THE SEC'S SHAREHOLDER PROPOSAL RULE: CREATING A CORPORATE PUBLIC SQUARE

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In this Article, we take advantage of this Symposium's goals to think broadly about the future of Rule 14a-8 of the Securities Exchange Act of 1934, the shareholder proposal rule. We set forth a vision for the rule to address boardroom insularity by likening the shareholder proposal rule as the public square for shareholders. The existence of such a forum would redound to the benefit of investors, officers, and boards of directors as a fount of current and useful information about their investors' and stakeholders' concerns.

We therefore rethink the mission of Rule 14a-8. In doing so, we explore whether it can provide a ready-made corporate public square for all companies; that is, rather than view Rule 14a-8 as purely enabling shareholders to sample the beliefs of their fellow shareholders, we perceive a broader social value. We cast Rule 14a-8 as a mechanism for assisting corporate directors generally, meaning not just those on the board of the corporation that is the target of a proposal, but also directors at all corporations, in gathering valuable information to help them better perform their duties.

In making these claims, we fully accept the functional view that Rule 14a-8 addresses itself to shareholders facing high barriers to their efforts to communicate with their directors

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and among themselves by providing them with an inexpensive vehicle for making their views known. We also believe it is equally important to understand that the message derived from proposals, and the votes they garner, is also heard by managers of other companies. We see that the temperature being taken through Rule 14a-8 is not just that of the proponent but a broad group of the company's stockholders that likely is reflective of societal beliefs.

Construing Rule 14a-8 to facilitate a public square will weaken the social and psychological forces that can insulate management and the board from alternative perspectives regarding the firm's objectives. Board directors often live cloistered lives and naturally identify with the firm's successes and the operating practices. Thus, as their length of service increases, directors risk failing to broaden their perspectives to reflect the constellation of views held by the shareholders. Overall, a public square could help directors preserve and even gain a far richer and aligned perspective.

Moreover, as opposed to one-off meetings with portfolio companies, voting on shareholder proposals provides both the chance to discern the views of other financial institutions and the opportunity to present a cohesive voice across a group of investors behind a recommended course of action set forth in a proposal.

To be sure, some conditions should be imposed on proponents to guard against abusive proposals. We review the data bearing on the extent that a small group of investors, so-called "gadflies," produce a disproportionate number of the poorly tailored proposals and hence are a distraction, and we believe that the SEC should study whether their proposals are associated with negative returns.

We conclude that recent SEC amendments to Rule 14a-8 are ill-advised. In making these changes, the SEC assessed the value of Rule 14a-8 by narrowly focusing on votes garnered by proposals. We argue the worth of this rule has many more features than the outcome of the votes cast in favor of a proposal.

I. Introduction 1149
II. Overview Of Rule 14a-8 1162
III. The Mechanics, Legislative-Regulatory History, and Commentary of Rule 14a-8 1166
A. Qualifying the Proposal 1169
B. Legislative History, Regulatory Evolution and Judicial Development of Rule 14a-8 1172
C. Analysis of the Legislative History and Policy Justifications for Rule 14a-8 1181
1. Legislative History Debate 1181
2. Theoretical and Policy Arguments 1184
IV. Insights from Empircal Studies of Rule 14a-8 1187
V. What is the Real Purpose of Rule 14a-8? The Corporate Public Square 1193
VI. Conclusion 1197

I. INTRODUCTION

Corporate law is once again at an important crossroad. Institutional and individual investors now evince a growing and animated interest in environmental, social, and governance (ESG) issues that is also mirrored by firm managers' public statements regarding the focus of their stewardship.[1] At the same time, an aging American workforce financially ill-prepared for retirement is seeking increased economic returns from the funds on which their retirements

[1] *See*, *e.g.*, José Azar et al., *The Big Three and Corporate Carbon Emissions Around the World*, 142 J. Fin. Econ. 674, 674–75 (2021) (noting how the largest institutional investors increasingly engage with firms on issue of high CO2 emissions); Michael Barzuza, Quinn Curtis & David H. Webber, The Millennial Corporation (Dec. 14, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3918443 (on file with the Columbia Business Law Review) (marshalling evidence and arguments that the growing influence of millennials will propel a dramatic shift within the executive suites toward stakeholder interests and socially responsible choices so that traditional obeisance to wealth maximization will be reduced).

depend.[2] Hence, the pursuit of gain, not good, is the other fork in the road.

Caught in the middle of these intersecting forces are firm managers—board members and officers—who are challenged to address both sets of concerns. The path forward, however, is confounded by the diverse nature of firms seeking to traverse this intersection—American public companies cover an enormous range of industries, employees, shareholders, debtholders, customers, and suppliers, in a wide variety of geographic areas of operation. Indeed, public companies impact, and are impacted by, a broad range of investors and other stakeholders. As such, their directors face the challenge of obtaining good information regarding the aspirations, values, and needs of their investors and stakeholders, particularly with regard to the managers' stewardship of the firm as well as the directors' level of accountability.[3] Boards of directors depend heavily on corporate management for this information, which may leave them unaware of various stakeholders' beliefs and needs[4] or simply poorly focused on shareholders' concerns; they may also not be aware of smaller shareholders views due to their significant collective action problems and steep communication barriers.[5] All these issues

[2] Stephen F. Befort, *The Perfect Storm of Retirement Security: Fixing the Three-Legged Stool of Social Security, Pensions, and Personal Savings*, 91 MINN. L. REV. 938, 938–39 (2006) (describing the looming American retirement crisis).

[3] DAVID M. SILK, SABASTIAN V. NILLES & CARMEN X. W. LU, WACHTELL, LIPTON, ROSEN & KATZ, ESG AND SUSTAINABILITY: KEY CONSIDERATIONS FOR 2021 (2021), https://www.wlrk.com/webdocs/wlrknew/ClientMemos/WLRK/WLRK.27332.21.pdf [https://perma.cc/UP6L-TVND] ("As investor and stakeholder scrutiny of ESG continues to accelerate, boards will also continue to face heightened expectations on their oversight of ESG.").

[4] James D. Cox & Randall S. Thomas, *Resisting the Return to Managerialism: Institutionalizing the Shareholder Voice in the Monitoring Model*, 99 TEX. L. REV. 1275 (2021) (discussing boards' lack of independent sources of information and need for alternative information flows in order to be well informed).

[5] *See* Paul H. Edelman, Randall S. Thomas & Robert B. Thompson, *Shareholder Voting in an Age of Intermediary Capitalism*, 87 S. CAL. L. REV.

exist at a time when major companies' boards of directors are increasingly and aggressively seeking input from their shareholders on their wide-ranging beliefs and concerns.[6]

Social-psychological forces further complicate the balancing act required of today's directors of public companies.[7] Studies reflect that since the last major change in corporate governance—the movement from managerialism to the share-value centric objective pursued by officers under the watchful eye of an independent board of directors— an inverse relationship has evolved between the tenure of officers and board member independence.[8] With greater board independence, the average tenure of directors has increased.[9] In fact, the average tenure of directors exceeds that of chief

1359, 1370, 1379, 1384 (2014) (discussing shareholders' collective action problems in voting).

[6] For example, Unilever recently voluntarily instituted an advisory shareholder vote on climate change issues. *See* Sabira Chaudhuri, *Unilever Allows Climate Input*, WALL ST. J. (Dec. 14, 2020, 1:43 PM), https://www.wsj.com/articles/unilever-to-give-investors-advisory-vote-on-climate-change-plan-11607971421 (on file with the Columbia Business Law Review). In addition, "[m]ajor investors are putting more emphasis on addressing the threats posed by climate change, with shareholder resolutions on the issue becoming more common." *Id.*

[7] *See* James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, LAW & CONTEMP. PROBS., Summer 1985, at 83, 84–85 (providing a psychological perspective on "independent directors' assessment whether the corporation's interest is served by a derivative suit against their 'insider' colleagues" and concluding that social-psychological mechanisms produce bias in directors' decisions that protect colleagues on the board from legal sanctions).

[8] *See e.g.*, Michael S. Weisbach, Outside Directors and CEO Turnover, 20 J. Fin. Econ. 431, 458 (1987) (finding that CEO turnover as observed during 1974-1983 was more likely correlated with poor firm performance when the board is dominated by independent directors); Eliezer M. Fich & Anil Shivdasani, *Are Busy Boards Effective Monitors?*, 61 J. FIN. 689, 714 (2006) (observing in a study of Forbes 500 firms during 1989-1995 high correlation between executive turnovers of poorly performing firms and the independence of directors).

[9] *See* Yaron Nili, *The "New Insiders": Rethinking Independent Director Tenure*, 68 HASTINGS L. J. 97, 113 & n., 132 & tbl.3 (2016) (finding that average director tenure has increased).

executive officers.[10] With insufficient turnover in the membership of the board of directors arises a host of concerns, not the least of which is undue obeisance to the status quo.[11] This can manifest itself by the board, and hence company policies and practices, becoming increasingly insular and thus removed from the interests of the firm's shareholders as well as the markets the firm seeks to serve.

We are taking advantage of this Symposium's mission to think broadly in casting a future role for securities regulation.[12] To this charge, we set forth a vision for addressing boardroom insularity by trying to incorporate a feature from a less complicated setting in which the smaller and privately held firm can advance by resorting to the model of the local public or town square. Historically, "[t]he town square was an integral city function for centuries throughout the world. It was the central hub of activity, a place for gathering to celebrate, receive information, conduct business, and to simply sit."[13] There, citizens of the same community could gather with business owners and share views likely derived from commonly observed and experienced developments.[14] The Greeks are widely recognized as the first society to fully embrace the value of civic engagement through the public square.[15] The Greek Agora in fifth century A.D. was constructed specifically for this purpose, serving as the nerve

[10] *Id.* at 124.

[11] Yaron Nili details a host of other concerns with longer director tenures, including affecting director independence, creating a "structural bias," and leading to groupthink. *Id.* at 118–20.

[12] *See Introduction,* 2021 COLUM. BUS. L. REV. 472, 475 (2021) ("The Symposium intends to jumpstart scholarly efforts to develop guidance for courts, lawmakers, and market participants.").

[13] Stephanie Rouse, A Return to the Town Square 1 (June 6, 2017) (unpublished manuscript), https://static1.squarespace.com/static/58b2397a2e69cf75a40cc057/t/5999e71b4c0dbfbeebed458a/1503258400531/A+Return+to+the+Town+Square+by+Stephanie+Rouse.pdf [https://perma.cc/66UV-Z8NW].

[14] *Id.* ("Before technology took off and created an environment that allowed for information at your fingertips, individuals gathered in town squares to share information, discuss politics and transact business.").

[15] *Id.* at 3.

center of the city of Athens and hosted up to twenty thousand citizens to engage in civil discourse.[16] Political theorist and philosopher Hanna Arendt wrote, "[T]o the Greek way of thinking, freedom was rooted in place, bound to one spot and limited in its dimensions, and the limits of freedom's space were congruent with the walls of the city, of the polis or, more precisely, the agora contained within it."[17]

Expanding on the Agora, European squares were designed physically as well as philosophically to sit at the heart of the city, functioning as important local and regional economic hubs for trade, civil engagement, and entertainment.[18] The multi-functional square "was a uniquely European invention, intimately connected to the development of democratic and representational self-government."[19] The early American tradition of town squares is borrowed directly from the European one.[20] In this country, these early squares were simply informal gathering places located in the middle of the town, allowing civic engagement to take place out in the open where all could participate.[21]

This quaint, perhaps romantic, image hardly characterizes the setting of today's public companies. In a multinational, high-tech, COVID-fearing world, it is no longer possible to make a trip to the local pub to gauge your fellow investors' feelings. Nonetheless, we invoke the analogy to the public square, as we believe the existence of such a forum would redound to the benefit of investors, officers, and boards of directors as a fount of current and useful information about their investors and stakeholders' concerns.

In this Article, we rethink the shareholder proposal rule, Rule 14a-8 of the Exchange Act of 1934 (the "Rule" or "Rule 14a-8").[22] In doing so, we explore whether it can provide a

16 *Id.*

17 HANNAH ARENDT, THE PROMISE OF POLITICS 170 (Jerome Kohn ed., 2005).

18 Rouse, *supra* note 13, at 3.

19 *Id.*

20 *Id.* at 4.

21 *Id.*

22 Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2021).

ready-made corporate public square for all companies; that is, rather than view Rule 14a-8 as purely enabling shareholders to sample the beliefs of fellow shareholders, we perceive a broader social value. We cast Rule 14a-8 as a mechanism for assisting corporate directors *generally*, meaning not just those on the board of the corporation that is the target of a proposal, but directors at all corporations, in gathering valuable information to help them better perform their duties. For example, the Rule can enable all directors to inform themselves about issues that require them to balance the effect of their actions on their firm's stock price and on other interests of their company.[23]

In making these claims, we fully accept the functional view that Rule 14a-8 addresses itself to shareholders facing high barriers to their efforts to communicate with directors and among themselves by providing them with an inexpensive vehicle for making their views known.[24] In essence, the functional view of the Rule is that it facilitates both shareholder communication and engagement by solving the collective action problem facing small investors, which in turn enables the board to take the temperature of a representative body of the firm's shareholders on a wide range of issues. We support this view but we believe it is equally important to understand that the message derived from proposals, and the votes they garner, is also heard by managers of companies that were not directly targeted by the proposal. Indeed, the record reflects that these "shareholder votes can lead to important corporate governance changes,"[25] and thus supports the view that corporate boards pay attention to

[23] One of the important functions of shareholder voting is "when there is an issue that requires a balancing between the share price and other legitimate interests of the company." Randall S. Thomas & Paul H. Edelman, *The Theory and Practice of Corporate Voting at U.S. Public Companies*, *in* RESEARCH HANDBOOK ON SHAREHOLDER POWER 459, 468 (Jennifer G. Hill & Randall S. Thomas eds., 2015).

[24] *See, e.g.*, Donald E. Schwartz & Elliott J. Weiss, *An Assessment of the SEC Shareholder Proposal Rule*, 65 GEO. L. J. 635, 639 (1977).

[25] Edelman et al., *supra* note 5, at 1369 (citation omitted).

them.[26] As such, directors who ignore issues and voting outcomes at other firms are ignoring valuable information.

We further accept the view that other stakeholders can use Rule 14a-8 to communicate their interests to corporate boards, if they are willing to purchase a certain amount of stock in the corporation and phrase their proposals appropriately.[27] With the surging interest among investors and managers concerning ESG, and especially matters bearing on sustainability, there has been a distinct tilt toward believing that boards in addressing sustainability explicitly need to take into account stakeholder interests in their decision-making.[28]

A further benefit of construing Rule 14a-8 to facilitate a public square is the weakening of the social and psychological forces that can insulate management and the board from alternative perspectives regarding the objectives of the firm and how they can be achieved. Boards live a cloistered life and their insularity sometimes is enhanced by practices of

[26] We do not limit ourselves to precatory votes because some 14a-8 votes may require a bylaw to be adopted. *See*, *e.g.*, Matthew F. Sullivan, *Shareholder Bylaw Proposals, Delaware Certification, and the SEC After* CA, Inc. v. AFSCME Employees Pension Plan, 87 U. DET. MERCY L. REV. 193, 195–201 (2010).

[27] Labor unions have been especially aggressive in using the rule in this fashion. *See* John G. Matsusaka et. al., *Opportunistic Proposals by Union Shareholders*, 32 REV. FIN. STUDS. 3215, 3219–3220 (2019). While companies sometimes object to these investors' dual interests, arguing that these proposals should be stricken on various grounds, frequently they concede the point and allow a shareholder vote on the proposal.

[28] Indeed, the public square vision complements the view that corporations are besieged by not just their owners but a wide range of stakeholders to address interests beyond maximizing the value of the firm. *See* Barzuza, Curtis & Webber, *supra* note 1. One prominent movement in this direction revolves around the so-called New Paradigm. For further discussion of this stakeholder-oriented vision of corporate governance, see MARTIN LIPTON ET AL., WACHTELL, LIPTON, ROSEN & KATZ & INT'L BUS. COUNCIL, WORLD ECON. F., THE NEW PARADIGM: A ROADMAP FOR AN IMPLICIT CORPORATE GOVERNANCE PARTNERSHIP BETWEEN CORPORATIONS AND INVESTORS TO ACHIEVE SUSTAINABLE LONG-TERM INVESTMENT AND GROWTH 5 (2016), https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf [https://perma.cc/2ZHJ-GXM6].

corporate management.[29] Through years of service, directors naturally identify with the firm's successes and the operating practices that produce the successes enjoyed. They risk being stewards of the status quo and not monitors of the stewardship of the officers. Thus, as their length of service increases, a director risks failing to broaden their perspective to reflect the constellation of views held by the shareholders. A public square in which shareholders could voice their views could therefore help directors preserve and even gain a far richer and aligned perspective.

Given these important purposes, how can the shareholders' beliefs best be communicated in a coordinated way? In theory and practice, institutional investors' holdings are sufficiently large to economically support minimal interaction with portfolio companies.[30] Nevertheless, as Professors Gilson and Gordon note, most of these investors are "rationally reticent" to initiate in a public fashion a campaign to persuade management and other holders to pursue a course of action.[31] This in part is a consequence of inherent conflicts faced by many institutions, such as the fact their business models may be jeopardized by overt criticism of a portfolio company's management that may also be a prospective client for its services.[32] Moreover, the dramatic shift to indexed investing is built on a model of low administrative costs, which does not enable resources to be directed toward raising issues for management.[33] Thus, among the largest group of

[29] *See* Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L. J. 262, 276 (2016) ("[F]rom the earliest stages of the process, corporate management oversees the submission process [for shareholder proposals], identifying excludable proposals and communicating with shareholders.").

[30] Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 130 (1994).

[31] Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 867 (2013).

[32] Edelman et al., *supra* note 5 at 1402–03.

[33] Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2020, 2050–55 (2019).

investors, financial institutions, few have or can be expected to initiate communications to boards of their portfolio companies. Yet, they can and do make themselves heard by voting in favor of initiatives they believe are in the best interests of their beneficial owners and by withholding votes for directors as a means to communicate their unhappiness.[34]

There is growing trend of index funds supporting shareholder proposals and otherwise signaling disapproval of board actions.[35] Moreover, there is reason to believe this trend will become even more observable as index funds compete for

[34] *See* Gilson & Gordon, *supra* note 31, at 887 ("[W]hile mutual funds are not proactive, they are not passive . . . They very frequently oppose management on core corporate governance issues. . . . when the issue is presented to them."); *see also* Brooke Fox, *"Against" Votes by Institutional Investors Spike*, AGENDA: A FIN. TIMES SERV., https://www.astfinancial.com/media/374142/against-votes-by-institutional-investors-spike.pdf [https://perma.cc/RU24-DGPK] ("As Agenda has reported, Vanguard Group, BlackRock Inc, State Street Global Advisors and Fidelity all announced new initiatives that suggested they would impose a higher level of scrutiny on directors of companies in their portfolios to elicit changes that were in the best interests of their shareholders. As it turns out, they're being true to their word.").

[35] *See e.g.*, Dawn Lim & Justin Baer, *BlackRock, Other Investors Target Climate Issues, Covid-19 Response and Board Seats in Shareholder Votes*, WALL ST. J. (Aug. 12, 2021, 7:00 AM), https://www.wsj.com/articles/blackrock-other-investors-wield-growing-board-shareholder-vote-clout-11628766001 (on file with the Columbia Business Law Review) (noting fund giant Blackrock, Inc. in the year ending June 30, 2021, withheld support for ten percent of all director nominees and backed sixty-four percent of the year's environmental shareholder proposals.); Marc Treviño, June M. Hu & Joshua L. Levin, *2021 Proxy Season Review: Shareholder Proposals on Environmental Matters*, HARV. L. SCH. F. CORP. GOVERNANCE (Aug. 11, 2021), https://corpgov.law.harvard.edu/2021/08/11/2021-proxy-season-review-shareholder-proposals-on-environmental-matters/ [https://perma.cc/W5PN-5SXU] (noting that Institutional Shareholder Services (ISS) supported sixty-four percent of environmental proposals in the year ending June 2021). One regularly watched metric is the number of companies whose board nominees received eighty percent or more of the votes cast. Lim & Baer, *supra*. In the year ending June 30, 2021, six percent of company-supported board candidates among companies in the Russell 3000 firms failed to garner at least eighty percent of shareholder support, the largest percentage in since 2017. *Id.*

the wealth of millennials, an investor group widely seen as deeply valuing ESG, and as fund managers, especially those following a passive strategy, continue to promote their funds aggressively by trumpeting their voting commitments to ESG.[36] As such, these funds will be expected to be consumers of the information embedded in well-crafted ESG proposals. Hence, the temperature being taken is not just that of the proponent but a broad group of the company's stockholders that likely is reflective of societal beliefs. However, given the relatively few formal communication channels for stakeholders to pass their unvarnished views directly to corporate boards, Rule 14a-8 can be a vehicle to distribute their views more directly to boards that are committed to stakeholder primacy.[37] To the extent that the legislative history of the Rule is unclear about supporting our view, we argue that it should be expanded by Congress to remove such doubts.

There is another advantage afforded to institutional investors by Rule 14a-8 proposals. As experience shows, even though many institutional investors are rationally reticent to initiate proposals, they do vote and in doing so support proposals they believe are well crafted.[38] Additionally, many institutions regularly meet with some or even many of their portfolio companies.[39] Missing from these one-off engagements, however, is both the chance to discern the views of other financial institutions and the opportunity to present a cohesive voice across a group of investors behind a recommended course of action set forth in a proposal. Moreover, these one-off discussions and their results are not

[36] Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1303–1305 (2020).

[37] *See* Thomas & Edelman, *supra* note 23, at 468. (arguing that a shareholder vote provides a measure of shareholders' intensity of preferences and aggregates the preferences of the shareholders as well as conveying that information to the board, which puts the board "in a better position to balance the interests of the various stakeholders of the firm.").

[38] *See* Gilson & Gordon, *supra* note 31, at 867, 887–88.

[39] *Id.*

nearly as transparent as the results of votes on shareholder proposals. That is, voting on proposals through the Rule 14a-8 mechanism not only informs financial institutions regarding the beliefs of other institutions, but it does so with the result that their collective sentiment is aggregated in the vote tally, thereby adding force to the view of the individual institutional investor.[40] And, equally significant, is that Rule 14a-8 enables overt coordination among institutions. Securities and Exchange Commission (SEC) rules allow, in connection with proxy solicitations, soft coordination among institutions by permitting them to not just announce how they will vote but also to encourage other institutions to similarly act.[41] Outside the proxy voting environment, such active coordination poses regulatory concerns among large investors who may fear their actions may unintentionally cross the line into requiring compliance with the securities laws' early notice provisions or even trigger an aggressive poison pill provision.[42] Hence, shareholder proposals enable coordination among institutions and the shareholder proposal itself is the focus for such coordination.

We share Professor Jonathan Macey's insightful explanation of the cause for rising interest in ESG considerations among investors as a growing belief that government cannot address contemporary social problems so

[40] *See* Robert B. Thompson & Paul H. Edelman, *Corporate Voting*, 62 VAND. L. REV. 127, 144 (2009); Thomas & Edelman, *supra* note 23, at 468.

[41] *See* 17 C.F.R. § 240.14a-l-2(iv) (2021) (exempting communications in a regular basis that state how shareholder will vote, and reasons for so voting, from proxy regulation); *id.* § 240.14a-2(b)(1) (exempting communication from most proxy rules a communication by one who does not solicit proxies and is not have certain self-interested relationships with the registrant); *id.* § 240.14a-2(b)(2) (creating broad exemption for soliciting where no more than ten persons are approached).

[42] *See* Jeffrey N. Gordon, *Corporate Vote Suppression: The Anti-Activist Pill in Williams Companies Stockholder Litigation*, CLS BLUE SKY BLOG (Aug. 19, 2021), https://clsbluesky.law.columbia.edu/2021/08/19/corporate-vote-suppression-the-anti-activist-pill-in-the-williams-companies-stockholder-litigation/ [https://perma.cc/99EX-FM8S] (closely examining legal perils of institutions following parallel course in the context of broadly worded poison pills with low ownership threshold).

that reliance on the private sector, most significantly businesses, is necessary for solutions to social problems.[43] At the same time, we part company with him in our hopefulness that incorporating the private sector will be successful. Macey wisely raises concerns that shareholders' focus on ESG faces formidable practical obstacles, such as firm managers being largely compensated by bonuses linked to the bottom line, being elected by owners, not other constituencies, and being subject to pressures from activist investors focused on financial performance.[44] We do not disagree with these concerns, but we believe Rule 14a-8 can nurture the public square so that the rising interest in ESG can more fully be gauged by the public company boards as they navigate among these dueling forces.

With this plethora of valuable purposes to serve, we find it surprising that the SEC, at the behest of corporate management, has recently sharply raised the requirements shareholders must meet to use the Rule.[45] Upon proposing the cuts ("Proposing Release"), the SEC observed that a handful of individual investors account for a sizable proportion of all proposals.[46] In adopting the final rules, it also raised concerns regarding the costs proponents with small stakes impose on companies and their shareholders through their proposals.[47]

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43 Jonathan R. Macey, *ESG Investing: Why Here? Why Now*? 2 (George Mason Law & Econ. Rsch., Working Paper No., 21-22, 2021) http://ssrn.com/absteact=3942903 (on file with the Columbia Business Law Review).

44 *Id.* at 25-29.

45 *See infra* Section III.A for discussion of these cutbacks.

46 *See* Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, Exchange Act Release No. 87,458, 84 Fed. Reg. 66,458, 66,483 (proposed Dec. 4, 2019) (to be codified at 17 C.F.R. pt. 240) [hereinafter Proposing Release] (relying on evidence that five individuals accounted for twenty-seven percent of all proposals to S&P 1500 firms during 2003-2014.).

47 Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, Exchange Act Release No. 89, 964, 84 Fed. Reg. 70,240, 70,245 (Nov. 4, 2020) (to be codified at 17 C.F.R. pt. 240) (estimating the cost to the company in addressing proposals to be between $50,000 and $150,000 per proposal). The SEC also recounted its repeated observations

In addition, critics have argued that environmental and social proposals have not increased firm value.[48]

We believe all boards should wish to learn about their investors' views concerning corporate governance issues, and boards, whether stakeholder-oriented or not, should believe it is in their interest to learn whether there are broadly held views regarding environmental and social issues impacted by the firm. While some conditions should be imposed on proponents to guard against abusive proposals, the data reviewed below shows that the former rule did a reasonable job of filtering out those proposals from meritorious ones.[49] Moreover, to the extent that a small group of investors, so-called "gadflies," produce a disproportionate number of the poorly tailored proposals and hence are a distraction, we believe that the SEC should study whether their proposals are associated with negative returns—as one of the studies reviewed below finds[50]—and, if so, consider why this might be the case. After such study, the SEC can craft an appropriate regulatory response. We envision the SEC carefully studying the question of how gadfly proposals may differ from proposals submitted by other less active individual investors. Just why is it likely that this group's proposals differ in impact from those of the average proponent? This inquiry could provide the basis for a searching cost-benefit analysis that could even lead to setting a limit on the total number of shareholder proposals that any *individual* can present annually at all public

that Rule 14a-8 can be subject to misuse and even harassment. *Id.* at 70,241 n.2.

48 The empirical evidence on the financial effects of environmental and social shareholder proposals is mixed. Yazhou He, Bige Kahraman & Michelle Lowry, *ES Risks and Shareholder Voice* 1 n.1 (ECGI, Working Paper No. 786/2021, 2021) (collecting studies finding financial benefits as well as those not finding benefits).

49 *See e.g.*, John G. Matsusaka, Oguzhan Ozbas & Irene Yi, *Can Shareholder Proposals Hurt Shareholders? Evidence from Securities and Exchange Commission No-Action Letter Decisions*, 64 J. LAW & ECON 107, 125–26 (2021) (finding statistically significant positive returns associated with SEC's decision to omit shareholder proposal thus supporting the view that this mechanism discriminates against negative value proposals).

50 *See supra* note 197 and accompanying text.

companies. We review data below that suggests this course of action.

This Article proceeds as follows. In Part II, we provide an overview of Rule 14a-8 and its broad range of uses in the areas of corporate governance and social responsibility. Part III offers a wide-ranging inquiry into the mechanics, legislative history, academic commentary, and judicial evolution of Rule 14a-8. We find that the Rule has implications that eclipse its role solely as a vehicle for shareholder voting on discrete issues. In Part IV, we next turn to the empirical evidence about Rule 14a-8: Its use by a broad variety of proponents, especially by corporate gadflies, targeting a wide range of topics and experiencing a diverse set of outcomes. In Part V, we turn to our policy recommendation that Rule 14a-8 should be viewed as a corporate public square, serving an important role informing boards of their investors and stakeholders' viewpoints. In Part VI, we conclude.

II. OVERVIEW OF RULE 14A-8

Rule 14a-8 allows a shareholder, subject to certain limitations, to submit a proposal for inclusion in the corporate proxy material, which will later be voted on by fellow shareholders on the corporation's proxy card.[51] Shareholders did not start to take significant advantage of Rule 14a-8 until the 1960s and 1970s.[52] Since that time, the rule has been often used in two different settings: initiating corporate governance changes and raising social responsibility issues.[53]

[51] 17 C.F.R. § 240.14a-8 (2021).

[52] Kosmas Papadopoulos, *The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance (2000-2018)*, HARV. L. SCH. F. CORP. GOVERNANCE (Feb. 6 2019), https://corpgov.law.harvard.edu/2019/02/06/the-long-view-the-role-of-shareholder-proposals-in-shaping-u-s-corporate-governance-2000-2018/ [https://perma.cc/RH32-CFD2].

[53] Haan, *supra* note 29, at 272 ("The academic literature generally divides shareholder proposals into a corporate governance category and a social and environmental category.") *See generally* Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium:*

Governance proposals first appeared during the 1960s and 1970s, when certain individual investors initiated many shareholder proposals on issues such as the repeal of classified boards and the adoption of cumulative voting.[54] In the late 1980s, institutional investors began submitting more shareholder proposals "in response to the widespread adoption of poison pills, payments of 'greenmail,' and other acts by boards to entrench themselves in the wake of a wave of 'hostile' takeovers."[55] Later, in the 1990s, shareholders made a substantial number of proposals seeking governance changes, including proposals to declassify boards, remove poison pills, and curb executive pay.[56] In the new millennium, some highly-successfully shareholder proposal campaigns influenced the broad adoption of various corporate governance practices, such as requiring majority vote standards for uncontested director elections and criticizing companies' "say on pay" policies.[57] Rule 14a–8 also has been used to shine a light on a broad range of social and environmental issues. Most notable of these were anti-apartheid proposals seeking to terminate a corporation's business activities in South Africa;[58] proposals seeking to prohibit a corporation from participating in the Arab boycott of Israel;[59] proposals seeking corporations to agree to comply with codes of environmental

Shareholder Support, Board Response, and Market Reaction, 13 J. CORP. FIN. 368 (2007) (discussing developments in shareholder proposals).

54 Papadopoulos, *supra* note 52.

55 *Id.*

56 *Id.* Labor unions were very active on corporate governance issues. *See* Stewart J. Schwab & Randall S. Thomas, Realigning Corporate Governance: Shareholder Activism by Labor Unions, 96 Mich. L. Rev. 1018, 1019–20 (1998).

57 Papadopoulos, *supra* note 52.

58 *See* Philip A. Broyles, *The Impact of Shareholder Activism on Corporate Involvement in South Africa During the Reagan Era*, INT'L REV. MOD. SOCIOLOGY, Spring 1998, at 1, 6–7 (examining effects of shareholder activism the Rule 14a-8 proposals and other methods of engagement).

59 *See*, *e.g.*, Maya Mueller, *The Shareholder Proposal Rule: Cracker Barrel, Institutional Investors, and the 1998 Amendments*, 28 STETSON L. REV. 453, 509 n. 422 (1998).

standards;[60] and proposals seeking to terminate a corporation's manufacture or sale of armaments.[61] While there is a broad range of proposals, they regularly are seen as falling into two distinct groups—governance and environmental/social—with the distinctions being of scope as well as of substance.[62] What the SEC's data reflects is that, initially, governance proposals on average garner a much greater percentage of support from shareholders than do social or environmental proposals.[63] However, there are more substantial increases in shareholder support on second and third votes on social and environmental proposals, leading to a similar rate of proposals that receive at least twenty-five percent of shareholder support for governance, social, and environmental proposals after resubmissions.[64] In fact, social and environmental proposals that initially fail to receive majority support are more likely to be re-submitted than governance proposals of the same category.[65] Thus, the steady, persistent efforts of their proponents shined a bright light on a particular problem that needed fixing. Ultimately, the repeated efforts garnered more votes, and in all cases the

60 Proposing Release, *supra* note 46, at 66,479, 66,480 fig.4, 66,484 fig.7B (capturing annual number of ESG proposals each year from 2004 through 2018).

61 *See*, *e.g.*, Medical Comm. for Human Rights v. SEC, 432 F.2d 659 (D.C. Cir.1970) (leading decision on scope of Rule 14a-8 upholding proposal in response to public company's ongoing production of napalm for use in Vietnam War).

62 *See* Elad L. Roisman, Comm'r, Sec. & Exch. Comm'n, Keynote Speech at the Society for Corporate Governance National Conference (July 7, 2020), https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020 [https://perma.cc/38UX-QQGA] ("[C]orporate governance stands by itself and rarely has a direct relationship to environmental or social issues. Best practices in corporate governance are usually the result of many years of private ordering experimentation and experience. Also, governance reform focuses on the company itself and what is best for its optimal operation as well as its shareholders. The same is not necessarily true of 'E' or 'S.' Those matters tend to be more society, or stakeholder, focused.").

63 Proposing Release, *supra* note 46, at 65,501 fig.10.

64 *Id.*

65 *Id.* at 66,500.

proposal process shined a light on investor concerns.[66] Like so many worthwhile ideas, reflection over time, not instant acceptance, leads to enduring change. We can appreciate that Rule 14a-8 has been a means for introducing change that aligns governance practices not just with owner preferences, but also with social norms.

More important for the purposes of this Article is the role Rule 14a-8 plays in raising and broadening the consciousness of the company's board and executives. Boards and executive ranks are necessarily small relative to the body of stockholders. Moreover, the perspective of board members, though elected by the shareholders, is not a microcosm of the shareholders and even less likely to be a microcosm of society as a whole. We believe that well-crafted shareholder proposals that seek reports, procedures, or other actions on a matter already determined to be a proper subject of shareholder action under applicable state law invite, and likely cause, the directors and executives to reflect on an issue that may not otherwise have been considered. Thus, we see that Rule 14a-8 is a means by which concerned shareholders can gain some attention within the boardroom and executive suite on a matter and even introduce a fresh perspective for consideration. The fruits of this perspective cannot be fully measured ex ante; history now reflects that important changes have been brought about in significant measure by shareholder proposals, such as occurred with proposals focused on majority vote resolutions, South Africa, and now climate change.[67]

Despite these virtues, proposals are often viewed negatively by corporate management.[68] Evidence of this

[66] *Id.* at 66,501 fig.10.

[67] See *supra* notes 58–61.

[68] *See* John G. Matsusak, *Why Do Managers Fight Shareholder Proposals? Evidence from No-Action Letter Decisions*, HARV. L. SCH. F. CORP. GOVERNANCE (Jan 20, 2017), https://corpgov.law.harvard.edu/2017/01/20/why-do-managers-fight-shareholder-proposals-evidence-from-no-action-letter-decisions/ [https://perma.cc/J5EL-7W2N] ("Corporate managers, by and large, are skeptical of shareholder proposals."). Even some defense side law firms urge

hostility is variously manifested. One direct reaction are frequent refusals by a company to include proposals on their ballot. Their refusal triggers the SEC no-action letter process, whereby the SEC, after receiving materials from the company and the proponent, determines whether to issue a no-action letter.[69] In most cases, if the SEC issues a no-action letter, then the proposal is not included in the proxy statement.[70] Another reaction by companies is to include the proposal in management's proxy solicitation alongside a detailed and long explanation of why shareholders should reject the proposal. Often accompanying management's rejection recommendation is an attack on the proponent for being a gadfly, a member of a small number of shareholders who yearly account for a high percentage of shareholder proposals. The charge that gadflies are not genuinely interested in the company's affairs is also a justification for the board's refusal to permit shareholders' access to the company's proxy statement.[71] We examine gadflies below.

III. THE MECHANICS, LEGISLATIVE-REGULATORY HISTORY, AND COMMENTARY OF RULE 14A-8

In this Part, we provide an overview of the legislative history, regulatory and judicial developments, and the academic commentary for Rule 14a-8; in doing so, we find support for our vision of the Rule as a mechanism for creating a corporate public square. We note at the outset that our focus is on proposals that are not otherwise excludable by Rule 14a-

board action on shareholder proposals that receive majority support by the company's shareholders. *See* Andrew R. Brownstein and Igor Kirman, *Can A Board Say No When Shareholders Say Yes? Responding to Majority Vote Resolutions*, BUS. LAWYER, Nov. 2004, at 23, 75 (lawyers from Wachtell, Lipton, Rosen & Katz arguing that "[f]ollowing a majority vote in favor of a shareholder proposal, companies should include consideration of the matter at an upcoming board meeting.").

69 *See* Matsusaka et al., *supra* note 49, at 112–14.

70 *Id.* at 113.

71 Matsusaka et al., *supra* note 49, at 113 (listing statutory bases for excluding shareholder proposals).

8. The rule contains a variety of exclusions under which a company can exclude a proposal from its proxy materials.[72] Among the many exclusions are that a proposal is not a proper subject of shareholder action under state law,[73] a violation of law,[74] false or misleading statement,[75]seeks to redress of a personal claim or grievance[76] or relates to operations accounting for less than five percent of a company's assets or business.[77] Rule 14a-8(j) sets forth the steps management

[72] 17 C.F.R. § 240.14a-8 (2021).

[73] If, under the laws of the state in which the corporation is incorporated, the proposal is not a proper subject for action by shareholders, the corporation is not required to include the shareholder proposal. Whether a proposal is a proper subject for action by shareholders will depend on the applicable state law. A proposal that mandates certain action by the board of directors may not be a proper subject matter for shareholder action, while a proposal recommending or requesting such action may be a proper subject. 17 C.F.R. § 240.14a-8(i)(1).

[74] If the shareholder proposal would require the corporation to violate state or federal law or the law of a foreign jurisdiction to which the corporation is subject, the corporation need not include it. *Id.* § 240.14a-8(i)(2).

[75] If the shareholder proposal or supporting statement is false or misleading, the corporation does not have to include it. *Id.* § 240.14a-8(i)(3).

[76] If the shareholder proposal concerns the redress of a personal claim or grievance against the corporation or any other person, or is designed to result in a benefit to the shareholder or to further a personal interest that is not shared with the other shareholders at large, the corporation need not include it. *Id.* § 240.14a-8(i) (4).

[77] If the shareholder proposal relates to operations that account for less than five percent of the corporation's total assets and less than five percent of its net earnings and gross sales, and is not otherwise significantly related to the registrant's business, the corporation does not have to include it. *Id.* § 240.14a-8(i)(1). In adopting the five percent standard, the SEC stated that shareholder proposals must be included in the proxy statement, notwithstanding their failure to reach the five percent threshold, "if a significant relationship to the issuer's business is demonstrated on the face of the resolution or supporting statement." Proposed Amendments to Rule 14a-8 Under the Security Exchange Act of 1934 Relating to Proposals by Security Holders, Exchange Act Release No. 19,135, Investment Company Act Release No. 12,734, 47 Fed Reg. 47.420, 47,428 (proposed Oct. 14, 1982) (to be codified at 17 C.F.R. pt. 240). The meaning of "significantly related" is not limited to economic significance. 17 C.F.R. § 240.14a-8(i)(5)–(13) contain a number of other restrictions; The corporation need not include a

must follow to exclude a proposal from its proxy materials.[78] Duly qualified proposals thereafter appear in the company's proxy materials and, unless they are withdrawn, stockholders vote upon them.[79] As we find in Part V, proposals opposed by management face a most uncertain fate; but of interest is that even those that fail to garner majority approval thereafter do lead to firms modifying their policies or practices in the wake of such voting.[80] However, the company sometimes ignores proposals that garner majority approval.[81] Of significance is that the existence of a proposal often is the basis for negotiations whereby firm policies or practices are changed to obtain the withdrawal of a shareholder proposal.[82] Proposals thus can lead to very different results regardless of the vote by the shareholders.

shareholder proposal in its proxy statement if: (i) the proposal deals with a matter beyond the registrant's power to effectuate; (ii) the proposal deals with a matter relating to the conduct of ordinary business operations; (iii) the proposal relates to director election by seeking to include a person for election on management's proxy materials, seeking to remove a director from office, disqualify a present nominee or question the competence or qualities of a nominee or director; (iv) the proposal conflicts with a proposal to be submitted by the corporation at the same meeting; (v) the corporation has already substantially implemented the proposal; and (vi) the proposal is substantially duplicative of a proposal submitted to the corporation by another shareholder that will be included in the corporation's proxy material for the meeting.

78 17 C.F.R. § 240.14a-8(j); *see* Matsusaka et al., *supra* note 49, at 112–14.

79 *See* Matsusaka et al., *supra* note 49, at 112–14.

80 *See infra* note 203 and accompanying text.

81 *See infra* note 150.

82 *See* Willard T. Carleton, James M. Nelson & Michael S. Weisbach, *The Influence of Institutions on Corporate Governance through Private Negotiations: Evidence from TIAA-CREF*, 53 J. FIN. 1335, 1335–37 (1998).

A. Qualifying the Proposal

A proponent's eligibility to use Rule 14a-8 is the doorway to the virtual public square.[83] Prior to January 4, 2021,[84] to be eligible to submit a proposal, a shareholder was required to own at least $2,000 in market value, or 1%, of the company's securities entitled to vote on the proposal for at least one year prior to the date on which the proposal is submitted.[85] For resubmitted proposals, prior to January 4, 2021, the restrictions provided that the proposal can be excluded if the proposal: (1) deals with substantially the same subject matter as a prior proposal that was submitted within the previous five years; (2) is submitted for a meeting to be held within three years of its last submission; (3) and either (i) the proposal was submitted at only one meeting during the previous five years and received less than three percent of the votes, (ii) the proposal was submitted at two meetings during the previous five years and received less than six percent of votes at the time of its second submission, or (iii) the proposal was submitted at three or more meetings during the previous five years and received less than ten percent of votes at the time of its last submission.[86]

Of particular importance for this Article, in 2020, the SEC voted to raise significantly the standards for proponent

[83] To be clear, we do support well-calibrated ownership criteria to be eligible to use Rule 14a-8; as we develop, the rule springs from a provision of the Securities Exchange Act focused on the shareholder franchise so that it would be inappropriate to extend the right to non-shareholders. We do believe there should be an amount of ownership requirement, with that amount set with an eye toward not foreclosing proposals from a large sector of retail investors so that some insight from the mode of retail holdings in a large cohort of public firms would be useful in developing a minimum holding amount.

[84] Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, Exchange Act Release No. 89,964, 84 Fed Reg. 70,240 (Nov. 4, 2020) (to be codified at 17 C.F.R. pt. 240) (amending Rule 14a-8(b), effective January 4, 2021).

[85] 17 C.F.R. § 240.14a-8(b)(1) (2021) (amended by Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, 84 Fed Reg. at 70,240.

[86] *Id,* § 240.14a-8(i)(12).

stockownership and the criteria to be met to resubmit proposals.[87] The new rules provide that to be eligible to make proposals under Rule 14a–8, submitting proposals must hold at least $2,000 of the company's securities for at least 3 years, $15,000 of the company's securities for at least 2 years, or $25,000 of the company's securities for at least 1 year ("New Stockownership Restrictions").[88] Also, under the new rules, a company may exclude a proposal from its proxy materials for any meeting held within three years of the last time it was included if the proposal received less than 5% of the vote if proposed once within the preceding 5 years; less than 15% of the vote on its last submission to shareholders if proposed twice previously within the preceding 5 years; or less than 25% of the vote on its last submission to shareholders if proposed 3 times or more previously within the preceding 5 years ("New Resubmission Restrictions").[89]

In proposing these changes, the SEC staff considered the likely impact on the number of shareholder proposals.[90] On one hand, the New Stockownership Rules not unexpectedly would have different effects depending on the length of the proponent's ownership in the company—if all the proponents held their shares for at least three years, under the new rules no higher ownership is imposed so there would be no exclusionary impact.[91] On the other hand, if the SEC assumed that all proponents acquired their shares one year before the meeting and held them through the meeting date, so that the $25,000 threshold would apply, the increased dollar threshold "would result in the exclusion of 51 percent of the proponents (and 56 percent of the proposals that were submitted) to be considered at the shareholder meeting held in 2018."[92]

87 Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, 84 Fed Reg. at 70,240.

88 17 C.F.R. § 240.14a-8(b) (2021).

89 *Id.* § 240.14a-8(i)(12).

90 Proposing Release, *supra* note 46.

91 *Id.* at 66,497.

92 *Id.* The SEC staff apparently attempted to submit an additional report on the impact of the distribution of stockownership on the effect of the New Stockownership Rules on the likely level of stockholder

Moreover, the SEC opined that the disproportionate impact of the New Stockownership Rules would fall on individual proponents and on the number of corporate governance proposals submitted.[93] More generally, the SEC salved any unease arising from reducing the overall number of proponents and proposals by observing, "shareholders now have alternative ways, such as through social media, to communicate."[94]

submissions using data provided by Broadridge Financial Services Inc. However, this preliminary study appears to have been temporarily excluded from public release at the request of the SEC's chief economist. *See* Memorandum from S.P. Kothari, Chief Economist, Sec. & Exch. Comm'n, to File S7-23-19, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (August 14, 2020), https://www.sec.gov/comments/s7-23-19/s72319-7645492-222330.pdf [https://perma.cc/B3GA-87MY] ("[I]t was my view that the preliminary draft analysis was not relevant to the economic question central to the proposal and that the data had limitations that reduced its potential value to analyzing the proposal.").

93 Proposing Release, *supra* note 46, at 66,499. The disproportionate impact on individuals would arise because "the average holdings of retail investors are typically lower than the average holdings of institutional investors." *Id*. The larger effect on corporate governance proposals stems from the fact that "86 percent of the proposals submitted by individual investors are governance proposals, whereas 47 percent of the proposals submitted by institutional investors are governance proposals." *Id*. (citation omitted).

94 *Id.* at 66,462. There is a growing increase in engagement by financial institutions with the management of portfolio companies. *See* Jeffrey D. Karpf, Helena K. Grannis & Gaia Goffe, *Shareholder Engagement Trends and Considerations*, CLEARY, GOTTLIEB, STEEN & HAMILTON (Jan. 10, 2020), https://www.clearygottlieb.com/news-and-insights/publication-listing/shareholder-engagement-trends-and-considerations [https://perma.cc/A83J-XVTJ]. *But see* Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?*, 2013 U. ILL. L. REV. 821, 842-43 (2013) (reasoning there is cause for skepticism of shareholder engagement not involving blockholders); Amy Borrus, Exec. Dir., Council of Institutional Invs. et al., Comment Letter on Proposed Rule: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (July 29, 2020), https://www.sec.gov/comments/s7-23-19/s72319-7502063-221908.pdf [https://perma.cc/G7VE-VMU7] (observing engagement by some blockholders with portfolio companies is not as encompassing as occurs through an inclusive shareholder proposal rule).

The Proposing Release also contains some estimates of the impact of the New Resubmission Rules were they in effect from 2011 to 2018: "[W]e estimate that the proposed amendments to the resubmission thresholds would result in an additional 212 resubmitted proposals being excludable (15 percent of the total resubmitted proposals in this timeframe)."[95] The SEC further observed that these cutbacks are likely to fall particularly heavily on proposals raising environmental and social issues.[96]

In light of the SEC's estimates of the large negative effects of the New Stockownership Rules and the New Resubmission Rules on the likely future use of the Rule, we believe it is important to ask if the new rules are justified as consistent with the important functions and goals served by the Rule. We turn next to a detailed exploration of those goals and policy objectives.

B. Legislative History, Regulatory Evolution and Judicial Development of Rule 14a-8

The SEC created Rule 14a-8 pursuant to its rule making authority set forth in section 14 of the Securities Exchange Act of 1934,[97] making it important to begin by examining the purpose and history of that statute. The Exchange Act has two overarching purposes: protecting investors engaged in securities transactions and assuring public confidence in the integrity of the securities markets.[98] Central to achieving these objectives, the Act created the SEC and, in section 14,

95 Proposing Release, *supra* note 46, at 66,500.

96 *Id.* at 66,500. One reason for this particularly adverse effect is that proposals on environmental and social issues tend to receive lower levels of voting support than do governance proposals. *Id.* A second reason is that these proposals tend to be resubmitted more often than governance proposals. *Id.* at 66,501.

97 Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78n (2018).

98 S. REP. NO. 100-265, at 46 (1987) ("The core of this 'truth in securities' law is a requirement that investors receive full and fair disclosure relating to the securities they purchase."); S. REP. NO. 73-47, at 1 (1933) (statement of Franklin D. Roosevelt) ("[O]ur broad purpose [is to] . . . protect[] investors and depositors.").

authorized it, among other tasks, to prescribe rules and regulations with regard to proxy solicitation as it deems "necessary or appropriate in the public interest or for the protection of investors."[99]

The legislative history of section 14(a), however, is very limited, and what does exist emphasizes the importance Congress placed on assuring that stockholders of public companies were adequately informed when exercising their voting franchise through the execution of a proxy. For example, a report by the Senate Committee on Banking and Currency in June 1934 (the "1934 Senate Report") observes that the objective of proxy regulation is to provide shareholders with greater information to assist them in the voting process—information about matters such as the financial condition of the company, the major questions of policy to be decided at shareholders' meetings, and the matters for which voting authority is sought through the proxy.[100] The report further states:

> In order that the stockholder may have adequate knowledge as to the manner in which his interests are being served, it is essential that he be enlightened not only as to the financial condition of the corporation, but also as to the major questions of policy, which are decided at stockholders' meetings. Too often proxies are solicited without explanation to the stockholder of the real nature of the matter for which authority to cast his vote is sought.[101]

The other key component of the Exchange Act's legislative history is the report prepared by the Committee on Interstate and Foreign Commerce in August 1934 (the "1934 House Report") that details many unfair practices in the proxy process.[102] The report states, "Fair corporate suffrage is an important right that should attach to every equity security

99 15 U.S.C. § 78n.

100 S. REP. NO. 73-1455, at 74–77 (1934).

101 *Id.* at 74.

102 H.R. REP. NO. 73-1383, at 13 (1934).

bought on a public exchange."[103] Then the report continues to describe the misuse of proxy rules by management:

> Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies. Insiders having little or no substantial interest in the properties they manage have often retained their control without an adequate disclosure of their interest and without an adequate explanation of the management policies they intend to pursue. Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights. Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according to shareholders fair suffrage. For this reason the proposed bill gives the . . . Commission power to control the conditions under which proxies may be solicited with a view to preventing the recurrence of abuses which have frustrated the free exercise of the voting rights of stockholders.[104]

The above quotes from section 14's legislative history are viewed by commentators as amenable to two very different interpretations: "(1) [I]t may suggest a role for shareholders as decision makers with respect to corporate policy, or (2) it may simply direct that shareholders receive information about corporate policies and objectives in addition to operating results."[105] We believe this legislative history reflects that Congress was most likely focused on providing disclosure to voting stockholders for the purpose of enhancing the quality of their voting. Nonetheless, the quotes reflect a

103 *Id.*

104 *Id.* at 13–14.

105 Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation*, 46 VAND. L. REV. 1129, 1179 (1993).

strong belief that proxy voting enables owner concerns to be reflected in voting rather than just the interest of managers, a thesis advanced in this Article. The 1934 House Report's concern that management's interest is less than that of the firm's owners suggests the use of disclosures through the proxy mechanism as an antidote for any misalignment of interests; our view is the dialogue fostered in the virtual public square by Rule 14a-8 can breed not only transparency of management's vision but better alignment of management and shareholder interests, one of the initial purposes of the proxy rule. Thus, as we will see, the SEC reflects this broader view, albeit in a disclosure-oriented context.

The SEC's views on the rationale for the rule have evolved over time. When the SEC issued the shareholder proposal rule in 1942, it was numbered Rule X-14A-7.[106] It required that stockholders making proposals for action which management opposed must be allowed to include not more than one hundred words to set forth their position in the proxy statement.[107] Since the inaugural shareholder proposal rule

106 General Rules and Regulations, Securities Act of 1934, 7 Fed. Reg. 10,655, 10,656 (1942).

107 *Id.* The full text of Rule x-14A-7 provided:

> In the event that a qualified security holder of the issuer has given the management reasonable notice that such security holder intends to present for action at a meeting of security holders of the issuer a proposal which is a proper subject for action by the security holders, the management shall set forth the proposal and provide means by which security holders can make a specification as provided in § 240.14a-2 [Rule X-14A-2]. Further, if the management opposes such proposal, it shall, upon the request of such security holder, include in its soliciting material the name and address of such security holder and a statement of such security holder setting forth the reasons advanced by him in support of such proposal: *Provided, however,* That a statement of reasons in support of a proposal shall not be longer than 100 words and *Provided further,* That such security holder and not the management shall be responsible for such statement. For the purposes of this rule notice given more than thirty days in advance of a day corresponding to the date on which proxy soliciting

predated the Administrative Procedures Act and its call for rigor in connection with promulgating rules,[108] the SEC did not explain the background, purpose, or operation of this shareholder proposal rule in its 1942 release. An intuitive explanation for the rule is that of disclosure; a company seeking proxies to be voted on any matter that may arise at the upcoming meeting commits a glaring omission in failing to disclose a matter to be voted on that it is aware will be submitted by a shareholder. Given the rhetoric in the preceding quotes from Senate and House reports regarding the importance of managers being accountable to shareholders in their management of the firm, especially the characterization of disclosure as protection of the shareholder voting franchise, the SEC naturally linked the need for disclosure of a proposal to be voted on at an upcoming meeting to management's request from shareholders for a proxy to vote on any matter at that meeting.

Subsequent SEC and judicial developments similarly supported a broad mission for Rule 14a-8. In 1976, the SEC proposed amendments to clarify several requirements applicable to proponents.[109] The 1976 release stated, "Section 14(a) of the Exchange Act . . . . was enacted to promote corporate suffrage and to limit those situations in which public corporations are controlled by a small number of

> material was released to security holders in connection with the last annual meeting of security holders shall, prima facie, be deemed to be reasonable notice.

Id.

108 The Administrative Procedures Act was signed into law in 1946. Administrative Procedures Act, Pub. L. No. 79-404, 60 Stat. 237 (codified as amended in scattered sections of 5 U.S.C.).

109 Proposals by Security Holders, Exchange Act Release No. 12,598, Investment Company Act Release No. 9343, 41 Fed. Reg. 29,982, 29,984 (proposed July 20, 1976) (to be codified at 17 C.F.R. pt. 240). The amendments were officially adopted on December 3, 1976. Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, Investment Company Act Release No. 9539, 41 Fed. Reg. 52,994, 52,994 (Dec. 3, 1976) (to be codified at 17 C.F.R. pt. 240).

persons."[110] The release further quoted from what would become a highly influential decision of the D.C. Circuit, *Medical Committee for Human Rights v. SEC*, stating that "the overriding purpose of Section 14(a) 'is to assure to corporate shareholders the ability to exercise their right—some would say their duty—to control the important decisions which affect them in their capacity as stockholders and owners of the corporation.'"[111]

The scope of the SEC's authority under section 14(a), however, was later qualified in *Business Roundtable v. SEC*, a case regarding the SEC's reliance on the provision to impose limits on the listing of dual-class voting structures.[112] The D.C. Circuit upheld the plaintiff's claim the SEC lacked the statutory authority under section 14(a) to address dual-class voting shares as a way of promoting fair corporate suffrage.[113] According to the court, Congress authorized the SEC to regulate the proxy process primarily to ensure that shareholders could exercise their votes on an informed basis.[114] Although the court acknowledged the SEC's authorization to enact regulations to promote "fair corporate suffrage," the court nonetheless concluded that Congress intended the regulations to bear "almost exclusively on disclosure" as the means of promoting fair corporate suffrage.[115] Because *Business Roundtable* addresses only the authority of the SEC to proscribe dual-class voting, it did not change the state-law based right of shareholders to submit proposals for consideration by the shareholders at a forthcoming meeting or for that matter whether a shareholder

110 Proposals by Security Holders, 41 Fed. Reg. at 29,984 (citing S. REP. NO. 73-1455, at 12 (1934) and H.R. REP. NO. 73-1383, at 13–14 (1934)).

111 *Id.* (quoting Med. Cmt. For Human Rts. v. SEC, 432 F.2d 659, 680–81 (D.C. Cir. 1970), *vacated*, 404 U.S. 403 (1972)).

112 Bus. Roundtable v. SEC, 905 F.2d 406 (D.C. Cir. 1990).

113 *Id.* at 408.

114 *Id.* at 410.

115 *Id.* ("Proxy solicitations are, after all, only communications with potential absentee voters. The goal of federal proxy regulation was to improve those communications and thereby to enable proxy voters to control the corporation as effectively as they might have by attending a shareholder meeting.").

proposal involving dual-class voting is a proper subject under Rule 14a-8. This state-based right can be understood to imply that a proposal must be included on the firm's proxy statement. Thus, *Business Roundtable* posed little threat to the validity of Rule 14a-8. The SEC has continued to justify its rulemaking as, at least partially, driven by the goal of promoting fair corporate suffrage. For instance, in 1992, the SEC proposed amendments to Rule 14a-8 to facilitate shareholder communication and enhance informed proxy voting, and to reduce the cost of compliance with the proxy rules.[116] In explaining its proposal, the SEC stated, "the Commission has focused on the role of its proxy and disclosure rules in impeding shareholder communication and participation in the corporate governance process, in order to further Congress' intent to assure fair, informed and effective shareholder suffrage."[117]

However, in 1997, the SEC, recasting Rule 14a-8 in a question & answer format, emphasized shareholder communication rather than fair suffrage as the rule's guiding purpose.

> Rule 14a8 provides, and then regulates, *a channel of communication among, and between shareholders and companies*. It is not the only avenue for communication, since a shareholder may undertake an independent proxy solicitation or may seek informal discussions with management or other shareholders outside the proxy process. Rule 14a-8 is popular because it provides an opportunity for any shareholder owning a relatively small amount of the company's shares to have his or her own proposal placed alongside management's proposals in the

116 Regulations of Communications Among Securityholders, Exchange Act Release No. 30,849, Investment Company Act Release No. 18,803, 51 SEC Docket 1208, 1224 (proposed June 23, 1992) (to be codified at 17 C.F.R. pt. 240).

117 *Id.* at 1226.

> company's proxy materials for presentation to a vote at an annual or special meeting of shareholders.[118]

In other words, the SEC justified the shareholder proposal rule as a means of facilitating small shareholder communication amongst themselves and with management.

The SEC continued to cite "fair corporate suffrage" as a goal of the rule in its 2007 proposals concerning bylaw proposals for shareholder nominations of directors and electronic shareholder forums.[119] The SEC observed that

> Congress intended that Section 14(a) give the Commission "the power to control the conditions under which proxies may be solicited," and that this power be exercised "as necessary or appropriate in the public interest or for the protection of investors." Because the Commission's authority under Section 14(a) encompasses both disclosure and proxy mechanics, the proxy rules have long governed not only the information required to be disclosed to ensure that shareholders receive full disclosure of all information that is material to the exercise of their voting rights under state law and the corporation's charter, but also the procedure for soliciting proxies.[120]

More recently, in 2019, when the SEC proposed amendments to proponents' eligibility requirements and

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118 Amendments to Rules on Shareholder Proposals, 62 Fed. Reg. 50,582 (proposed Sept. 18, 1997) (to be codified at 17 C.F.R. pt. 240) (emphasis added). The SEC finally modified the rule into a question & answer format in 1998. Amendments to Rules on Shareholder Proposals, 63 Fed. Reg. 29,106 (May 28, 1998) (to be codified at 17 C.F.R. pt. 240).

119 Shareholder Proposals, 72 Fed. Reg. 43,466 (proposed Aug. 3, 2007) (to be codified at 17 C.F.R. pt. 240).

120 *Id.* (footnotes and citations omitted) (first quoting H.R. REP. NO. 73-1383, at 14 (1934); and then quoting 15 U.S.C. § 78n(a) (2006)) The SEC's 2007 release cited comments from Professor John C. Coffee Jr., who said that "Section 14(a) 'does not focus exclusively on disclosure; rather, it contemplates SEC rules regulating procedure in order to grant shareholders a "fair" right of corporate suffrage.'" *Id.* at 43,467 n.12 (quoting John C. Coffee Jr., *Corporate Securities; Federalism and the SEC's Proxy Proposals*, 231 N.Y.L.J. 5 (March 18, 2004)).

proposal number,[121] the SEC emphasized that the proxy solicitation process has become the forum within which shareholder suffrage occurs:

> Under state corporate law, shareholders have the right to vote their shares to elect directors and to approve or reject major corporate transactions at shareholder meetings, and shareholders may appoint proxies to vote on their behalf at such meetings. Because most shareholders do not attend public company shareholder meetings in person and, instead, vote their shares by the use of proxies that are solicited before the shareholder meeting takes place, *the proxy solicitation process rather than the shareholder meeting itself has become the "forum for shareholder suffrage."*[122]

Our view for a SEC-created town square rests on the reality that the proxy solicitation has effectively replaced the in-person exchanges that once occurred among shareholders.[123] Moreover, the SEC's view in the above quote is consistent with the broad nature of our corporate public square idea: The shareholder proposal rule facilitates dialogue among shareholders of all sizes as well as greater awareness within the managerial and investor communities of an ever evolving range of issues, including the intensity of beliefs on those issues. As a communication device, it distributes information among shareholders that enriches their understanding of the corporation's operations. As such, proposals thereby enrich the environment in which shareholders exercise their right of suffrage.

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121 Proposing Release, *supra* note 46.

122 *Id.* at 66,458–59 (emphasis added) (footnotes and citation omitted) (quoting Proposed Amendments to Rule 14a-8 Under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders 47 Fed. Reg. 47,420, 47,421 (proposed Oct. 26, 1982) (to be codified at 17 C.F.R. pt. 240); Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982, 42,984 (proposed July 10, 2010) (to be codified at 17 C.F.R. pts. 240, 270, 274, 275); and Roosevelt v. E. I. Du Pont de Nemours & Co., 958 F.2d 416, 422 (D.C. Cir. 1992)).

123 *See id.*

C. Analysis of the Legislative History and Policy Justifications for Rule 14a-8

As discussed below, commentators differ over whether Congress' objectives in enacting section 14(a) were limited to furthering disclosure or also included promoting fair corporate suffrage.[124] Proponents of the rule tend to cite to the House Report, whereas detractors favor the Senate Report as summarized in the next section.

1. Legislative History Debate

Relying on the limited legislative materials examined above,[125] several commentators argue the rule is limited to increasing disclosure in connection with the proxy process or beyond,[126] while others claim that the rule authorizes the SEC to address questions of substantive fairness in the voting

[124] *See generally* Susan W. Liebeler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425 (1984) (arguing disclosure only); George W. Dent, Jr., *SEC Rule 14a-8: A Study in Regulatory Failure*, 30 N.Y. L. SCH. L. REV. 1 (1985) (arguing disclosure only); Patrick J. Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97 (1988) (discussing different views of the rule); Milton V. Freeman, *An Estimate of the Practical Consequences of the Stockholder's Proposal Rule*, 34 U. DET. L.J. 549 (1957) (arguing for promotion of corporate democracy); David C. Bayne, *The Basic Rationale of Proper Subject*, 34 U. DET. L.J. 575 (1957) (arguing for promotion of corporate democracy); Frank D. Emerson & Franklin C. Latcham, *The SEC Proxy Proposal Rule: The Corporate Gadfly*, 19 U. CHI. L. REV. 807 (1952) (arguing for promotion of corporate democracy). At least one scholar has concluded that, "[t]he statutory language and legislative history are ambiguous as to whether the SEC is authorized to enact rules with a substantive effect on corporate governance or simply to implement disclosure requirements." Fisch, *supra* note 105, at 1179.

[125] *See supra* Section III.B.

[126] *See e.g.*, Stephen M. Bainbridge, *Redirecting State Takeover Laws at Proxy Contests*, 1992 Wis. L. Rev. 1071, 1118 (1992) ("A federal right to full disclosure and fair procedures does not equal a federal right to wage proxy contests. Rather, the legislative history reflects a congressional desire to do nothing more than enable shareholders to make effective use of whatever voting rights they possess by virtue of state law.").

process to promote "corporate democracy."[127] The "disclosure only" oriented commentators argue that the shareholder proposal rule itself developed as an adjunct to the SEC's disclosure requirements,[128] mainly basing their arguments on the misuse of proxy rules described in 1934 Senate Report.

For example, Professor Bainbridge supports the disclosure-oriented justification, claiming that Congress did not intend to regulate substantive issues such as when shareholders are entitled to vote; instead it sought to ensure shareholders receive full disclosure and procedural fairness when state law gives them an opportunity to vote.[129] He argues that Congress did not intend the SEC, in regulating the solicitation of proxies, to affect the substantive voting rights of shareholders.[130] In his view, although the 1934 House Report makes reference to fair corporate suffrage, nothing in it concerned substantive aspects of shareholders' voting rights; the sole focus is on providing full disclosure and fair procedures.[131] Bainbridge believes that when Congress spoke of fair corporate suffrage, it meant that shareholders should be allowed to make an independent, informed decision when asked to exercise the franchise, leaving it to the states to determine when shareholders are entitled to exercise the franchise as well as other substantive corporate governance questions.[132] He concludes that the legislative history reflects a congressional desire to do nothing more than enable

127 *See e.g.*, Ryan, *supra* note 124, at 103, 140 (discussing different views of the rule)*;* Schwartz & Weiss, *supra* note 24, at 638–39 ("[T]he rule is designed to provide shareholders an opportunity to express their point of view on issues affecting the corporation for the purpose either of holding management accountable or of influencing management's actions with respect to those issues).

128 *See generally* Note, *Liberalizing SEC Rule 14a-8 Through the Use of Advisory Proposals*, 80 Yale L.J. 845, 847–848 (1971); Fisch*, supra* note 105, at 1179.

129 Stephen M. Bainbridge, *supra* note 126, at 1112.

130 *Id.* at 1116.

131 *Id.* at 1111–12.

132 *Id.*at 1116.

shareholders to make effective use of whatever voting rights they possess by virtue of state law.[133]

In contrast to this "disclosure only" view are commentators who emphasize the 1934 House Report's statement that, "Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange."[134] This group of commentators argue the House Committee on Interstate and Foreign Commerce understood the importance of shareholders' role in corporate governance.[135] The 1934 House Report indicates that proxy regulation demanded a new system of "fair corporate suffrage," which would prevent improper self-perpetuation by management and limit abuse by those in control.[136] Thus, Professor Ryan concludes from the legislative history that the SEC's proxy regulation power was designed to protect the shareholder voice in control of the corporation,[137] making it essential to the successful functioning of corporate democracy.[138] In this view, "[t]he shareholder proposal rule gives shareholders what amounts to a right to weigh in and influence management."[139]

In a highly significant article, Professors Schwartz and Weiss develop a broad interpretation of Rule 14a-8, arguing that if the SEC only intended to increase disclosure, it could accomplish that goal by a more simple disclosure requirement to the company.[140] "The more detailed requirements of the shareholder proposal rule," they state, "reflect an effort on the part of the SEC to act in what it deems 'the public interest.'"[141] We endorse this view and find it consistent with our view of the Rule as creating a corporate public square. Schwartz and

133 *Id.* at 1117.

134 Ryan, *supra* note 127, at 139 (quoting H.R. REP. NO. 73-1383, at 13-14 (1934)).

135 *Id.* at 140 (describing shareholder participation in the governance of the company in the legislative record).

136 *Id.* at 139 (quoting H.R. REP. NO. 73-1383, at 13-14 (1934)).

137 *Id.* at 140.

138 *Id.* at 97.

139 Haan, *supra* note 29, at 291 (emphasis omitted).

140 Schwartz & Weiss, *supra* note 24, at 638.

141 *Id.*

Weiss further reason that "the shareholder proposal rule provides a relatively unique opportunity to question management" and improve management's action by compelling it to respond more meaningfully to shareholder questions and to publish the question and response.[142]

We believe that the corporate public square is in the public interest and will benefit all of the corporation's stakeholders as well as the public because it will foster greater communication amongst them and corporate management.

2. Theoretical and Policy Arguments

In addition to the legislative history debate, there are a number of policy and theoretical arguments to consider.[143] From a theoretical perspective, shareholders have voting rights for a number of good reasons: the shareholder vote can play a monitoring role;[144] it can provide a "superior information aggregation device for private information held by shareholders when there is uncertainty about the correct decision;"[145] and it provides "an efficient mechanism for aggregating heterogeneous preferences when the decision differentially affects shareholders."[146] Under this view, shareholders should vote on low-dollar immediate value issues, such as Rule 14-8 shareholder proposals, where the subject may have an effect on the long-term value of the

142 *Id.* at 641; *see also* Freeman. *supra* note 124, at 551 ("[M]anagement must prepare and circulate a formal justification of its own position in opposition to the shareholder"). Critics have questioned whether shareholders are really ever asking questions seeking an answer. *See* Dent Jr., *supra* note 124, at 17 ("[T]he proponent is rarely seeking an answer to a question.").

143 For an extensive review of the academic literature on shareholder proposals, see Haan, *supra* note 29, at 288 n.101.

144 Edelman et al., *supra* note 5, at 1378. The monitoring function of shareholder voting is limited to issues that affect the stock price immediately or in the long run, where the board is conflicted or likely to be captured, and the benefits of voting exceed its costs. This rationale will not apply to issues with little impact on the long-run value of the company. *Id.* at 1380.

145 *Id.* at 1378.

146 *Id.*

firm.[147] Because empirical evidence on whether shareholder votes on Rule 14a-8 proposals enhance long-run value is mixed,[148] we do not rely upon the monitoring rationale as a theoretical justification for the Rule.

However, the preference aggregation justification for the vote supports Rule 14a-8 because "a shareholder vote acts as a measure of the intensity of shareholders' interests, more accurately conveying to the board the concerns and beliefs of the shareholders."[149] Even though shareholder proposals are often technically advisory, boards often implement proposals that garner a majority of shareholder votes.[150] In any case, in considering future actions, the board will be in a better position to balance the interests of the firm's stakeholders so that management's decision-making may be improved.[151]

Others also credit Rule 14a-8 with providing valuable information. Professor Freeman believes the rule provides shareholders an opportunity to express their point of view on issues that impact the corporation for the purpose either of holding management accountable or of influencing management's actions with respect to those issues.[152] Similarly, Professor Ryan points out that the rule permits the expression of shareholder opinions about corporate affairs that differ from management's views, and that it serves to

147 *Id.* at 1421.

148 *See* He et al., *supra* note 48, at 1.

149 Thomas & Edelman, *supra* note 23.

150 Nickolay Gantchev & Mariassunta Giannetti, *The Costs and Benefits of Shareholder Democracy: Gadflies and Low-Cost Activism*, *34 REV. FIN. STUD. 5629,* 5632 (2020). However, there are still proposals that receive a majority of shareholder votes that are not then implemented by the company. *See* Yonca Ertimu, Fabrizio Ferri & Stephen R. Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 54 (2010) (finding that, among S&P 1500 firms in 2004, forty percent of majority-vote proposals were implemented).

151 *See* Thomas & Edelman, *supra* note 23; Ryan, *supra* note 124, at 112.

152 Freeman, *supra* note 124, at 556.

engage the corporate players in a dialogue about broader corporate, social and economic concerns.[153]

Another benefit Rule 14a-8 accords is it provides the individual shareholder the right to demand and receive from management a public justification of its action.[154] Shareholder proposals "elicit[] a reasonably full exposition of management's point of view concerning the issues raised by the shareholder proponents."[155] As Professor Ryan notes, "[u]nlike other sources of information available to management, such as stock market performance, shareholder proposals are infrequent and harder to overlook or misinterpret."[156] He also reasons, "a shareholder proposal, and management's response to it, may force management to articulate its reasons for pursuing a particular policy."[157] This may improve managerial decision-making by "facilitating information gathering, analysis, and dissemination."[158]

As supporters of Rule 14a-8, Professors Schwartz and Weiss think that Rule 14a-8 is justified by its constructive impact on corporate behavior.[159] They argue that "[i]n numerous instances, corporations have taken actions that were either tied directly to or seemingly stimulated by shareholder proposals."[160] They also claim that Rule 14a-8, when compared with the "Wall Street Rule" (i.e., if you disagree with management, you should sell your stock), provides the interested investor with an opportunity to voice its concerns while keeping its stock.[161]

153 Ryan, *supra* note 124, at 99, 181.

154 Freeman, *supra* note 124, at 551.

155 Schwartz & Weiss, *supra* note 24, at 641.

156 Ryan, *supra* note 124, at 112.

157 *Id.*

158 Haan, *supra* note 29, at 292.

159 Schwartz & Weiss, *supra* note 24, at 642.

160 *Id.* at 642–43.

161 *Id.* at 642. Professor Liebeler notes that "[t]o the extent that stockholders attempt to use Rule 14a-8 instead of selling their shares, the market for corporate control works less effectively". Liebeler, *supra* note 124, at 448.

The legislative history and academic commentary about Rule 14a-8 suggest that its purpose is far bigger than just ensuring fair voting. We believe that Rule 14a-8, among other things, offers a mechanism for raising issues to be considered within the firm's boardroom and executive suite that otherwise may not be focused upon. The shareholder proposal rule thereby enriches the information environment in which management operates and by which the board oversees management's stewardship. The latter is an especially important contribution in an era in which ESG is enjoying such an important role among investors.[162]

In the next Part, we provide an overview of the empirical literature on how Rule 14a-8 has been used in recent years.

IV. INSIGHTS FROM EMPIRCAL STUDIES OF RULE 14A-8

Not surprisingly, experience under Rule 14a-8 has been extensively studied.[163] Indeed, it is a natural target for empirical investigation as there is a diverse cast of proponents and firms targeted by proposals, a broad range of subjects covered by proposals that are nonetheless amenable to classification in discrete but broad categories, and an equally observable range of outcomes for proposals.[164] Resolution proponents typically are individuals, labor pension funds, or financial institutions.[165] A subset within individual proponents are so-called gadflies, an important group as they regularly lodge a disproportionate percentage of all proposals.[166] A recent study by Gantchev and Giannetti of shareholder proposals raised between 2003 and 2014 found

[162] For discussion, *see supra* note 28 and accompanying text.

[163] For a recent survey article of the empirical literature, *see* Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. CORP. FIN. 405 (2017).

[164] *See generally* Luc Renneboog & Peter G. Szilagyi, *The Role of Shareholder Proposals in Corporate Governance*, 17 J. CORP. FIN. 167 (2011).

[165] *Id.* at 170–171.

[166] Gantchev & Giannetti, *supra* note 150, at 5630.

three gadflies initiated nearly half of all individual sponsored proposals.[167] Among the institutional category, the same study found public pension funds enjoy greater support for their proposals, on average, though they bring forward fewer proposals than labor pension funds.[168] Not surprisingly, investment companies do not resort to Rule 14a-8 due to potential conflicts of interests.[169] Larger corporations are subject to a disproportionate share of all shareholder proposals.[170] Among the outcomes observed are the withdrawal of a proposal, the company seeking an SEC no-action letter, the grant or denial of such a letter, or an actual shareholder vote on the proposal.[171]

How has the Rule been used in the past and by whom? Several empirical studies have shown that the shareholder proposal rule has played a positive role in corporate governance reform. One recent study by Kosmas Papadopoulos of Institutional Shareholder Services (ISS) shows that shareholder proposals have spurred the adoption of a variety of governance best practices over the past three decades.[172] Shareholder proposal campaigns enabled corporate practices such as annual director elections, majority vote rules for director elections, shareholder approval for poison pills, and proxy access bylaws to become common practice.[173] In contrast, approximately twenty-five percent of shareholder proposals relate to environmental and social issues, for which shareholder support, although growing rapidly, nonetheless rarely exceeds fifty percent.[174] There is

167 *Id.* at 5637 tbl.1.

168 *Id.*

169 *Id.* at 11.

170 *Id.* at 5640 tbl.2 (finding statistically significant correlation between market capitalization and probability of being targeted by shareholder proposals).

171 Randall S. Thomas and Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1045 (1999).

172 Papadopoulos, *supra* note 52.

173 *Id.*

174 He et al., *supra* note 48, at 1.

mixed evidence on the question of whether these environmental and social proposals have led to changes of corporate practices or firm value.[175]

One prominent recent study of shareholder proposal proponents and their success is by Professors Renneboog and Szilagyi. They analyzed 2,436 proposals submitted between 1996 and 2005.[176] Among other things, they found that:

i. union pension funds were the most prolific with 810 submissions, including 506 between 2003 and 2005;[177]
ii. public pension funds submitted 116 proposals;
iii. investment funds submitted 39 proposals;
iv. coordinated investor groups such as the Investor Rights Association of America submitted 170 proposals;
v. socially responsible and religious investors submitted 112 proposals; and
vi. the overwhelming majority of the remaining 1189 proposals were submitted by individuals, who dominated the proxy process almost entirely until the mid-1980s.[178]

The most prominent individual gadfly investors have been active for many years and include Evelyn Y. Davis and the Chevedden, Rossi, and Gilbert families, who together submitted 516 of the 2,436 studied proposals.[179]

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175 *Id.* at 1 n.1.

176 Renneboog & Szilagyi, *supra* note 164, at 170.

177 A concern with labor fund proposals is evidence they use the shareholder proposal rule strategically to garner benefits at the negotiating table, launching more proposals during period of contract renewal, and dropping the proposals after obtaining benefits at the bargaining table. John G. Matsusaka, Oguzhan, Ozbas & Irene Yi, *Opportunistic Proposals by Union Shareholders*, 32 REV. FIN. STUDS. 3215, 3215–16.

178 Renneboog & Szilagyi, *supra* note 164, at 170–71.

179 *Id.* at 171. There are several other papers that document the proponent types for shareholder proposals. *See, e.g.*, Matsusaka et al., *supra* note 179; Gantchev & Giannetti, *supra* note 150, 5637 tbl.1. For example, John G. Matsusaka, Oguzhan Ozbas, and Irene Yi analyze shareholder proposals received by Standard & Poor (S&P) 1500 index companies during the period 1997-2013. Matsusaka et al., *supra* note 177, at 3224. They categorize proponent types and number of their proposals and find that individuals and union pension funds are the most frequent proponents, with

Professors Renneboog and Szilagyi further show that takeover-related proposals performed well irrespective of the proposal's sponsor.[180] Otherwise, public pension funds and investment funds were the most successful in building voting coalitions, with an average 44.1% and 42.6% of the votes, respectively.[181] Union pension funds won a lower share of the votes at 35.6%, which may reflect shareholder concerns over their political or social agendas, but is also consistent with the greater diversity of their proposal objectives.[182] The percentage votes achieved by coordinated investor groups and socially responsible and religious investors were 29.7% and 20.4%, respectively.[183] Finally, individual activists attracted an average 33.1% of votes cast. However, several gadfly investors popular in the business media were very successful in gathering voting support, with the Chevedden and Rossi families achieving particularly strong voting outcomes.[184]

Especially helpful in evaluating not just Rule 14a-8, and supportive of our suggestion of orienting the Rule toward nurturing a corporate public square, is the recent study by Gantchev and Giannetti that used data on 4,878 shareholder proposals between 2003 and 2014 for all firms in the Standard & Poor's (S&P) 1500 index.[185] The issue that concerns them is whether harmful proposals can, despite their effect, receive majority support and then destroy shareholder value if they are subsequently implemented. In particular, they investigate whether gadflies that submit many one-size-fits-all shareholder proposals every year are thereby adversely affecting targeted firms.[186]

They find that firms targeted by individuals do not differ in any meaningful way from firms targeted by institutions—

public pension funds, religious groups, and socially responsible investors also frequent proponents. *Id.*

180 Renneboog & Szilagyi, *supra* note 176, at 172.

181 *Id.*

182 *Id.*

183 *Id.*

184 *Id.*

185 Gantchev & Giannetti, *supra* note 150.

186 *Id.* at 5630.

both target firms that are all relatively large and have reported low profitability.[187] About twenty percent of the proposals voted on garnered a majority or greater vote, with individuals the most frequent proponents accounting for over thirty-five percent of all proposals voted on at meetings.[188] Proposals submitted by individuals were more likely to be approved than those submitted by institutions.[189]

The study's authors document that a small group of individual gadfly investors submit a disproportionate number of proposals. These individual sponsors, such as John Chevedden and William Steiner, do not acquire large stakes and are not particularly wealthy, but they submit dozens of shareholder proposals every year, convinced that "it is the right thing to do."[190] Recently, Professors Yaron Nili and Kobi Kastiel extolled the virtues of gadflies, reporting that, even though gadflies account for 27.3% of all proposals during their study period, they were behind 53% of proposals submitted to the S&P 1500 that received majority support.[191] They also found that in nearly two-thirds of the instances in which gadfly sponsored proposals received majority support, management followed up with a proposal to modify the company's governance terms, a success rate above that of

187 *Id.* at 5637.

188 *Id.* at 5636–37.

189 There is a conflict in the studies over whether proposals submitted by individuals are more likely to pass than proposals submitted by institutions. *Compare* Stuart L. Gillan & Laura T. Starks, *Corporate Governance Proposals and Shareholder Activism: The Role of Institutional Investors*, 57 J. FIN. ECON. 275, 288 (2000) (finding proposals sponsored by individuals less likely to pass) *with* Gantchev & Giannetti, *supra* note 150, at 5636 (finding shareholder proposals by individuals more likely to pass). The sample period for Gillan & Starks is much earlier than that of the other study, suggesting a change in behavior may have occurred over time. *Compare* Gillian & Starks, *supra*, at 275 (analyzing proposals between 1987 and 1994) *with* Gantchev & Giannetti, *supra* note 150, at 5635 (studying proposals between 2003 and 2014).

190 Gantchev & Giannetti, *supra* note 150, at 5634.

191 Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies* 20, 24 (Univ. of Wis. Legal Studs., Working Paper No. 1523, 2020) (examining 6,827 shareholder proposals between 2005 and 2018 among the S&P 1500).

pension funds.[192] Much of the success enjoyed by gadflies is attributed to their strategy focusing on standardized governance proposals that are recognized to have a good deal of salience among institutional investors.[193]

However, Gantchev and Giannetti project a much darker view of gadflies, reporting that proposals by such active individuals receive the lowest percentage of votes across a range of types of proposals and only are implemented by boards three percent of the time, whereas overall the implementation rate for majority-passed proposals is twelve percent.[194] This is a significant observation as it suggests gadflies' proposals, which, if broadly viewed, can be seen as the generic equivalent to that of an institution or non-active individual, perform less well in the particular setting because, as the authors explain, the proposals submitted by gadflies are not tailored to the conditions that surround the targeted firm. And this is understood by the stockholders: if the gadflies' proposals obtain majority voting support this "trigger[s] sales by informed mutual funds that voted against them and, arguably as a consequence, negative abnormal returns."[195] They also find that "proposals by [gadflies] destroy shareholder value if they are implemented."[196]

However, "there are benefits from the implementation of other individuals' proposals," and these large benefits must be weighed against the costs associated with implemented gadfly proposals, "cast[ing] doubt on the desirability of limiting individual shareholder proposals."[197] The authors caution the

192 *Id.* at 25.

193 *Id.* at 30–32.

194 Gantchev & Giannetti, *supra* note 150, at 5642. The authors argue that even this small percentage of proposals destroy value when they are implemented, but that boards do so because they fear "the personal consequences arising from ISS withhold-vote recommendations, which are typically issued when majority-supported proposals are not implemented, regardless of their quality." *Id.* at 5631.

195 *Id.*

196 *Id.* at 5630 We note that this study is still a working paper at the time of this writing and therefore this conclusion is subject to potential revision.

197 *Id.* at 5650–51.

SEC to weigh both the benefits of the other individuals' proposals against the costs associated with the gadflies' proposals before deciding whether to limit individual proposals overall.[198] We share this view.

V. WHAT IS THE REAL PURPOSE OF RULE 14A-8? THE CORPORATE PUBLIC SQUARE

How should we evaluate the worth of a shareholder proposal? Answering this question and applying it collectively across at least recent experiences under Rule 14a-8 would guide us to considering how it may be improved. From the multiple foci of the studies reviewed in the preceding Part, we can see their authors' focus on the voting outcome as the currency they use to measure the worth of a proposal or even its proponent.[199] The SEC followed a similar approach in supporting the rule changes it adopted in 2019, as it emphasized the approved/not approved record proposals had before the voting shareholders.[200]

We believe there are several reasons why assessing the value of Rule 14a-8, and for that matter the worth of any reform matter, requires looking beyond the voting outcome. For one, it is important to recognize the value associated with proposals that are withdrawn by their proponent. Nearly one-

198 *Id*. at 5651.

199 We also observe that the empiricists' focus on voting outcomes also resonates the general complaint regarding the impacts of Rule 14a-8. Rule 14a-8 has many policy critics. For example, Professor Dent argues that the SEC should not force companies to devote significant resources to circulating proposals that have virtually no chance of being adopted. *See* Dent Jr., *supra* note 124, at 17; Professor Liebeler also notes that there is no reason to expect security holders to express their dissatisfaction through shareholder resolutions as long as they are able to sell their shares. *See* Liebeler, *supra* note 124, at 447.

200 Proposing Release, *supra* note 46, at 66,484 figs.7A & B, 66,485 fig.7C, 66,486 figs 8A & B, 66,587 fig.8C (collecting data on proposals garnering shareholder approval overall, type of proponent and type of proposal).

half of all submitted proposals are withdrawn.[201] Opponents of the shareholder proposal rule could reason the high withdrawal rate reflects a proponent acting, at last, sensibly in reaching the conclusion advanced by management that the proposal was ill-conceived and not in the interest of the company or its shareholders. But there is evidence that the withdrawal is a settlement between the proponent and the company.[202] Where this happens, there is every reason to believe the proposal produced more than nothing so that such settlements should be weighed in the calculus of the social benefits of Rule 14a-8.

The withdrawal itself, especially as a result of a settlement, suggests another benefit, namely facilitating shareholder dialogue with the company. That is, the proposal itself was the vehicle for dialogue. To be sure, a blockholder can be expected to enjoy access to the company's management because of the attention its sizable holdings attract. The smaller shareholder lacks this magnetism. On the other hand, the withdrawal record among individual shareholders suggests to us that a shareholder proposal does fill the void by attracting management's attention. We do not know how often withdrawals occur because of negotiations, but strongly suspect the number of instances is substantially greater than trivial. This at least means that focusing on the win-loss voting record before the shareholders understates the value of a rule that facilitates proposals, but also means the shareholder proposal rule has the additional benefit of enabling a dialogue between the corporation and its shareholders. Enabling dialogue is empowering for small

[201] *Id.* at 66,478 fig.2 (finding that, in 2018, there were 831 proposals of which 123 were omitted, 447 were voted upon, and 261 (31.4%) that were withdrawn).

[202] Rob Bauer, Frank Moers & Michael Viehs, *Who Withdraws Shareholder Proposals and Does It Matter? An Analysis of Sponsor Identity and Pay Practices*, 23 CORP. GOVERNANCE 472, 477 tbl.1. 484 (2015) (finding that over the past few decades there has been a significant increase in the number of ESG proposals that are withdrawn because of a settlement reached between the proponent and the company).

shareholders who lack the gravitas that surrounds a blockholder that can earn a meeting with management.

Resting the worth of Rule 14a-8 on the number of instances proposals garner majority support with the stockholders further overlooks the arch of history with shareholder votes. Dramatic instances exist where practices first advanced as shareholder proposals became widely adopted across public companies, not because they initially won a majority vote but because their proponents' persistence over a multi-year campaign shined a light on the need for reforms that were ultimately judged a good development.[203] A classic example is the movement to separate the positions of CEO and board chair. Though the proposal garnered mixed results in shareholder votes, firms may choose this course of action even without a compelling positive shareholder vote. The point is that focusing only on the win-loss record within firms targeted by a proposal overlooks the role that proposal has at non-targeted firms. Thus, the shareholder proposal rule enjoys substantial positive externalities, uncaptured by the win-loss record, that that must be considered in evaluating its worth.

We therefore take a more holistic approach and consider Rule 14a-8's potential in light of the broad sweep of contemporary corporate governance. There is a broad call for corporations to balance the pursuit of shareholder wealth against a range of social concerns in which attention is to be given to stakeholder interests.[204] This cascade of interest is joined by calls that management and owners should collaborate in pursuing long-term interests rather than short-term gain.[205] The latter has gained a good deal of traction

[203] *See* Rosanna Landis-Weaver, *Protecting the Shareholder Proposal Process*, AS YOU SOW (Nov. 19, 2018), https://www.asyousow.org/blog/2018/11/19/sec-shareholder-proxy-process [https://perma.cc/G3LC-WYJN] (noting that "support grows slowly" for issues addressed in multi-year proposals, which initially "do not receive significant shareholder support" but "are no less critical").

[204] *See* James D. Cox & Randall S. Thomas, *A Revised Monitoring Model Confronts Today's Movement Toward Managerialism*, 99 TEX. L. REV. 1275, 1301 (2021).

[205] *Id.* at 1294–1295.

across corporate America under the rubric of the New Paradigm where on-going dialogue, not confrontational battles for control, is prescribed.[206] We therefore place the future of Rule 14a-8 within this constellation, seeing it as yet another medium for the owners' voice to reach the suites of corporate executives. To be sure, there are multiple mediums for that voice to be heard and for its impact to be felt. In another era, the takeover was the popular method and today there are activist investors. Nonetheless, both those forces, largely out of economic considerations, often target small firms, as the capital needed for a credible threat was too great for large firms.[207] We can thus see the role of Rule 14a-8 complementing these more adversarial engagements[208] while at the same time targeting firms that were less likely to be the target of takeovers in the past or of activist investors today. Moreover, the data reviewed earlier reflected that a significant portion of Rule 14a-8 proposals are by individuals, not institutions;[209] this comports with the reality that individual investors, unlike institutions, cannot undertake one-on-one dialogue with company management. And, the negligible number of shareholder proposals sponsored by mutual funds is consistent with their well-documented custom of engaging portfolio companies through direct discussion.[210] Nonetheless, dialogue between investor and management is not as public as a shareholder proposal. Hence, proponents of a governance issue or an approach to sustainability who wish to shine a light on the issue can reach a much broader audience via Rule 14a-8 than one-on-one dialogue with a company's management. That is, the proposal and the shareholder vote that flow from a proposal launched under Rule 14a-8 enjoy a broad audience, one that is certainly

206 *Id.* at 1297–1298.

207 Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1747, 1752 (2008).

208 Gantchev & Giannetti, *supra* note 150, at 5639 (shareholder proposals are "an important complementary mechanism of external corporate governance.").

209 *See supra* Part IV.

210 *See id.*

more inclusive than that engaging in a dialogue with management. Moreover, the transparency of the Rule 14a-8 process, not the least of which is the proxy solicitation process, affords the proponent much more hydraulic pressure than can ever arise in the one-off consultation process.

Rule 14a-8 therefore should be seen as a public, not a private, forum. It is now very much a forum where management and investors can witness the contesting visions among investors and between investors and management. Such exchanges promote discussion, reflection, study, and the evolution of corporate governance as well as the mission of the company. In an era of rising interest in both ESG and company responsiveness to stakeholders as well as shareholders, there is a heightened need for evolving values among shareholders to be broadly communicated to management, shareholders, and the public. The vision is that the shareholder proposal rule is the corporate public square.

VI. CONCLUSION

In our critique of assessing the contributions of Rule 14a-8 by focusing on the level of support garnered in the voting on a proposal we observed that the value of Rule 14a-8 is much broader as it must be understood as a communication mechanism among the proponent, the corporation and its management, the company shareholders, the corporation to its various non-shareholder stakeholders, and to boardrooms and investors everywhere. It enables shareholders to communicate within these networks the intensity of feeling and beliefs on a breadth of concerns. Just as the ancient Greeks and Romans, and more recently Europeans and Americans, built their cities around the public square, from the beginning of its classical conception, the public square is featured as a core element of public discourse in urban life.[211]

[211] As Michael Kimmelman writes in *City Squares*, "a successful square is not just about light, air, proportion, and people. It must also give form to some shared notion of civic identity." *See* Michael Kimmelman, *Culture: the Power of Place: Introduction, in* CITY SQUARES: EIGHTEEN WRITERS ON THE

Rule 14a-8 should be viewed as creating the functional equivalent of the public square where corporate management and directors can take the pulse of their shareholders and even extrapolate from that measurement the views of various stakeholders, and more generally the public, as part of their ongoing processing of information about the environment to be navigated to conduct the firm's business.

The legislative history and academic commentary about the Rule suggest that it embraces a bigger role than regulating only the mechanical action of shareholder voting. The shareholder proposal rule serves many other functions as well: It informs the board about the views of its investors and stakeholders; it promotes active investor involvement with the company; it can lead to valuable corporate governance changes; and it provides the board with alternative views of the firm's objectives so that it does not become over-reliant on corporate management. Each of these we believe are highly valuable contributions to the board's information base.

We believe that the Rule can perform all of these functions and thus facilitate the opening of a corporate public square while remaining consistent with its legislative history and the SEC's interpretation of that history over time. However, if necessary, we would ask Congress to authorize the Rule's use to facilitate the creation of a corporate public square.

Finally, we are concerned that gadfly investors are making an excessive number of proposals that decrease the value of targeted firms. At least one empirical study has found that gadfly proposals that obtain majority voting support and are implemented by the targeted firms lead to negative effects on firm value.[212] However, other individual investors' proposals appear to be value enhancing so we cannot endorse overall cutbacks on proposals by all individual proponents. We urge the SEC to take a cautious approach to this issue and to generate studies of the comparative value of shareholder proposals by the different proponents before taking action to directly limit individual proposals.

SPIRIT AND SIGNIFICANCE OF SQUARES AROUND THE WORLD 1, 8 (Catie Marron ed., 2016).

[212] *See* Gantchev & Giannetti, *supra* note 150, at 5630.