01e390a%7C74c0265a-20b3-478c-846b-69784730ccbd; *see* Institutional S'holder Servs., *United States Proxy Voting Guidelines 2022*, ISS Governance at 17 (Dec. 13, 2022), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf?v=1 ("Directors should respond to investor input, such as that expressed through . . . significant support for shareholder proposals (whether binding or non-binding).").

shareholder proposals that receive a majority vote are often successful in securing company commitments.

Even shareholder proposals that fail to achieve majority support can also be influential. Glass Lewis's guidelines provide that companies' boards should be responsive to any shareholder proposal that achieves at least 20% of shareholder support contrary to the board's recommendation.[74] For example, JPMorgan Chase undertook a racial equity audit after 40% of JPMorgan Chase & Co. shareholders supported a so-called "racial equity" audit proposal submitted by the activist SOC Investment Group; in other words, the company determined to take this action after a clear majority of its shareholders voted against it.[75]

Shareholder proposals that do not receive significant shareholder support also provide pressure points for proxy-process actors to work with. In a 2020 comment, the pension fund and shareholder activist CalPERS called it "wholly inappropriate to measure [the] 'success' of a shareholder proposal by solely [sic] whether it was passed."[76] Instead, CalPERS described how "[s]hareholder proposals are a key component of our efforts to continuously engage with companies," and serve as a "tool[]" the fund uses to "engage in private discussions with management," "send letters" to corporate actors and stakeholders, and organize support for its agenda.[77] Shareholder proposals serve as platform for activists to communicate with one another and with other shareholders, and develop more successful campaigns down the road.

Votes on shareholder proposals position proxy-process actors like ISS, Glass Lewis, and large asset managers to ultimately play their trump card: denying reelection to corporate directors. These actors pressure companies through whipping up support for the actual shareholder proposals themselves, but those are formally precatory and non-binding. The real pressure comes in voting against or withholding votes from directors who fail to follow the activists' directions that are communicated via shareholder proposals. This forces individual directors to take a stand on those topics, or otherwise risk their careers.

An illustrative case study was documented in a recent report published by the group, Consumers' Research.[78] The case study highlights the background chain of events in the proxy process that concluded with the American oil and gas company Phillips 66 pledging to adopt "Scope 3" emissions-reduction targets in 2022. In the 2014 and 2015 proxy seasons, Phillips 66

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[74] Glass Lewis, *supra*.
[75] JPMorgan Chase & Co., Submission of Matters to a Vote of Security Holders (Form 8-K), May, 18, 2021, https://www.sec.gov/ix?doc=/Archives/edgar/data/19617/000001961721000343/jpm-20210518.htm.
[76] Letter from Marcie Frost, Chief Executive Officer, CalPERS to Vanessa Countryman, Secretary, U.S. Securities and Exchange Commission 4 (Feb. 3, 2020), https://www.calpers.ca.gov/docs/legislative-regulatory-letters/02-20-comment-sec-shareholder-proposals.pdf.
[77] *Id*. at 3.
[78] *Defeating the ESG Attack on the American Free Enterprise System*, CONSUMERS' RES. (Mar. 8, 2023), https://consumersresearch.org/wp-content/uploads/2023/05/CR_Defeating-the-ESG-White-Paper_Final.pdf.

received shareholder proposals from activists that called on the company to disclose its carbon emissions and set reduction targets.[79] The 2014 proposal earned only 22% of shareholder support, and the 2015 proposal earned only 23%.[80] Of note, BlackRock voted against both proposals.[81]

While this activism at Phillips 66 was beginning, shareholder proposals were helping to influence other market actors in the proxy process, which would eventually help activists gain leverage over Phillips 66 and other energy companies. In the 2020 proxy season, the activist As You Sow submitted a shareholder proposal to BlackRock requesting a report on how the company intended to implement the Business Roundtable's 2019 Statement of Purpose to make the company "accountable to stakeholders" and "move[] away from shareholder primacy" in order to better "manage environmental, social, and governance matters."[82] While the proposal failed, soon after it was filed, BlackRock CEO Larry Fink publicly committed BlackRock to "plac[ing] sustainability at the center of our investment approach."[83] In response, the activists Boston Trust Walden and Mercy Investments publicly announced they had agreed to withdraw shareholder proposals on BlackRock's proxy statement in exchange for BlackRock's commitment to a "more active voting position" in companies in which BlackRock holds shares *on behalf of other investors* and on the basis of a "slew of new pledges on climate change and sustainability" by BlackRock.[84]

Back at Phillips 66, in May 2020 As You Sow (which is also a Climate Action 100+ signatory), submitted a shareholder proposal calling on Philipps 66 to report on the health risks

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[79] Phillips 66, Definitive Proxy Statement (Schedule 14A), Mar. 26, 2014 at 70, https://www.sec.gov/Archives/edgar/data/1534701/000119312514115477/d663078ddef14a.htm#toc663078_24; Phillips 66, Definitive Proxy Statement (Schedule 14A), Mar. 25, 2015 at 60, https://www.sec.gov/Archives/edgar/data/1534701/000104746915002683/a2223551zdef14a.htm#Proposal_5.

[80] Phillips 66, Submission of Matters to a Vote of Security Holders (Form 8-K), May 7, 2014, https://www.sec.gov/Archives/edgar/data/1534701/000153470114000080/annualmeeting8-k.htm; Phillips 66 (Form 8-K), May 6, 2015, https://www.sec.gov/Archives/edgar/data/1534701/000153470115000052/psx8-k20150506annualmeetin.htm

[81] iShares, Inc., Annual Report of Proxy Voting Record of Registered Management Investment Company (Form N-PX), Aug. 27, 2014, https://www.sec.gov/Archives/edgar/data/930667/000119312514323161/d770504dnpx.txt; iShares, Inc., Annual Report of Proxy Voting Record of Registered Management Investment Company (Form N-PX), Aug. 26, 2015, https://www.sec.gov/Archives/edgar/data/930667/000119312515301938/d22371dnpx.txt.

[82] *BlackRock: Implementation Plan for New Business Roundtable "Purpose of a Corporation,"* AS YOU SOW (Dec. 12, 2019), https://www.asyousow.org/resolutions/2019/12/12/blackrock-corporate-purpose.

[83] Larry Fink, 2020 Letter to CEOs, *A Fundamental Reshaping of Finance*, BLACKROCK (2020), https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter.

[84] Paul Verney, *BlackRock and JP Morgan spared ESG voting proposals following sustainability pushes*, Boston Trust Walden Co., RESPONSIBLE INV. (Mar. 10, 2020), https://www.bostontrustwalden.com/wp-content/uploads/2020/03/Blackrock-and-JP-Morgan-spared-ESG-voting-proposals-following-sustainability-pushes_.pdf.

of expanding petrochemical in areas "increasingly prone to climate-change induced storms, flooding, and sea level rise."[85] The Climate Action 100+ steering committee, which includes representatives of the Activists Ceres, CalPERS, and PRI, sent a letter to Phillips 66 requesting that the company commit to disclosures aligned with Climate Action 100+'s net-zero benchmark, and increased transparency of lobbying expenditures.

Finally, in the 2021 proxy season, Phillips 66 received a shareholder proposal from the activist Follow This calling for Scope 1, Scope 2, and Scope 3 reduction and targets and a CalSTRS and Presbyterian Church (U.S.A.) proposal calling for the company to produce a climate lobbying report. The emissions-reductions proposal was approved with 79% support, and the climate lobbying report with 62% support.[86] And this time, unlike at the start of the campaigns in 2014 and 2014, BlackRock flipped, supporting both proposals.[87] After Phillips 66 announced the results, Climate Action 100+ claimed victory:

> Following the 2021 annual meeting votes and further investor engagement around emissions reduction targets, later that year Phillips 66 became the first U.S. refiner and second U.S. oil company to set a Scope 3 emissions target, pledging a 15 percent reduction in emissions by 2030. . . . Investors will continue to engage closely with Phillips 66 to deliver on their commitments and set more ambitious targets for dealing with Scope 3 emissions, as well as increased alignment with the Climate Action 100+ Net-Zero Company Benchmark.[88]

This case study is but one of many examples of how the shareholder process plays a critical role in conducting influence operations on public companies.

B. Like the SEC, proxy-process market actors also arbitrarily discriminate in favor of ESG proposals.

Proxy advisers and asset managers have sometimes represented that they decline to weigh in on "political" shareholder proposals. But these claims are belied by the facts, which indicate that proxy advisers and asset managers are inconsistent with their treatment of political and ideological shareholder proposals.

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[85] *Phillips 66: Report on Petrochemical Risks*, AS YOU SOW (2019), https://www.asyousow.org/resolutions/2019/12/10/phillips-66-report-on-petrochemical-risks.
[86] Phillips 66, Submission of Matters to a Vote of Security Holders (Form 8-K), May 12, 2021, https://www.sec.gov/ix?doc=/Archives/edgar/data/1534701/000153470121000116/psx-20210512.htm.
[87] iShares, Inc. Annual Report of Proxy Voting Record of Registered Management Investment Company (Form N-PX), Aug. 27, 2021, https://www.sec.gov/Archives/edgar/data/930667/000119312521258996/0001193125-21-258996-index.htm.
[88] *Phillips 66 increases Ambition of GHG Emissions Reduction Targets*, CLIMATE ACTION 100+ (Jan. 31, 2022), https://www.climateaction100.org/news/phillips-66-increases-ambition-of-ghg-emissions-reduction-targets-2/.

In a display of hypocrisy, asset managers will often recommend that their own shareholders vote against shareholder proposals proposed on their own proxy statements that the asset managers, in turn, vote in favor of at their portfolio companies. For example, Charles Schwab's board recommended that its shareholders vote against a shareholder proposal it received from the activist Friends Fiduciary Corporation to publish a detailed report of the company's lobbying activities.[89] Yet Charles Schwab voted in favor of substantially similar proposals to disclose lobbying activities to its portfolio companies Alphabet, Amazon, Eli Lilly, Netflix, Travelers, UPS, and Walmart.[90] Similarly, both Charles Schwab and State Street recommended against shareholder proposals requesting that the companies perform racial equity audits, but then voted in favor of racial equity audit-shareholder proposals at their own portfolio companies.[91] Following the trend, Northern Trust's board recommended its shareholders vote against a proposal that would require Northern Trust to prepare a report of its political contributions and expenditures. But Northern Trust's own investment arm voted in favor of proposals requiring Northern Trust (split vote), Western Union (split vote), and Fiserv to prepare reports of their political contributions and expenditures.[92] These examples make clear that these

[89] The Charles Schwab Corp., Definitive Proxy Statement (Schedule 14A), Apr. 1, 2022, at 92-95, https://www.sec.gov/Archives/edgar/data/316709/000119312522093320/d246025ddef14a.htm.
[90] Alphabet Inc., Definitive Proxy Statement (Schedule 14A), Apr. 22, 2022, at 70–73, https://www.sec.gov/Archives/edgar/data/1652044/000130817922000262/lgoog2022_def14a.htm; Amazon.com, Inc., Definitive Proxy Statement (Schedule 14A), Apr. 14, 2022, at 61–64, https://www.sec.gov/Archives/edgar/data/1018724/000110465922045572/tm223357-5_def14a.htm#tSHPR; Eli Lilly and Co., Definitive Proxy Statement (Schedule 14A), Mar. 18, 2022, at 72–75, https://www.sec.gov/Archives/edgar/data/59478/000005947822000099/llydef14a2022.htm#i9b9da9148a184c2c97520b2c3fd6d0c1_112; Netflix, Inc., Definitive Proxy Statement (Schedule 14A), Apr. 22, 2022, at 89–93, https://www.sec.gov/Archives/edgar/data/1065280/000119312522115102/d202881ddef14a.htm; The Travelers Companies, Inc., Definitive Proxy Statement (Schedule 14A), Apr. 8, 2022, at 68–71, https://www.sec.gov/Archives/edgar/data/86312/000008631222000019/a2022proxystatement.htm#ib65a69730f0f4e238d2897c7ecf4a773_1284;
United Parcel Service, Inc., Definitive Proxy Statement (Schedule 14A), Mar. 21, 2022, at 62–64, https://www.sec.gov/Archives/edgar/data/1090727/000120677422000792/ups3995501-def14a.htm; Walmart Inc., Definitive Proxy Statement (Schedule 14A), Apr. 21, 2022, at 99, https://www.sec.gov/Archives/edgar/data/104169/000010416922000019/a2022proxystatement.htm.
[91] State Street Corp., Definitive Proxy Statement (Schedule 14A), Apr. 6, 2021, at 79–80, https://s201.q4cdn.com/681076340/files/doc_financials/2021/ar/STT-2021-Proxy-Statement.pdf; Amazon.com, Inc., Definitive Proxy Statement (Schedule 14A), Apr. 15, 2021, at 43–49, https://www.sec.gov/Archives/edgar/data/1018724/000110465921050333/tm2035374-1_def14a.htm. Oracle Corp., Definitive Proxy Statement (Schedule 14A), Sept. 24, 2021, at 78–81, https://www.sec.gov/Archives/edgar/data/1341439/000119312521282422/d162163ddef14a.htm.
[92] Northern Trust Corp., Definitive Proxy Statement (Schedule 14A), Mar. 12, 2019, at 65–66, https://www.sec.gov/Archives/edgar/data/73124/000119312519072131/d673202ddef14a.htm; The Western Union Company, Definitive Proxy Statement (Schedule 14A), Apr. 3, 2019, at 69–71, https://www.sec.gov/Archives/edgar/data/1365135/000120677419001208/wu3490101-def14a.htm; Fiserv

(footnote continues on the following page)

entities are missing the mark somewhere as it pertains to their fiduciary responsibilities—either to their own shareholders or to the shareholders of other companies on behalf of whom they are voting.

While I am working on further research to provide data on this front, proxy advisers and asset managers likewise will vote against "anti-ESG" proposals, even when they relate to the same subject matter as pro-ESG proposals, such as in employment discrimination. I am not aware of a single instance in which any of the largest and most significant proxy process actors have ever voted in favor of an "anti-ESG" proposal. By way of recent example, asset managers uniformly opposed the National Center's employee viewpoint discrimination proposal at Kroger, while simultaneously voting in favor of a "race and gender pay gap" proposal at Kroger, and also voting in favor of employee discrimination proposals at other companies on all sorts of liberal-focused subjects. In this way, the proxy process replicates in the private sector the same viewpoint discrimination against conservative viewpoints that the SEC does via government regulation.

IV. Overview of Recently Proposed Solutions

There are serious problems with the current proxy process, including with Rule 14a-8 and how market actors use it to advance unlawful objectives in corporate governance. Fortunately, there are several promising policy initiatives underway to try and solve or mitigate these issues, including those undertaken by this Committee.

A. Private ordering

While Rule 14a-8 purports to compel companies to include shareholder proposals that qualify under the rule's standards in their proxy statements, companies may be able to adopt their own internal corporate provisions to limit shareholder proxy proposals. Companies already regulate via corporate bylaws shareholders' ability to present proposal *in-person* at the annual meeting. While the conventional view is that Rule 14a-8 precludes companies from adopting bylaws restricting shareholder proposals that are inconsistent with Rule 14a-8,[93] the principal legal authority for this view, a Third Circuit opinion from 1947, is highly questionable.[94] Under state corporate law, companies are authorized to adopt, and many companies have in fact adopted, provisions in their charters that authorize the board of directors to unilaterally adopt bylaws, including bylaws relating to the rights of shareholders.[95] Once adopted, valid corporate bylaws are enforceable under state law. As I discussed *supra*, Rule 14a-8 is likely invalid to the

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Inc., Definitive Proxy Statement (Schedule 14A), Apr. 9, 2019, at 69–70, https://www.sec.gov/Archives/edgar/data/798354/000119312519101679/d643515ddef14a.htm.

[93] *See generally* Stephen Bainbridge, *Can a corporation opt out of Rule 14a-8*?, PROFESSORBAINBRIDGE.COM (May 24, 2020), https://www.professorbainbridge.com/professorbainbridgecom/2020/05/can-a-corporation-opt-out-of-rule-14a-8.html (collecting sources from conflicting perspectives).

[94] *See Proxy Rule 14a-8: Omission of Shareholder Proposals*, 84 HARV. L. REV. 700, 704 (1971).

[95] *See, e.g.*, 8 Del. C. § 109(a), (b).

extent it intrudes upon state corporate law. If, pursuant to state corporate law, a company has validly altered the rights of its shareholders to submit shareholder proposals, I would consider it doubtful that Rule 14a-8 should operate to invalidate the company's lawful choice under state law.

Companies could take a range of approaches to stem the tide of unmeritorious shareholder proposals. SEC Commissioner Mark Uyeda thoughtfully explored these ideas in a recent speech delivered to the Society for Corporate Governance. In Commissioner Uyeda's view, "rule 14a-8's procedural bases for exclusion . . . should be viewed as default standards that apply only if companies decline to establish their own standards in their governing documents."[96] For example, a company could raise the minimum share ownership threshold required of shareholders to submit a proposal above the minimum $2,000 that Rule 14a-8 provides for. More substantively, a company could attempt to affirmatively exclude climate-related proposals, or other subject-matter areas.

While the possibility of greater private ordering would, in concept, allow for more diverse and efficient approaches to shareholder proposals, it is also no substitute for taking on other challenges in the proxy system. As the proxy process currently operates, issuers that adopt creative shareholder proposal-restricting bylaws would run the risk of running afoul of the market actors and the power they wield that I described *supra* Part III.A. That power must be highly restricted or broken up in order to allow for the market in corporate governance models to function properly.

B. Litigation challenging Rule 14a-8.

As I mentioned earlier, I currently represent the National Center for Public Policy Research in litigation against the SEC over the SEC's application of Rule 14a-8 to determine that the National Center's shareholder proposal focusing on viewpoint discrimination against companies' employees was not a "significant social policy." In that case, among First Amendment viewpoint-discrimination and other claims, the National Center argued in its briefings with the SEC that Rule 14a-8 exceeds the statutory authority of the Exchange Act.[97] The National Association for Manufacturers has intervened in the case and filed a brief arguing to similar effect.[98]

As Congress considers legislation modifying Rule 14a-8, it should consider ways to ensure that such changes do not affirm Rule 14a-8 and inadvertently deny meaningful judicial review to the SEC's unlawful conduct in issuing and applying it to private market actors.

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[96] SEC Commissioner Mark Uyeda, *Remarks at the Society for Corporate Governance 2023 National Conference* (June 21, 2023), https://www.sec.gov/news/speech/uyeda-remarks-society-corporate-governance-conference-062123.
[97] The Kroger Co. (Apr. 12, 2023) at 26–28, https://www.sec.gov/files/corpfin/no-action/14a-8/ncpprkroger041223-14a8.pdf.
[98] Nat'l Center for Public Pol'y Research v. SEC, No. 23-60230 (5th Cir., May 24, 2023), https://documents.nam.org/law/NAM_Intervention_Motion_NCPPR_v_SEC.pdf.

C. Legislation.

In conjunction with this hearing and related hearings, the Committee has presented several important bills that I believe would make valuable and important reforms to the proxy process. Each of the reforms to Rule 14a-8 proposed in the Committee's legislation under consideration would be a step forward in returning the proxy process to truly focus on investor interests. Specifically, I applaud the Committee for grasping the fundamental nature of the problems caused by Rule 14a-8 and proposing legislation to authorize the exclusion of shareholder proposals if the subject matter is environmental, social, or political—or, at least, eliminating the significant social policy exception—and, ultimately, prohibiting the SEC from continuing to implement Rule 14a-8.

I also commend the Committee's focus on ensuring proxy advisers and asset managers face greater accountability for how they recommend and vote on shareholder proposals. A private right of action against proxy advisers for advising that companies adopt shareholder proposals that violate state law, as Representative Steil's bill would do, would be a promising development. Creating binding voting rules for passive funds via the Investment Advisers Act, as one of the bills under consideration proposes, is an especially bold and innovative approach. Some ESG investing concepts flatly violate the Investment Advisers Act's provision of advisers' fiduciary duties to their clients,[99] but because enforcement discretion is left with the SEC, there has been little effort to police this misconduct. Inserting binding voting rules into the Advisers Act could be a valuable prophylactic measure for Congress to prescribe. Amendments to the Advisers Act would be a potentially powerful tool, and could be also be used to make clear there is no fiduciary obligation to vote all proxies, and that it is not a breach of fiduciary duty to vote in favor of all proxies supported by management.[100]

Finally, I would like to note that there is an increasing amount of legislative and regulatory activity going on in the states on these subjects. Numerous states have limited or prohibited the consideration of ESG investment methodologies with state funds. At the same time, Delaware, which is where the vast majority of public companies are incorporated and which has the most highly developed body of state corporate law, has increased liability risks for directors and management under the *Caremark* doctrine, which some have noted may supplement the SEC's recent pro-ESG disclosure proposed rulemakings and enforcement priorities.[101] If these trends continue, I anticipate that states will become increasingly creative in their efforts to either advance or defeat ESG concepts in corporate governance and asset management under state law. Forward-looking policymakers in Congress would do well to

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[99] *See* Letter of Boyden Gray & Associates to Gary Gensler, Chairman, Securities and Exchange Commission 8–11 (Aug. 16, 2022), https://www.sec.gov/comments/s7-17-22/s71722-20137865-308198.pdf.

[100] SEC Commissioners Hester Peirce and Mark Uyeda, *Statement Regarding In the Matter of Toews Corporation*, Sept. 20, 2022, https://www.sec.gov/news/statement/peirce-uyeda-statement-toews-corporation.

[101] *See* Jacob H. Hupart et al., *Caremark Liability Following the SEC's New ESG Reporting Requirements*, Mintz (Dec. 16, 2022), https://www.mintz.com/insights-center/viewpoints/2301/2022-12-21-caremark-liability-following-secs-new-esg-reporting.

revisit federal securities and investment adviser statutes that preempt state law in these areas and attempt to identify solutions that allow for some constructive state-level experimentation.

I thank the Committee again for the invitation to testify today on this important subject, and I look forward to discussing it further with the Committee's members.