

RAISING THE SEC'S RESUBMISSION THRESHOLDS:

"ZOMBIE" PROPOSALS

AND THE NEED TO MODERNIZE
AN OUTDATED SYSTEM



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Shareholder Proposal “Zombies”

The shareholder proposal system administered by the Securities and Exchange Commission (SEC) was designed as a means to facilitate constructive ideas from shareholders regarding the management of public companies. Unfortunately, this system has turned into one that is largely dominated by a small minority of activists that increasingly target American businesses over social or politically-charged issues. Compounding the problem, current SEC rules allow proposals that have received very low support to be resubmitted year after year, even if a vast majority of shareholders continually vote against them. In fact, over the last two decades, a large number of proposals have been submitted three or more times at companies without garnering majority support – thus becoming “zombie” proposals that stick around long after shareholders have decided they have no merit. This poses enormous costs not just in terms of corporate resources spent to deal with proposals every year, but also in terms of the distractions they create for management and boards, which have a duty to focus on the long-term best interests of the company. The U.S. Chamber strongly believes that reform of the shareholder proposal rules should be a top priority for policymakers.

In July 2017, the U.S. Chamber’s (“Chamber”) Center for Capital Markets Competitiveness (“CCMC”) put forward seven specific recommendations for how the Securities and Exchange Commission (SEC) could improve the rules governing shareholder proposals under Rule 14a-8 of the Securities Exchange Act. As the Chamber explained in that report, the shareholder proposal system has devolved into a mechanism that a small group of activists use to advance parochial agendas which are uncorrelated to enhancing the long-term value of public companies. As a result, the vast majority of public company shareholders are disenfranchised by these outdated rules.

In November 2017, the SEC issued staff guidance intended to improve the “no-action” process which helps determine whether a company is required to include a certain shareholder proposal with its proxy materials.¹ For example, the staff sought to reassert a provision allowing companies to exclude proposals that do not significantly impact a company’s earnings or assets, and also created strict guidelines related to the use of images or graphs alongside proposals. The staff guidance incorporated many of the recommendations made by the Chamber and was an incremental but important step towards improving the administration of Rule 14a-8.

However, we continue to believe that the most meaningful reform the SEC could undertake would be to raise the “resubmission thresholds” that determine when proposals that receive a low amount of shareholder support may be resubmitted in a subsequent year.²

Current SEC rules can allow, for example, a proposal that received nearly 90% opposition in multiple years to be continuously resubmitted, forcing the vast majority of that company’s shareholders to register their opposition over and over.

¹ Staff Legal Bulletin No. 14I (CF) November 1, 2017.

² The current Resubmission Rule allows a company to exclude a shareholder proposal only if it failed to receive the support of 3% of shareholders if voted on once in the last five years; 6% if voted on twice in the last five years; and 10% if voted on three or more times in the last five years.

In other words, the current shareholder proposal system allows the “tyranny of the minority” to prevail at the expense of Main Street investors.

Political Proposal Making

Shareholder proposals increasingly deal with social or political matters that most shareholders deem immaterial to their decision making. The Manhattan Institute’s Proxy Monitor Report found that in 2017, fully 56% of shareholder proposals at Fortune 250 companies dealt with social or policy concerns.³ Despite the prevalence of such proposals, shareholders have overwhelmingly rejected them when put to a vote. To highlight just one example, from 2006 to 2016, Fortune 250 companies received 445 proposals dealing with political spending disclosures – a perennial favorite topic of activists. Only 1 of these proposals during that time frame received majority backing, and in most years, proponents failed to garner the support of more than 20% of voting shareholders.⁴ Proposals dealing with other social or political matters have similarly received very low support when put to a vote.

Main Street investors have also demonstrated an aversion to bringing social and policy issues into corporate governance. A striking survey released earlier this year by the Spectrem Group found that 88% of public pension plan beneficiaries want plan assets to be used for maximizing returns and not political agendas, even if they agree with whatever cause the overseers of the plan may be advocating.⁵ The survey also found that beneficiaries largely believe pension funds should have to explain and justify their votes on proxy matters such as shareholder proposals, or abstain from voting if it cannot.

3 Proxy Monitor 2017: Season Review, available at <https://www.manhattan-institute.org/html/proxy-monitor-2017-season-review-10757.html>

4 Proxy Monitor 2016: A Report on Corporate Governance and Shareholder Activism, available at <https://www.manhattan-institute.org/html/proxy-monitor-2016-report-9297.html>

5 Tensions with Pensions: An Analysis of Public Pension Fund Members’ Knowledge and Sentiment About How Their Money is Being Invested, available at https://spectrem.com/Content_Whitepaper/Tensions-with-pensions.aspx

The low level of support provided by retail investors for politically motivated shareholder proposals—coupled with an increasing skepticism over the role played by public pension plans in promoting such proposals—demonstrate the growing disconnect between the agendas of many who claim to speak for Main Street investors, and the actual investors themselves.

Raising Resubmission Thresholds

Raising the resubmission thresholds under Rule 14a-8 would be an important step towards rebalancing this system in favor of the vast majority of public company shareholders. In 2014, the Chamber—along with eight other organizations—submitted a rulemaking petition to the SEC requesting that the Commission raise the thresholds to a more reasonable level.⁶ As was explained in that petition, the current resubmission rule “imposes adverse consequences on shareholders, in the form of (a) wasted shareholder resources, (b) diminished comprehension and attention of shareholders on matters of economic significance, and (c) diffused management attention better spent on economically significant matters.” Several other organizations – representing a broad cross-section of American industry—have also called on the SEC to take action.⁷

The SEC has recognized this problem in the past, and in 1997, the SEC proposed raising the resubmission thresholds from the current 3%/6%/10% system to a more reasonable 6%/15%/30%.

⁶ Rulemaking petition available at <https://www.sec.gov/rules/petitions/2014/petn4-675.pdf>

⁷ See e.g. letter from Corporate Governance Coalition for Investor Value July 17, 2017., available at: <https://www.centerforcapitalmarkets.com/wp-content/uploads/2017/07/20170717-CGCIV-Final-Resubmission-Thresholds-letter.pdf>

As the SEC stated in the proposing release: “we believe that a proposal that has not achieved these [proposed] levels of support has been fairly tested and stands no significant chance of obtaining the level of voting support required for approval.”⁸

The increase in activism under Rule 14a-8 since the SEC’s 1997 proposal only emphasizes the urgency for the SEC to modernize this outdated system. Updating the thresholds would not in any way “disenfranchise” shareholders. It would still allow shareholders who meet current holding requirements to submit a proposal, but it would not subject others to the costs and distractions that occur when unpopular proposals are repeatedly included in a company’s proxy statement. Simply put, raising the resubmission thresholds would be good for shareholders as a whole.

“Zombie” Proposals

Current SEC rules state that companies may only exclude a proposal from its proxy materials if it failed to gain:

- Less than 3% support on the previous submission if voted on once within the previous five calendar years.
- Less than 6% support on the previous submission if voted on twice within the previous five calendar years.
- Less than 10% support on the previous submission if voted on three or more times within the previous five calendar years.

Thus, a proponent is allowed to resubmit a proposal even if nearly 90% of shareholders vote against it on multiple occasions.

⁸ Proposed Rule: Amendments to Rules on Shareholder Proposals, available at: <https://www.sec.gov/rules/proposed/34-39093.htm>

And if a proposal happens to breach 10% support within three years, there is no limit to how many times it can be submitted in the future.

Many such proposals will be submitted for multiple years, but never come close to gaining majority support, thus becoming “zombie” proposals that must nevertheless be dealt with by shareholders on an ongoing basis.

A recent thought leadership piece, which analyzed proxy proposals that have been placed on company ballots over the last 17 years, illustrates the extent to which zombie proposals have continued to be introduced for three years or more without reaching a majority vote.⁹

The piece examined 2,449 shareholder proposals submitted from 2001 to 2018 relating to special meetings, environmental and social, political and social, and human rights matters. According to the analysis:

- Only 5% of these types of proposals passed.
- Zombie proposals (those submitted three or more times without garnering majority support) made up 32% of all failed proposals.
- Out of 2,449 total proposals examined, 723 were zombie proposals.

If the SEC were to implement a new threshold rule of 6%-15%-30% (as was proposed in 1997), only 27% of zombies would have been eligible for a fourth year on company ballots.

A threshold of this kind would therefore continue to allow shareholders to introduce proposals, but would at the same time recognize and to an extent reflect shareholder votes, which overwhelmingly reject these proposals.

9 2018 Proxy Season Trends, available at <https://fticommunications.com/2018/08/2018-proxy-season-trends/>

Role of Proxy Advisors

Evidence suggests it is likely that fewer zombie proposals would survive without the persistent support of proxy advisors, such as ISS and Glass Lewis. These firms have come under increased scrutiny for their increasing influence on the voting process, and research shows that a proxy advisory firm recommendation in favor of a shareholder proposal can significantly increase the level of support that the proposal receives.

Research shows that:

- ISS has recommended voting “for” 79% of zombie proposals at least one of the times they have appeared on the ballot.¹⁰
- In 2018, ISS supported 95% of the zombie proposals examined, a slight increase from 88% in 2016.¹¹

According to a 2012 Manhattan Institute Proxy Monitor report, an ISS recommendation that shareholders support a given shareholder proposal corresponds with a 15% increase in the shareholder vote, controlling for other factors.¹² As the Manhattan Institute’s Proxy Monitor Report in 2017 notes:

10 *Ibid.*

11 *Ibid.*

12 Proxy Monitor 2012: A Report on Corporate Governance and Shareholder Activism, can be found: http://www.proxymonitor.org/pdf/pmr_04.pdf

“Given the empirical evidence that a recommendation by the proxy-advisory firm ISS that shareholders vote “for” a given shareholder proposal is associated with a 15% boost in the proposal’s shareholder vote, all else being equal, the current SEC rule means that ISS (and probably Glass Lewis, its principal competitor) effectively serves as the gatekeeper for shareholder-proposal resubmissions: if ISS supports a proposal, it can remain indefinitely on the ballot.”

These analyses on some of the longest running zombie proposals also show that proxy advisors have a pedigree of supporting proposals regardless of action taken by issuers, or the continued opposition of a majority of shareholders.

Conclusion

The most meaningful reform the SEC could undertake would be to raise the “resubmission thresholds” that determine when proposals that receive a low amount of shareholder support may be resubmitted in a subsequent year. Continuous resubmissions are a drain on shareholders and companies alike, requiring significant time and monetary resources to defend against proposals that have time and time again been rejected. It is time to enact real shareholder proposal reform to bring an end to these zombies, for good.



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