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THE PROXY WAR AGAINST PROXY ADVISORS

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This Article argues that the criticisms and calls for the regulation of the proxy advisory industry are not really directed at the proxy advisors themselves, but at their clients: the holders of public company stock. Many corporate executives, directors and their representatives want to make it more difficult for shareholders to vote against management recommendations. The assumption underlying this view—sometimes stated, sometimes not—is that executives and directors know what is best for their companies, and, in many instances, shareholders do not. Almost by definition, this means that recommendations that do not agree with management are viewed as inaccurate, uninformed, and value destroying. Rather than allow shareholders to support non-value maximizing shareholder proposals and say-on-pay recommendations unfettered, corporate interests have sought to make it more difficult for institutional investors to vote proxies independently of management by urging measures that would hamstring their proxy service providers. Before endorsing regulatory intervention, it is worth first asking if there are other potential market solutions to address the existing deficiencies. If uninformed shareholder voting is the problem, then both corporate managers and the SEC should be open to alternative solutions that would address the tension between the sometimes-competing interests of shareholders making informed voting decisions and controlling the costs of procuring and managing the information necessary to make those decisions.

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INTRODUCTION

> "PROXY WAR" – a war instigated by a major power which does not itself become involved.[1]

On November 5, 2019, the U.S. Securities and Exchange Commission ("SEC") released for public comment a proposal for a series of rule amendments, which, if adopted, have the potential to significantly change the way proxy advisory firms provide voting advice and shareholders vote proxies (the "Proposed Amendments").[2] The release comes on the heels of separate SEC guidance on the use of proxy advisors issued in August 2019, which itself was a follow-up to a roundtable discussion convened in November 2018.[3] Prior to these recent actions by the SEC, separate bipartisan bills had been introduced in Congress that would have subjected proxy advisors to additional regulation and oversight.[4]

Typically, when a normally obscure corner of the financial markets gets this much attention from the SEC and Congress, it is after a headline-grabbing scandal, such as the collapse of Enron or the unmasking of Bernie Madoff's Ponzi scheme.

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1. *Proxy War*, LEXICO, https://www.lexico.com/definition/proxy_war (last visited Apr. 22, 2020).
2. *See infra* note 132 and accompanying text.
3. *See infra* notes 124–43 and accompanying text.
4. *See infra* notes 121–23 and accompanying text.

But there has been no such scandal involving proxy advisors. So, how did proxy advisors find themselves in the crosshairs of the nation's top regulators?

The recent calls for action are the culmination of lobbying efforts by think tanks, business trade associations, and corporate executives in a decades-long struggle between the nation's corporate managers and activist shareholders. Since the proxy reforms of the 1980s gave shareholders a greater say over matters of corporate governance, groups representing corporate interests have been fighting to retain their grip on corporate control. These recent calls for the regulation of proxy advisors represent a coordinated effort by corporate interests—acting through a series of proxies—to undermine activist shareholders and the voting reforms that have given shareholders more say and influence over corporate matters. These corporate interests are seeking to use the mechanisms of government regulation to weaken the voting rights of shareholders. What the advocates of reform really want is to make it more difficult for shareholders to vote independently of management.

This Article is divided into five Parts. Part I summarizes four megatrends behind the growth of the proxy advisor industry and the regulatory framework for proxy advisory services. Part II describes the controversy, including a brief account of the key players, a summary of the most frequent complaints, and recent proposals for reform, including the Proposed Amendments by the SEC. Readers familiar with the literature may wish to skip the introductory sections. Part III examines the controversy more critically and provides an alternate explanation of the current landscape, placing the recent calls for reform within the broader contest for corporate control between pro-management interests and shareholders. Part IV considers the alternatives from the perspective of management. If the problem is that management really does know best, then what measures could companies adopt to improve the information quality of shareholders' voting or limit the negative impact of misinformed shareholder voting? The final Part provides some concluding thoughts.

I.
Background

A. *Four Trends*

In the early days of the investment management industry, professional investors followed the gentleman's practice of either voting with management or selling their shares.[5] This practice was sometimes called the "Wall Street Rule."[6] It had the benefit of keeping investors out of the knitting of corporate executives while preserving an incentive for investors to monitor the performance of corporate executives. Followers of the Wall Street Rule had no need for outside firms to help with proxy voting research because there was nothing to research. When they received the proxy ballot in the mail each year to vote on the director slate, they voted with management.[7] But much has changed in the last half century. The increasing prominence and profile of proxy advisory firms can be traced to four trends that have reshaped the investment management industry in that time.

Increased institutional ownership of public stocks. Whereas once stocks were once predominantly held directly or indirectly by wealthy individuals, most shares of public companies are now owned or controlled by professional investment managers and large asset owners like pensions and endowments (collectively, "institutional investors"). Today, institutional investors control approximately 70% of the market value on US exchanges.[8] This is important for two reasons. First, institutional investors not only tend to own larger percentages of each company, but they own a broader swath of the market as well. As a result, stock ownership is concentrated among fewer

5. *See* Alan R. Palmiter, *Mutual Fund Voting of Portfolio Shares: Why Not Disclose?*, 23 Cardozo L. Rev. 1419, 1430 (2002).

6. *Id.*

7. This ignores the rare case of the contentious merger or acquisition vote.

8. Chuck Callan & Paul DeNicola, *2019 Proxy Season Review*, Harv. L. Sch. F. on Corp. Governance (Oct. 28, 2019), https://corpgov.law.harvard.edu/2019/10/28/2019-proxy-season-review/. By one estimate, the percentage is even higher. *See* Charles McGrath, *80% of Equity Market Cap Held by Institutions*, Pensions & Inv. (Apr. 25, 2017), http://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions (estimating the market value held by institutional investors at 80%).

large stockholders. Just three giant index fund managers, BlackRock, Vanguard, and State Street Global Advisors ("SSgA," and collectively, the "Big Three"), together hold on average more than 20% of S&P 500 companies.[9] Second, institutional investors are more likely to vote their shares. For example, because not all other shareholders vote their shares, the Big Three collectively control about 25% of the votes of the average S&P 500 company.[10]

More diverse portfolios. Another long-term trend is towards institutional investors holding more diverse portfolios. Modern portfolio theory ("MPT") provided mathematical support for the idea that holding a well-diversified portfolio of many assets is less risky than, and therefore preferable to, holding a portfolio of fewer stocks.[11] Since then, institutional investors have sought to lower risk, and thereby increase returns, by holding a greater number of issues. As a consequence, the average number of stocks held in fund portfolios has risen dramatically. According to one study, the number of stocks in the average mutual fund rose from 54 in 1979 to 126 by 2014, an increase of about 100%.[12] The larger number of issues per portfolio has led to a larger number of proxy ballots that each institutional investor needs to process and vote each year.

The race to lower fees. All else being equal, as asset managers manage and oversee portfolios with a greater number of stocks, one might expect advisory fees and expense loads to increase to offset the additional burden of tracking and analyzing hundreds or even thousands more securities and settling many thousands more trades each year. In fact, the opposite has occurred. This is partially the result of firms capturing the available economies of scale. Managing a portfolio of 125 stocks is not 25% more costly on an absolute basis than managing a portfolio of 100 stocks. In fact, it is cheaper as a percentage of assets managed.[13] But many investors have sought to

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9. Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 721–41 (2019).

10. *Id.*

11. Modern portfolio theory is generally traced to the publication of *Portfolio Selection* by Harry M. Markowitz in 1952. Harry M. Markowitz, *Portfolio Selection*, 7 J. FIN. 77, 77–91 (1952).

12. Lubos Pastor, Robert Stambaugh & Lucian A. Taylor, *Fund Tradeoffs*, J. FIN. ECON. (forthcoming).

13. *Id.*

avoid the hassle and expense of holding thousands of different stocks by investing through passive index funds. Managing a passive portfolio designed to match the performance of an index takes considerably less creativity and talent—two highly compensated skills—than managing an active portfolio. This trend from active to passive management is another byproduct of MPT.[14] The pioneer in the low-cost index funds industry was Vanguard, which launched its first low-cost mutual fund in 1975.[15] But where once Vanguard was unique, it now has many followers, as BlackRock, SSgA, and even traditionally active managers like Fidelity and PIMCO, have jumped into the fray to offer low-cost index products. As more money has flowed into passive indexing—by one estimate, more than 80% of all assets that have flowed into investment funds in the past decade has gone to index funds[16]—it has put increasing pressure on both passive and active managers to lower fees. As a consequence, nearly all institutional investors now have to do more with less, which means fewer resources to dedicate to non-core function like analyzing proxy votes.

Shareholder activism. SEC rule changes in the mid-1980s made it easier for shareholders to use the shareholder voting process to advocate for corporate change.[17] In 2010, Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd–Frank Act"), which requires companies to hold a non-binding shareholder vote on executive compensation at least once every three years (the so-called "Say-on-Pay" rule).[18] The Dodd–Frank Act also authorized, and the SEC adopted, rules making it easier for certain shareholders to nominate directors on a company's proxy ballot (the so-called "proxy access" rule) and to propose changes

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14. The optimally diversified portfolio is one that owns the entire market. Once diversification expands to mean everything, the only other factor on which to compete is price. *See* Markowitz, *supra* note 11 and accompanying text.

15. *A Remarkable History*, VANGUARD, https://about.vanguard.com/who-we-are/a-remarkable-history/.

16. Bebchuk & Hirst, *supra* note 9, at 2.

17. Séan Patrick O'Brien, *The 1983 Amendments to SEC Rule 14A-8: Upsetting a Precarious Balance*, 19 VAL. U. L. REV. 221, 281 (1984).

18. Dodd–Frank Wall Street Reform and Consumer Protection Act § 951, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78n-1 (2018)).

to the corporate bylaws.[19] By one estimate, the Dodd–Frank Act, which was supported by a number of shareholder advocacy groups, created an additional 16,000 proxy votes each year.[20] Many of the resulting shareholder proposals have focused on social and environmental issues that corporate managers sometimes believe are orthogonal to, or incompatible with, the company's corporate mission.[21] The effects of shareholder activism are addressed in greater detail *infra* Section III.B.

These four trends have led to an explosion in the number of proxies that institutional investors need to process and vote each year. According to one large asset manager, it receives and processes in excess of 80,000 unique voting items each year.[22] Considering and voting on each of these proxies is a monumental task. If the investment firm had to conduct independent research on each item, that could be a cost-prohibitive challenge. This stands in stark contrast to earlier eras—before the internet and MPT—when institutional investors received many fewer proxies and were able to complete proxy ballots by hand using pen and paper. Since exiting is not an option for passive fund managers that track an index, they have instead turned to proxy voting as a mechanism for holding directors and CEOs accountable. Yet, precisely as the operational burdens on asset managers have increased, so too has the downward competitive pressure on fees and costs. Investment managers trying to keep their expense ratios down have a strong incentive to underfund proxy research to minimize costs.[23] Stewardship teams among the larger asset managers

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19. Holly J. Gregory, Rebecca Grapsas & Claire Holland, *The Latest on Proxy Access*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 1, 2019), https://corpgov.law.harvard.edu/2019/02/01/the-latest-on-proxy-access/; *see also infra* note 168 and accompanying text.

20. COEC REPORT, *infra* note 33.

21. JAMES GLASSMAN & J.W. VERRET, MERCATUS CTR. AT GEORGE MASON UNIV., HOW TO FIX OUR BROKEN PROXY SYSTEM (2013), https://www.mercatus.org/system/files/Glassman_ProxyAdvisorySystem_04152013.pdf.

22. Letter from Jonathan Feigelson, Senior Vice President & Gen. Counsel, Teachers Ins. & Annity Ass'n of Am. & Coll. Ret. Equities Fund (TIAA-CREF), to Elizabeth M. Murphy, Sec'y, SEC (Nov. 18, 2010), https://www.sec.gov/comments/s7-14-10/s71410-263.pdf.

23. Tamara Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 STAN. J.L. BUS. & FIN. 384, 409 (2009).

have grown to help with the additional burdens, but the numbers remain small as a percentage of assets under management or when expressed as a ratio of personnel time per portfolio company.[24] Even the Big Three may supplement their internal proxy research with external research and support.[25]

These changing dynamics have made the use of proxy advisors an increasingly attractive option for institutional investors as a means of managing the proxy voting process. Proxy advisors provide all manner of services related to proxy voting, such as aggregating and standardizing information, providing platforms for managing votes, and providing voting recommendations. Importantly, they economize the proxy research and voting functions by spreading the costs of tracking, analyzing, and processing many thousands of proxy votes over a larger pool of shareholders. If asset managers or owners had to perform these functions themselves, they would face an unattractive choice between bearing the costs of additional staff to perform the research or not adding resources and therefore being less informed and less responsible voters. Not wanting to accept either of these similarly unpalatable alternatives, investment managers *en masse* have chosen to outsource proxy servicing to third-party proxy advisors.

B. *The Regulatory Framework*

As the first proxy advisor service offerings were coming to market in the mid-1980s, the obligations of investment advisers with respect to proxy voting remained unclear. In 1988, in an attempt to clarify the fiduciary duties surrounding pension plans, the Department of Labor issued a letter ruling stating that pension funds have a fiduciary duty to vote proxies in the

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24. Lucian Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 100 (2017).

25. *Id.* Another implication of these trends is that as asset managers increase in size, they face diminishing incentives to invest in proxy voting. For example, an investment manager that holds upwards of 4,000 different companies has little at stake in the outcome of any one proxy vote or even the collective votes at any one company. In those cases, the incentive may be to free ride on the responsible proxy voting efforts of other shareholders. The fact that the manager of an index product cannot sell the shares of a company with poor governance practices further compounds the problem. *Id.*

best interest of their clients.[26] In 2003, the SEC passed a rule under the Investment Company Act of 1940 requiring registered mutual funds to adopt policies and procedures to ensure that proxies are voted in the best interest of clients and to publicly disclose their voting records.[27] That same year the SEC adopted Rule 206(4)-6 under the Investment Advisers Act of 1940 (the "Advisers Act") providing parallel requirements for registered investment advisers to adopt policies and procedures reasonably designed to ensure that proxies are voted in the best interest of clients and to disclose certain information about their proxy voting to clients.[28] Together, these three rules created the regulatory framework for the proxy voting for institutional investors that remains in place today.

The 2003 SEC rules left several key questions unanswered regarding the use of proxy advisers. To what extent may investment advisers rely on the advice and recommendations of third-party proxy advisors in discharging their fiduciary duty? And if reliance on third-party proxy advisors is permissible, within what boundaries? What checks must be in place to avoid conflicts of interest? The SEC staff sought to answer these questions the following year in what came to be known as the *Egan–Jones* and *ISS* no-action letters.[29] Together, the letters provided that investment advisers could fulfill their fiduciary duties if they relied on the recommendations of independent, third-party proxy advisers, provided that the voting was not a product of conflict of interest and the proxies were voted in accordance with a pre-determined policy.[30] Many commentators (and critics) credited (or blamed) these two no-action letters for the increased use of proxy advisors by registered investment advisers in the following years.[31] While these letters

26. Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, U.S. Dep't of Labor, to Helmuth Fandl, Chairman of the Ret. Bd., Avon Prods., Inc. (Feb. 23, 1988).

27. Disclosure of Proxy Voting Policies Voting Records by Registered Management Investment Companies, Investment Company Act Release No. 25,922, 17 C.F.R. pt. 239 (2003).

28. Proxy Voting by Investment Advisers, 17 C.F.R. pt. 275 (2020).

29. Egan–Jones Proxy Servs., SEC No-Action Letter, 2004 SEC No-Act. (May 27, 2004); Institutional Shareholder Servs., Inc., SEC No-Action Letter, 2004 SEC No-Act. (Sept. 15, 2004).

30. Institutional Shareholder Servs., *supra* note 29.

31. *See, e.g.*, Andrew L. Oringer, Edward L. Pittman & Michael L. Sherman, *A Vote in Favor of Balance and Care in Policies Regarding the Use of Proxy*

enabled the outsourcing of proxy voting responsibilities for investment advisors and likely contributed to further industry growth, it is worth noting that the underlying trends discussed above—increased institutional ownership, larger portfolios, the push to lower costs, and more proxy items per company—were already underway. For example, new entrants such as Glass Lewis began offering proxy advisory services around that time to meet the growing market demand.[32]

The rise in prominence and influence of proxy advisors, particularly of ISS, in the early 2000s soon led to calls for reform.[33] The concerns about the use and growing influence of proxy advisers, discussed in more detail *infra* Part II, led the SEC in 2014 to issue new guidance on the use of proxy advisory services by investment advisers. The guidance provided that investment advisers wishing to rely on a proxy advisor's recommendation need to perform due diligence to ensure that the proxy advisor has the "capacity and competency to adequately analyze proxy issues."[34] Investment advisers need to make their own assessment of whether a proxy advisor has sufficient policies and procedures to "identify and address any conflicts of interest" and proxy advisors are further required to disclose any significant conflicts of interest.[35] In August 2019, the SEC issued further interpretive guidance on the proxy voting responsibilities of investment advisers.[36] Among other

Advisors, 21 INV. LAW. 24, 26 (2014); Donna Musolli, A Distraction in Disguise: How a Focus on Regulating the Proxy-Advisory Industry Fails to Address the Unnecessary Creation of an Extra Layer of Conflict 15, 34 (2017) (unpublished comment), http://digitalcommons.law.msu.edu/king/254 (citing GLASSMAN & VERRET, *supra* note 21).

32. *See infra* note 49 and accompanying text.

33. CTR. ON EXEC. COMP., A CALL FOR CHANGE IN THE PROXY ADVISORY INDUSTRY STATUS QUO: THE CASE FOR GREATER ACCOUNTABILITY AND OVERSIGHT 42 (Jan. 2011), http://www.execcomp.org/Docs/c11-07a%20Proxy%20Advisory%20White%20Paper%20_FULL%20COLOR_.pdf [hereinafter COEC REPORT] ("Almost from the time the industry was created, proxy advisory firms have been criticized for providing product offerings or ownership structures that could compromise the analyses they provide.").

34. SEC Staff Legal Bulletin No. 20 (June 30, 2014), https://www.sec.gov/interps/legal/cfslb20.htm.

35. *Id.*

36. Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Release No. 5325, Investment Company Act Release No. 33,605 (Sept. 10, 2019) [hereinafter 2019 Proxy Voting Guidance].

things, the 2019 Proxy Voting Guidance clarified certain considerations that an investment adviser should take into account if it retains a proxy advisory firm, steps to consider if an investment advisers becomes aware of potential errors or weaknesses in the proxy advisory firm's analysis, and an investment adviser's fiduciary duties with respect to proxy voting, including that there is no requirement for investment advisers to vote on all proxy matters irrespective of the cost and benefit to the client.[37]

Unlike the case with investment advisers and the Advisers Act, there is no dedicated regime for regulating proxy advisors. Although they meet the definition of "investment adviser" under the Advisers Act, proxy advisors may be exempt from registration if their regulatory assets under management do not meet the SEC registration threshold.[38] Several proxy advisors, including ISS, are registered with the SEC under a section of the Advisers Act that allows firms that provide consulting services to pension plans to register, but others, such as Glass Lewis, are not registered.[39] All investment advisers, including unregistered proxy advisors, are subject to the parts of the Advisers Act that apply to investment advisers regardless of registration status, including the anti-fraud provisions in Section 206-2. The provision of proxy advice also comes within the SEC's broad definition of "solicitation" under the Securities Exchange Act of 1934 (the "Exchange Act"),[40] but is generally excused from the information and filing requirements of the proxy solicitation rules pursuant to an exemption under Rule 14a-2(b) for communications by persons not seeking

37. *Id.* Investment advisers' fiduciary duty to vote proxies in the best interest of its client is sometimes mischaracterized as a requirement to vote *all* proxies. *See infra* note 114.

38. Investment Advisers Act of 1940 § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (2018) (defining "investment adviser" as any firm engaged in the business of providing advice on securities, including issuing reports or analyses).

39. Investment Advisers Act of 1940 § 203A-2, 15 U.S.C. § 80b-3a(a) (2018).

40. *See* Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326 (Oct. 16, 1992) ("Underlying the adoption of section 14(a) of the Exchange Act was a Congressional concern that the solicitation of proxy voting authority be conducted on a fair, honest and informed basis. Therefore, Congress granted the Commission the broad 'power to control the conditions under which proxies may be solicited' . . . .").

proxy authority.[41] In August 2019, the SEC issued interpretative guidance clarifying the application of the proxy solicitation rules to proxy voting services and foreshadowing the Proposed Amendments.[42] The new guidance included an interpretation that proxy voting advice may constitute a "solicitation" under the federal proxy rules established under Section 14(a) of the Exchange Act. In his accompanying statement, Chairperson Clayton stated that the staff was reviewing the definition of "solicitation" and would be taking a "fresh look" at Rule 14a-2(b) to see whether changes were needed.[43]

II. THE CONTROVERSY

A. *Dramatis Personae*

The controversy over proxy advisor regulation has two distinct sides. On the side of maintaining the status quo are, naturally, the proxy advisors themselves, as well as a healthy selection of their clients. The status quo camp includes:

Institutional Shareholder Services, Inc. ("ISS"). ISS was founded in 1985, making it the first mover in the industry. It has over 2,000 institutional clients[44] and an estimated market share of over 61% of the proxy advisory industry.[45] According to one study, at one point ISS's clients included twenty-four of the top twenty-five mutual funds, twenty-five of the top twenty-five asset managers, and seventeen of the twenty-five largest

41. Shareholder Communications, Shareholder Participation in Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 16,356, 44 Fed. Reg. 68,764 (Nov. 29, 1979).

42. Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Release No. 86,721, 84 Fed. Reg. 47,416 (Sept. 10, 2019) [hereinafter Release No. 86,721].

43. Chairman Jay Clayton, Statement at Open Meeting on Commission Guidance and Interpretation Regarding Proxy Voting and Proxy Voting Advice (Aug. 21, 2019), https://www.sec.gov/news/public-statement/statement-clayton-082119.

44. *About ISS*, ISS, https://www.issgovernance.com/about/about-iss/ (last visited Mar. 22, 2020).

45. James R. Copland, *A Report on Corporate Governance and Shareholder Activism*, PROXY MONITOR (2014), http://www.proxymonitor.org/Forms/pmr_09.aspx.

public pension funds.[46] ISS provides research on more than 40,000 different companies and processes and votes more than 10 million ballots each year.[47] ISS has staunchly defended the proxy advisory industry and its business model.[48] It is currently owned by Genstar Capital, a private equity firm.

Glass, Lewis & Co. ("Glass Lewis"). Glass Lewis launched in 2003, making it a relative newcomer to the industry. Despite its late start, it has become the second largest proxy advisory firm, with over 1,300 institutional clients representing assets under management of $35 trillion.[49] It covers proxy matters for around 20,000 company meetings each year. Glass Lewis, too, has publicly defended itself against critics.[50] It is currently owned by the Ontario Teachers' Pension Plan and the Alberta Investment Management Corp., two prominent Canadian institutional investors.

Other firms compete in the proxy advisor space. In the United States, they include Egan–Jones Proxy Services, Segal Marco Advisors, and ProxyVote Plus.[51] In Europe, there is Minerva Analytics (UK), PIRC (UK), and Proxinvest (France).[52] But the U.S. market is dominated by ISS and Glass Lewis. By

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46. James Cotter, Alan Palmiter & Randall Thomas, *ISS Recommendations and Mutual Fund Voting on Proxy Proposals*, 55 VILL. L. REV. 1, 25 n.88 (2010) (citing Meredith Jones & Andrea Capellas, "Transparent" Seems Translucent: What Mutual Fund Families Are Actually Disclosing About Their Proxy Voting Policies and Procedures (2008) (unpublished manuscript)).

47. ISS, *supra* note 44.

48. *See* Letter from Gary Retelny, President & Chief Exec. Officer, ISS, to Brent J. Fields, SEC (Nov. 7, 2018), https://www.issgovernance.com/file/publications/iss-roundtable-comment-letter.pdf.

49. *Company Overview*, GLASS LEWIS, https://www.glasslewis.com/company-overview/ (last visited Mar. 22, 2020).

50. Letter from Katherine H. Rabin, Chief Exec. Officer, Glass Lewis, to Senator Dean Heller, Chairman, Subcomm. on Sec., Ins. & Inv., Sen. Comm. on Banking (June 1, 2018), http://www.glasslewis.com/wp-content/uploads/2018/06/Glass-Lewis-Response-to-May-9-2018-Chairman-Heller-Letter_0601_FINAL.pdf.

51. *See* Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518 (Nov. 5, 2019) [hereinafter Proposing Release].

52. Along with ISS, Glass Lewis, IVOX—which has since been acquired by Glass Lewis—Minerva Analytics, PIRC, and Proxinvest were all founding members of the BPP Group, a virtual organization formed to promote best practices in shareholder voting research. *See BPP Committee*, BPP GRP., https://bppgrp.info/working-group-members/ (last visited Mar. 22, 2020).

one estimate, their combined share of the market for U.S. proxy advisory services is 97%.[53]

The Council of Institutional Investors ("CII"). CII is a trade group comprised of over 135 institutional investors representing more than $4 trillion in assets under management. Its general members include public pension funds, such as the California Public Employees' Retirement System ("CalPERS"), California State Teachers' Retirement System ("CalSTERS"), Florida State Board of Administration, Los Angeles County Employees Retirement Association, Massachusetts Pension Reserves Investment Management Board, and the Office of the NYC Comptroller, labor union pension funds, and corporate members, such as AIG, Ebay, General Motors, Intel, and Microsoft.[54] CII also represents more than sixty of the largest investment managers with combined assets of more than $35 trillion, including each of the Big Three, BNY Mellon, Capital Group, Elliot Management, JPMorgan Chase, and Wellington Management. CII has served as the main voice for institutional investors in the contest over proxy advisor regulation. CII has consistently defended the proxy advisors and supported the status quo in proxy advisor regulation through a series of position papers and letters to the SEC.[55]

The critics of proxy advisors—and ISS and Glass Lewis in particular—can be found in every corner of the financial industry. They include Republican and Democratic members of Congress,[56] current and former SEC Commissioners,[57] Wall

53. JAMES K. GLASSMAN & HESTER PEIRCE, MERCATUS CTR. AT GEORGE MASON UNIV., HOW PROXY ADVISORY SERVICES BECAME SO POWERFUL (June 18, 2014), https://www.mercatus.org/system/files/Peirce-Proxy-Advisory-Services-MOP.pdf.

54. *General Members*, COUNCIL OF INSTITUTIONAL INV'RS, https://www.cii.org/general_members (last visited Mar. 22, 2020).

55. *See* Letter from Jeff Mahoney, Council of Institutional Inv'rs, to Senator Michael Crapo & Senator Sherrod Brown (Feb. 27, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/Feb%2027-18%20Final%20Letter%20CII%20on%20proxy%20advisor%20legislation.pdf; Letter from Kenneth A. Bertsch, Council of Institutional Inv'rs, to Jay Clayton, Comm'r, SEC (Oct. 15, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/201910015proxy_advisor_sign_on_final.pdf [hereinafter Letter from Kenneth A. Bertsch].

56. *See, e.g.*, George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1289 n.7 (2014).

57. *Id.*

Street luminaries,[58] academics,[59] and average citizens.[60] However, the loudest critics have been the lobbyists, trade associations, and executive consultants funded by corporate interests to look out for the benefit of corporate executives. These groups have lobbied Congress, published position papers and op-eds, submitted SEC comment letters, spoken at conferences and Congressional hearings calling for change in the proxy advisory industry, and prominently feature the issue of proxy advisor regulation on their websites. This group (collectively, the "Corporate Lobbyists") includes, but is not limited to:

The Business Roundtable. The Business Roundtable is an association of chief executive officers of leading U.S. companies.[61] It has been a leader of the opposition against ISS and Glass Lewis through a high profile combination of litigation,[62] support of industry competitors,[63] and public advocacy for greater proxy advisor oversight.[64] In 2019, The Business Roundtable received international attention following the release of its revised Statement on Corporate Purpose in which it sought to redefine the purpose of a corporation to consider the interests of all stakeholders.[65]

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58. Hugh Son, *Dimon Chides 'Lazy' Shareholders Who Follow Proxy Advisers*, BLOOMBERG (May 27, 2015), https://www.bloomberg.com/news/articles/2015-05-27/dimon-chides-lazy-shareholders-who-blindly-heed-proxy-advisers.

59. *See* Belinfanti, *supra* note 23; GLASSMAN & VERRET, *supra* note 21.

60. *Comments on Statement Announcing SEC Staff Roundtable on the Proxy Process*, SEC, https://www.sec.gov/comments/4-725/4-725.htm.

61. *See About Us*, BUS. ROUNDTABLE, https://www.businessroundtable.org/about-us (last visited Mar. 22, 2020).

62. *See infra* note 170.

63. *See infra* note 212 and accompanying text.

64. *See Proxy Advisory Firms Need Greater Oversight*, BUS. ROUNDTABLE, https://www.businessroundtable.org/archive/media/news-releases/proxy-advisory-firms-need-greater-oversight (last visited Jan. 28, 2019); Letter from Maria Ghazal, Senior Vice President & Counsel, Bus. Roundtable, to Vanessa Countryman, Acting Sec'y, SEC (June 3, 2019), https://www.sec.gov/comments/4-725/4725-5619758-185567.pdf; Letter from Maria Ghazal, Senior Vice President & Counsel, Bus. Roundtable, to Brent J. Fields, Sec'y, SEC (Nov. 7, 2018), https://www.sec.gov/comments/4-725/4725-4635930-176425.pdf.

65. *Business Roundtable Redefines the Purpose of a Corporation to Promote "An Economy that Serves All Americans,"* BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

The U.S. Chamber of Commerce (the "U.S. Chamber"). The U.S. Chamber is the world's largest business-oriented lobbying group.[66] It has sought to bring additional attention to the conflicts of proxy advisory firms through their public advocacy and SEC consultations.[67]

The Center on Executive Compensation (the "COEC"). The COEC is a lobbying organization that represents senior human resources executives at more than 325 companies in the United States.[68] It issued perhaps the most comprehensive white paper on the proxy advisory industry of any of the Corporate Lobbyists, in which the authors argue for greater accountability and oversight of proxy advisors.[69] The COEC commented on the SEC roundtable discussion and publicly supported a bill for additional regulatory oversight proposed in the U.S. Senate (described below).[70] It has also lobbied institutional investors directly on the risks posed by conflicts of interest at ISS and Glass Lewis.[71]

The Main Street Investors Coalition. Formed in 2018, the Main Street Investors Coalition was a single-issue think tank dedicated to shedding light on the outsized power of institutional investors.[72] It was run by a group of five business associ-

66. *See About Us*, U.S. CHAMBER OF COMMERCE, https://www.uschamber.com/about-us-chamber-commerce (last visited Mar. 22, 2020).

67. *See U.S. Chamber: Proxy Advisory Industry and Shareholder Proposal System Need Reform*, U.S. CHAMBER OF COM. (Oct. 9, 2018, 1:30 PM), https://www.uschamber.com/press-release/us-chamber-proxy-advisory-industry-and-shareholder-proposal-system-need-reform; Letter from Tom Quaadman, Exec. Vice President, Ctr. for Capital Mkts. Competitiveness, to Brent J. Fields, SEC (Dec. 20, 2018), https://www.sec.gov/comments/4-725/4725-4826117-177028.pdf; Letter from Tom Quaadman, Exec. Vice President, Ctr. for Capital Mkts. Competitiveness, to Brent J. Fields, SEC (Nov. 12, 2018), https://www.sec.gov/comments/4-725/4725-4636525-176432.pdf.

68. *See About the Center on Executive Compensation*, CTR. ON EXECUTIVE COMPENSATION, http://www.execcomp.org/About (last visited Mar. 22, 2020).

69. *See* COEC REPORT, *supra* note 33.

70. *See* Letter from Henry D. Eickelberg, Chief Operating Officer, Ctr. on Exec. Compensation, to Brent J. Fields, SEC (Mar. 7, 2019), https://www.sec.gov/comments/4-725/4725-5033823-183086.pdf; *Center Urges SEC to Mandate Disclosures from Proxy Advisory Firms as Bipartisan Reform Bill Introduced in Senate*, CTR. ON EXECUTIVE COMPENSATION (Nov. 20, 2018), http://www.execcomp.org/News/NewsStories/center-urges-sec-to-mandate-disclosures-from-proxy-advisory-firms-as-bipartisan-reform-bill-introduced-in-senate.

71. Dent, *supra* note 56, at 1302.

72. Press Release, PRNewswire-USNewswire, Leading National Associations Announce Launch of First-Of-Its-Kind Investor Coalition (May 18,

ates affiliated with other free market think tanks, such as the Cato Institute.[73] Despite its name, the Main Street Investors Coalition was funded by corporate executives, not retail investors.[74] Through its Astroturfing-style[75] activism, it sought to bring attention to the harm to retail investors from proxy advisory firms.[76]

B. *The Complaints*

Grievances against proxy advisors are plenty and come from all quarters, but the most vocal opponents have been the Corporate Lobbyists. Their most common complaints are: (a) proxy advisors have too much influence; (b) proxy advisors are not transparent; (c) proxy advisors provide inaccurate research; and (d) proxy advisors' business model is riddled with conflicts of interest. Each of these criticisms is considered in turn below.

1. *Proxy Advisors Have Too Much Influence*

As the number of shareholder matters voted on by institutional investors has risen, and the demand for proxy advisory

2018), https://www.prnewswire.com/news-releases/leading-national-associations-announce-launch-of-first-of-its-kind-investor-coalition-300652366.html.

73. *See* James McRitchie, *Main Street Investors: Battle Coming*, CORPGOV.NET (Oct. 2, 2018), https://www.corpgov.net/2018/10/main-street-investors-battle-coming/.

74. *See* Andrew Ross Sorkin, *What's Behind a Pitch for the Little-Guy Investor? Big Money Interests*, N.Y. TIMES DEALBOOK (July 24, 2018), https://www.nytimes.com/2018/07/24/business/dealbook/main-street-investors-coalition.html.

75. According to the Merriam-Webster's Dictionary, Astroturfing is an "organized activity that is intended to create a false impression of a widespread, spontaneously arising, grassroots movement in support of or in opposition to something (such as a political policy) but that is in reality initiated and controlled by a concealed group or organization." *Astroturfing*, MERRIAM-WEBSTER'S DICTIONARY, https://www.merriam-webster.com/dictionary/astroturfing.

76. *See* Nan Bauroth, Main Street Inv'rs Coal. Advisory Council, Comment Letter to Jay Clayton on SEC Regulation of Proxy Advisory Firms (Jan. 25, 2019), https://www.sec.gov/comments/4-725/4725-177214.htm [hereinafter Letter from Nan Bauroth]; *New Report Details Rampant Robo-Voting In Line With Proxy Advisory Firms' Recommendations*, MAIN STREET INV., https://mainstreetinvestors.org/new-report-details-rampant-robo-voting-in-line-with-proxy-advisory-firms-recommendations/. The Main Street Investors Coalition disbanded in 2019 and its website is no longer active.

services has grown, so too has the influence of proxy advisors over voting outcomes. Critics find this influence by "unaccountable" third-party agents to be problematic for the corporate governance system.[77] As evidence, the critics cite the facts that institutional investors control approximately 70% of the outstanding shares of U.S. corporations[78] and that together, ISS and Glass Lewis control about 97% of the market to provide proxy advisory services to such institutional investors.[79]

Although many institutional investors use the tools provided by ISS and Glass Lewis to inform their own research, a significant number of clients take the recommendations of proxy advisors into account in some manner, and some portion automatically vote with the recommendations (derisively referred to as "robo-voting").[80] Even when they do not actually control the votes, the recommendations of ISS and Glass Lewis often align with institutional investors' votes, creating the appearance of herd-like shareholder voting, with the proxy advisors serving as the shepherds. They have become so influential that third-party media sometimes report on their recommendations on controversial votes.[81] Just the fact that their recommendations are so broadly known and distributed gives the proxy advisors' recommendations tremendous sway in corporate boardrooms.

Perhaps nowhere is the perception of the proxy advisors' influence greater than in the area of executive compensation. Following the enactment of the Dodd–Frank Act in 2010, com-

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77. *See, e.g.*, Belinfanti, *supra* note 23, at 406 ("From an agency theory perspective, ISS presents a lethal combination – significant power and virtually no accountability.").

78. *See supra* note 8.

79. *See* Timothy M. Doyle, *The Realities of Robo-Voting*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 29, 2018), https://corpgov.law.harvard.edu/2018/11/29/the-realities-of-robo-voting/.

80. "Robo-voting" is the practice of investment companies adopting proxy advisors' recommendations without further review. Although most larger investment managers deny that they engage in the practice of robo-voting, it is generally acknowledged that some portion of the smaller managers do automatically follow their proxy advisor's recommendation. Ike Brannon & Jared Whitley, *Corporate Governance Oversight and Proxy Advisory Firms*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 7, 2018), https://corpgov.law.harvard.edu/2018/09/17/corporate-governance-oversight-and-proxy-advisory-firms/.

81. *See, e.g.*, *infra* note 181.

panies have been subject to periodic say-on-pay votes.[82] According to a 2010 survey by Towers Watson, 59% of corporate executives believed that proxy advisors have a significant influence on executive pay decisions. In a separate study by COEC, 54% of the corporate officers surveyed reported that their company had changed or adopted a new compensation plan in the prior three years to meet the executive compensation standards of ISS or Glass Lewis.

Considerable academic research has gone into examining the extent of the influence exercised by ISS and Glass Lewis. Academics and commentators have attempted to identify the approximate percentage of the aggregate proxy votes cast that are determined by their recommendations.[83] Parsing the correlation of the recommendations by proxy advisors with institutional investor preferences from the causation of directly affecting outcomes has proven to be easier said than done. So far, no consensus has emerged in the literature. The best estimates of the percentage of proxy votes controlled by the proxy advisors range from as low as 3% for Glass Lewis to as much as "a third or more" of the votes cast for ISS.[84] Some less rigorous estimates have placed the estimate even higher.[85] Statistical analysis may never give us a definitive answer, as the underlying factors and causal drivers are continually changing. But there is little question that ISS and Glass Lewis do control a portion of the votes cast and influence even more, giving them a significant role in the U.S. corporate governance system.

2. *Proxy Advisor Research Is Inaccurate*

In the abstract, proxy advisors wielding influence on the voting behavior of institutional investors is not necessarily a

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82. *See* YVAN ALLAIRE, INST. FOR GOVERNANCE OF PRIVATE AND PUB. ORGS., THE TROUBLING CASE OF PROXY ADVISORS: SOME POLICY RECOMMENDATIONS (Jan. 2013) [hereinafter IGOPP].

83. Stephen Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 871 (2010).

84. *See id.*

85. Belinfanti, *supra* note 23, at 387 (quoting Lynn A. Stout, *Why Should ISS Be the New Master of the Corporate Governance Universe?*, DOW JONES CORP. GOVERNANCE, Jan. 4, 2006) ("[W]hen institutional investors follow ISS [recommendations] en masse, directors of public corporations can expect to see 20%, 30% even 50% of their company's shares being voted not as the directors recommend, but as ISS recommends.").

problem. After all, if their influence leads to better corporate governance outcomes, say, through the production of better or more rigorous proxy research, then the system as a whole benefits. However, critics argue that the research proffered by the proxy advisors is often inaccurate, leading to poor voting recommendations and misinformed votes. Of all of the concerns held by Corporate Lobbyists, this is the one that has resonated the loudest at the SEC. The SEC has repeatedly remarked on the potential risks to institutional investors of following inaccurate proxy recommendations and has made them the focus of their Proposed Amendments.[86]

The volume of data processed by the proxy advisors is enormous. Each year, ISS and Glass Lewis process and analyze millions of proxies.[87] Yet, the internal resources devoted to data collection and analysis are comparatively modest. This is of necessity. Both ISS and Glass Lewis are subject to the standard economic pressure to contain costs relative to revenue. To attempt to remediate their resource constraints, they rely on temporary seasonal employees, "big data" analysis, and overseas contracting firms.[88] Such methods likely result in increased error rates. Often, the time available to review and process proxies is highly compressed. Under Delaware corporate law, companies are required to provide notices of annual meetings at least ten days but no more than sixty days before the meetings.[89] Because most companies hold their annual meetings in the spring, it means that the proxy advisors only have a few weeks to process and analyze the majority of all the votes cast each year.

While the vicissitudes of managing such a large number of items in such a compressed timeframe has undoubtedly led to inaccuracies in proxy advisors' research, hard data on the extent or frequency of the problem is difficult to pin down. In the 2010 COEC survey of corporate officers, 53% reported

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86. *See* Concept Release on the U.S. Proxy System, Exchange Act Release No. 62,495, 75 Fed. Reg. 42,982 (July 22, 2010) [hereinafter Concept Release]; 2019 Proxy Voting Guidance, *supra* note 36; Proposing Release, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518 (Nov. 5, 2019).

87. *See* ISS, *supra* note 44 and accompanying text; GLASS LEWIS, *supra* note 49.

88. COEC REPORT, *supra* note 33, at 56–57.

89. DEL. CODE ANN. tit. 8, § 213 (2009) (fixing date for determination of stockholders of record).

that a proxy advisory firm had made one or more mistakes in their final company compensation report.[90] The types of errors mentioned included improper peer grouping, inaccurate calculations, and research based on a plan or program no longer in effect. A review by the law firm Patton Boggs examining 107 supplemental proxy filings from 94 companies over the three-year period of 2016–2018 found that 90 of the filings cited factual or analytical errors by a proxy advisor.[91] Evidence of inaccuracies in proxy advisors' research ranges from the trivial to the legitimately troubling. For example, on the lighter end, one executive noted that ISS' report stated that "our CEO was 'entitled' to use company aircraft for personal travel, when in fact he is required to do so."[92] On the more serious side, a 2011 Stanford study examining proxy advisors' recommendations on exchange offers found that shareholders who ignored ISS experienced better post-exchange returns.[93]

Acknowledging the general lack of quality data on the errors of proxy advisors, the SEC included in its release to the Proposed Amendments information on the number of times companies cited proxy voting advice when filing amendments to their definitive proxies. Of the 5,690, 5,744, and 5,862 registrants that filed definitive proxies in 2016, 2017 and 2018, respectively, 99 (1.7%), 77 (1.3%), and 84 (1.4%) referenced errors, disputes or other discrepancies with other proxy voting materials.[94] While an error rate of less than 2% does not necessarily indicate the existence of a serious problem, the SEC was careful to point out that these numbers may underrepresent the extent of the concern, since not all companies file amendments to respond to the errors.[95]

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90. COEC REPORT, *supra* note 33, at 10.

91. Frank M. Placenti, *Are Proxy Advisors Really a Problem?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 7, 2018), https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-really-a-problem/.

92. COEC REPORT, *supra* note 33, at 59.

93. GLASSMAN & VERRET, *supra* note 21, at 14.

94. Proposing Release, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518, 66,544 (Nov. 5, 2019).

95. *Id.* at 97. The numbers may also overstate the problem, as the preponderance of the amendment filings each year referenced a general or policy dispute, which may or may not tilt towards the proxy advisor's favor, not a factual or analytical error.

3. *Proxy Advisors Are Not Transparent*

In addition to inaccuracy, Corporate Lobbyists also complain about the opacity of the methodologies the proxy advisors use to determine their voting recommendations. They allege that the proxy advisors employ a "one-size-fits-all" approach that fails to account for meaningful differences between companies and situations and other times follow a "case-by-case" approach that can lead to inconsistent recommendations.[96] This can be particularly frustrating for companies in the context of shareholder votes on executive compensation, where the difference between recommending for or against a particular compensation program can come down to complicated calculations and subjective peer group analysis.[97] After reviewing ISS' guidelines for say-on-pay votes, one critic called the assumptions underlying the ISS compensation guidelines "grand delusions," and asserted that, "It would be difficult to conjure up a more value destroying way of assessing executive compensation."[98] The lack of transparency raises questions about institutional investors' reliance on proxy advisors' recommendations in light of their duties under SEC Rule 206(4)(7), weakens their accountability, and excites concerns that the proxy advisors may have undisclosed conflicts of interest. This brings us to the next, and perhaps most serious, criticism.

4. *Proxy Advisors Are Riddled with Conflicts of Interest*

Corporate Lobbyists accuse the proxy advisors of being compromised by conflicts of interest. These charges come in two basic forms, one that focuses on worries about favoritism and another that accuses the proxy advisors—principally ISS—of self-dealing.

As for-profit firms that compete with each other for clients, proxy advisors are conflicted any time they issue a voting recommendation on a shareholder proposal brought by one of their existing or prospective clients. Because the set of prospective clients essentially constitutes the entire universe of institutional investors, some Corporate Lobbyists have suggested that this leads to proxy advisors voting in favor of more share-

96. COEC REPORT, *supra* note 33, at 60.
97. *Id.* at 58.
98. IGOPP, *supra* note 82, at 13.

holder proposals than they would if they assessed the proposals purely on the merits.[99] This conflict is even more acute for Glass Lewis, which is owned by an institutional investor, Ontario Teachers' Pension Plan, that itself makes shareholder proposals from time to time.[100]

As with any agent in a principal–agent relationship, proxy advisors have an incentive to make recommendations based on their own beliefs or to enhance their own reputation at the expense of their clients' best interests. Proxy advisors have a fiduciary duty to not substitute their personal preferences or beliefs for those of their clients on voting matters,[101] but the temptation may be difficult to resist. Even greater is the temptation to favor the views or preferences of large, lucrative clients over broader principles of shareholder value. On issues that do not lend themselves to straightforward, objective analysis, one's judgment can turn on subjective determinations or personal beliefs. It has been suggested that this is a particular concern in respect of votes on environmental, social, and governance ("ESG") matters, where proxy advisors have shown a tendency toward ideological bias.[102] There is some evidence that ISS is more likely to support proposals sponsored by labor unions.[103] Other commentators have suggested that such conflicts make proxy advisors, and particularly Glass Lewis due to its affiliation with OTPP, more likely to favor ESG proposals, even when such proposals may not provide the most benefit to their clients.[104]

Uniquely, ISS offers corporate governance consulting services to corporate clients through an affiliate of its proxy advisor. In many cases, the clients of these services are the same issuers that are the subject of ISS's proxy advisory recommendations. Although ISS has taken steps to insulate its proxy advisors from its corporate consultants, opportunities for conflicts in such situations are easy to imagine. Indeed, some companies have indicated that they have felt pressure to use ISS's corporate consulting services or else they might not receive

99. COEC REPORT, *supra* note 33, at 8.
100. *Id.*
101. Dent, *supra* note 56, at 1296.
102. GLASSMAN & VERRET, *supra* note 21, at 8.
103. *See* Tao Li, *Outsourcing Corporate Governance: Conflicts of Interest Within the Proxy Advisory Industry*, 64 MGMT. SCI. 2951, 2962 (2018).
104. Musolli, *supra* note 31, at 21–22.

favorable voting recommendations on their proxies.[105] One researcher has found evidence that ISS's voting record suggests a favoritism towards corporate managers that use their consulting services.[106] While ISS has instituted information barriers and issued disclosure to attempt to mitigate this conflict, many commentators believe that it compromises their ability to provide independent recommendations.[107]

C. *Reform Proposals*

Like the complaints, proposals for regulatory reform to address the problems with the proxy advisors have come from all quarters. Also like with the complaints, the loudest advocates for reform have been the Corporate Lobbyists. They have argued that proxy advisory firms are either unregulated or under-regulated, opaque, and largely insulated from normal market forces, creating a market failure that warrants intervention by the SEC or Congress.[108] It has not gone unnoticed that these calls for reform have come from usually reliable *opponents* of regulation, who are themselves opaque, largely unregulated, and unaccountable.[109] Proposals for regulatory change offered to fix the problems with proxy advisors include:

- requiring all proxy advisors to register as investment advisors under the Advisers Act;[110]
- requiring a mandatory issuer review and comment period for all research;[111]

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105. *Id.* at 19–20; Li, *supra* note 103, app. at 1–2 (citing Axcelis Techs. Inc., Comment Letter on Concept Release on the U.S. Proxy System (July 19, 2013), https://www.sec.gov/comments/s7-14-10/s71410-322.pdf).

106. Li, *supra* note 103, app. at 1.

107. COEC REPORT, *supra* note 33, at 42.

108. *See, e.g.*, David F. Larcker, Brian Tayan & James R. Copland, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 14, 2018), https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/.

109. Dent, *supra* note 56.

110. *See* Letter from Maria Ghazal, *supra* note 64, at 15. As ISS and Segal Marco Advisors, among other proxy advisors, are already registered as investment advisers with the SEC, it is unlikely this is a solution to the perceived problem. Musolli, *supra* note 31, at 34.

111. *See* Charles Nathan, *Proxy Advisory Business: Apotheosis or Apogee?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (March 23, 2011), https://corpgov.law.harvard.edu/2011/03/23/proxy-advisory-business-apotheosis-or-apogee/.

- new regulations on proxy advisors modeled after the regulations for credit rating agencies, or nationally recognized statistical rating organizations ("NRSROs");[112]
- a new oversight board for proxy advisors modeled after the Public Company Accounting Oversight Board ("PCAOB");[113]
- lifting the "requirement" that institutional investors vote all proxies;[114]
- additional guidance on the fiduciary duty of proxy advisors and new rules requiring additional conflicts disclosures;[115]
- requiring increased disclosure around the methods proxy advisors use to determine ratings or recommendations;[116]
- requiring the public disclosure of voting recommendations (on a delayed basis);[117]
- enhanced disclosure of policies and procedures for proxy advisors' and their affiliates' interactions with issuers;[118] and
- a new self-regulatory organization for the industry, with a code of conduct and mandatory rulebook.[119]

These proposals range from the common sense (standardized conflicts disclosure) to the byzantine (do the U.S. financial markets really need another oversight board?). Some of the proposed reforms would require an act of Congress,

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112. *See* Belinfanti, *supra* note 23, at 390; IGOPP, *supra* note 82, at 16; Concept Release, Exchange Act Release No. 62,495, 75 Fed. Reg. 42,982, 43,013 (July 22, 2010).

113. Belinfanti, *supra* note 23, at 390.

114. *See* GLASSMAN & VERRET, *supra* note 21; Brannon & Whitley, *supra* note 80, at 9. *But see supra* note 37 and accompanying text (clarifying that there is no SEC rule requiring investment advisers to vote all proxies regardless of the benefit to clients).

115. *See* COEC REPORT, *supra* note 33, at 13; Letter from Nan Bauroth, *supra* note 76.

116. *See* COEC REPORT, *supra* note 33, at 69.

117. *Id.*

118. *Id.*

119. Meagan Thompson-Mann, *Voting Integrity: Practice for Investors and the Global Proxy Advisory Industry* (Yale Sch. of Mgmt. Millstein Ctr. for Corp. Governance & Performance, Policy Briefing No. 3, 2009).

such as setting up a new government regulatory body, while others can be addressed by the SEC on its own. As commentators have pointed out, some of the proposals could have negative unintended consequences.[120] Several of the reform proposals have gotten the attention of the regulators in Washington, D.C.

D. *House and Senate Bills*

In response to the concerns about the growing influence of ISS and Glass Lewis and pressure from the Corporate Lobbyists, in late 2017 the U.S. House passed a bipartisan bill co-sponsored by Rep. Sean Duffy (R-WI) and Rep. Gregory Meeks (D-NY).[121] The bill proposed amending the Exchange Act to require proxy advisors to register with the SEC under a new proxy advisory regulatory framework to be devised by the SEC. In addition to registration, the bill would have required firms to employ an ombudsman, designate a compliance officer, make certain disclosures with the SEC and on its website, and it would have prohibited "unfair, coercive, or abusive practices."[122]

Although the Senate never voted on the bill during the 115th Congress, in November 2018, a bipartisan group of U.S. Senators in the Banking, Housing, and Urban Affairs Committee introduced a bill to amend the Advisers Act to require all proxy advisors to register as investment advisers.[123] More modest than its House counterpart, the Senate bill would have swept proxy advisors into the penumbra of existing regulations covering registered investment advisers rather than create a new regulatory framework specifically for the proxy advisory industry.

At the time of this writing, the prospects for legislative action on the proxy advisory industry in Congress are unclear. The Democratic House leadership has not yet taken a position on the issue of proxy advisor reform. For any bill to pass both chambers, there would have to be agreement on whether the new regulation should be enacted under the Exchange Act or

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120. *See* COEC REPORT, *supra* note 33, at 11; Dent, *supra* note 56, at 1304.

121. Corporate Governance Reform and Transparency Act of 2017, H.R. 4015, 115th Cong. (2017).

122. *Id.*

123. S. 3614, 115th Cong. (2018).

the Advisers Act (or another regime altogether). This distinction is likely to matter only to proxy advisor compliance practitioners, but it could have significant ramifications for the proxy advisors themselves and whether such reform helps to increase or suppress competition in the industry. It is also worth noting that during a period of heightened partisanship in Washington, both bills were introduced with bipartisan support, suggesting that there is a potential path forward for legislative reform despite the split party leadership in the House and Senate. That is, unless the SEC gets to the issue first.

E. *SEC Response*

Following the ISS and Egan–Jones no-action letters, the SEC next weighed in on proxy advisor regulation in 2010 when it issued a concept release on various aspects of the proxy voting system.[124] The release included a comprehensive discussion of the proxy advisory industry, the concerns around transparency and inaccuracy in proxy research, and conflicts of interest. Although it did not issue any definitive proposals, the release included a request for comment on a number of proposals by Corporate Lobbyists. The SEC staff held a roundtable on the use of proxy advisory firms in 2013. In 2014, it issued Staff Legal Bulletin No. 20, which provided guidance on the proxy voting responsibilities of investment advisers and the availability and requirements the Rule 14a-2(b)(1) and 14a-2(b)(3) exemptions for proxy advisors.[125]In July 2018, Chairperson Jay Clayton announced that the SEC would be holding a staff roundtable on the proxy process in November 2018.[126] The announcement included an outline of specific concerns relating to proxy advisory firms, including whether various factors were leading to the overreliance on proxy advisor recommendations. This led to speculation that the SEC was considering withdrawing its prior no-action guidance. Indeed, in September 2018, the SEC Division of Investment Management withdrew the *Egan–Jones* and *ISS* no-action letters

124. Concept Release on the U.S. Proxy System, Exchange Act Release No. 62,495, 75 Fed. Reg. 42,982 (July 22, 2010).

125. SEC Staff Legal Bulletin No. 20 (June 30, 2014), https://www.sec.gov/interps/legal/cfslb20.htm.

126. Press Release, SEC, Statement Announcing SEC Staff Roundtable on Proxy Process (July 30, 2018), https://www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process.

in anticipation of the upcoming roundtable. In light of nearly two decades of established practice, the effect of the withdrawal of the letters remains unclear.[127] Although the recent activity by the Senate Banking Committee had some people's hopes up for a spirited discussion at the roundtable, the issue of proxy advisory firms was just one of a number of proxy-related issues on the agenda for the day, and the last one at that. According to one commentator, the discussion around proxy advisors was surprisingly tepid.[128] It ended without a seeming consensus on any of the potential regulatory solutions, including mandatory proxy report review periods or the registration of proxy advisors as investment advisers.

But the SEC did not wait long before acting again. In remarks made during a speech on December 6, 2018, Chairperson Jay Clayton said that regulation of the proxy process, including proxy advisors, was one of his top initiatives for 2019.[129] In early 2019, Commissioner Elad Roisman announced that he would be taking the lead in the Commission's efforts to review the proxy voting system.[130] Then on the same day in August 2019, the SEC issued the 2019 Proxy Voting Guidance and the 2019 Solicitation Guidance. While it is too soon to assess the effect of the new guidance on market practice, the SEC sent the message that it remains concerned with the

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127. *See* SULLIVAN & CROMWELL LLP, SEC STAFF WITHDRAWS PROXY ADVISORY GUIDANCE AHEAD OF FALL ROUNDTABLE ON PROXY PROCESS (Sept. 14, 2018), https://www.sullcrom.com/files/upload/SC-Publication-SEC-Withdraws-Proxy-Advisory-Guidance-Ahead-of-Fall-Roundtable-on-Proxy-Process.pdf.

128. Cydney Posner, *What Happened at the SEC's Proxy Process Roundtable?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 21, 2018), https://corpgov.law.harvard.edu/2018/11/21/what-happened-at-the-secs-proxy-process-roundtable/.

129. Jay Clayton, Chairman, SEC, SEC Rulemaking Over the Past Year, the Road Ahead and Challenges Posed by Brexit, LIBOR Transition and Cybersecurity Risks (Dec. 6, 2018), https://www.sec.gov/news/speech/speech-clayton-120618.

130. Brian Croce, *SEC Commissioner Takes Agency Lead on Proxy-voting Efforts*, PENSIONS & INV. (Mar. 19, 2019), https://www.pionline.com/article/20190319/ONLINE/190319842/sec-commissioner-takes-agency-lead-on-proxy-voting-efforts.

use of proxy advisors by investment advisers and of the legal status of proxy advisory firms within the U.S. proxy system.[131]

Only a few months later, on November 5, 2019, in a split 3–2 vote, the SEC approved and released the Proposed Amendments.[132] If adopted, the proposal would impose a mandatory company review period for proxy adviser recommendations and create stricter conflicts disclosure requirements. It calls for amending Rule 14a-1(1) under the Exchange Act to make it clear that proxy voting advice may be considered a type of "solicitation" under the rules and revising Rule 14a-2(b) to provide a specific exemption from the information and filing requirements of the proxy rules for proxy research that meets a series of conditions. The conditions, which proxy advisors must meet to avoid the considerably more onerous solicitation rules, include providing enhanced disclosure of their conflicts of interest, giving companies between 5 and 10 days (depending on the number of days between the filing and the annual general meeting) to review and provide feedback on the proxy voting advice before it is released, giving companies a last look at the final proxy voting advice before distribution to clients, and requiring proxy advisors to include in their reports a hyperlink to the company's or soliciting person's response to the advice.[133] The proposal also includes an amendment of Rule 14a-9 clarifying when proxy voting advice could be misleading.

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131. *See* Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Exchange Act Release No. 86,721, 84 Fed. Reg. 47,416 (Sept. 10, 2019).

132. Proposing Release, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518 (Nov. 5, 2019).

133. *Id.* After receiving significant criticism during the comment period, the SEC appears to be preparing to walk back its proposal. In a speech in March 2020, Commissioner Roisman indicated that the SEC was open to considering other, less onerous options for accomplishing its policy goals than the company pre-review. Elad L. Roisman, SEC Comm'r, Speech at the Council of Institutional Investors' ("CII") Conference (Mar. 10, 2020), htps://www.sec.gov/news/speech/speech-roisman-cii-2020-03-10.

III.
ANALYSIS

A. *A Look at the Proposed "Fixes"*

The curious thing about many of the proposals for proxy voting reform, including the SEC's latest proposal, is that they would create an additional choke point in what is already a complex, multi-layered system. One of the greater challenges institutional investors face in voting proxies is how to process and analyze a large number of ballots in a relatively short amount of time. Institutional investors rely on proxy advisors in large part to help them deal with this very issue. Yet, many of the purported fixes have the potential to make the problem worse. Other proposed solutions stand to further ensconce the already entrenched proxy voting incumbents.

As we have seen, one of the top complaints against ISS and Glass Lewis is that they have too much influence. Considering the number of clients they retain and the number of ballots they administer each year, it is impossible to deny that these two dominant proxy advisors play an important role in the US corporate governance system. But certain of the reform proposals, such as those calling for enhanced oversight under the Advisers Act, regulation under a new self-regulatory organization, and registration with a new PCAOB-like advisory board, would only further entrench ISS and Glass Lewis by creating greater barriers to entry and increasing the cost of providing proxy advisory services. Greater regulatory burdens and compliance costs would suppress—not promote—the competition the industry needs.[134] While the costs might be passed along to clients eventually, the greatest burden would be felt by the smaller proxy advisory firms and potential new entrants with smaller revenue bases across which to spread the costs. Some commentators worry that additional regulation would additionally confer upon ISS and Glass Lewis a sort of government "seal of approval."[135] The SEC's prior reforms, which allowed registered investment advisers to use of third-party service providers in proxy voting, has been accused of abetting the rise of the proxy advisors in just this way.[136] It was also one

134. COEC REPORT, *supra* note 33, at 76.
135. *Id.* at 74.
136. Dent, *supra* note 56, at 1296.

of the criticisms levied against NRSRO regulation after the Global Financial Crisis, which many blamed in part on the failings of credit rating agencies.[137] The SEC raised the prospect of new proxy advisor regulations analogous to that of NRSROs in its 2010 Concept Release, noting several similarities between the business models of proxy advisors and credit rating agencies.[138] But it is hard to see how giving proxy advisors their own regulatory schema would do anything to reduce their influence in governance matters, while it might increase their perceived legitimacy.

Another common criticism is that proxy advisors do not adequately disclose all of their conflicts of interest. Many of the proposed solutions include more regulatory oversight and requiring additional mandatory disclosures. Yet, both ISS and Glass Lewis already make public disclosures on their conflicts of interest.[139] ISS disclosures cover their relationship with their corporate consulting affiliate, ISS Corporate Services, Inc.; director affiliated companies (public companies that are affiliated with a member of ISS's board of directors); their corporate Code of Ethics; and their relationship with their corporate parent, among other matters.[140] It is not clear what, if any, additional information critics are seeking when they call for greater disclosure, and whether they would ever be satisfied that the proxy advisors have provided enough disclosure. The Proposed Amendments would formalize proxy advisors' duty to disclose by requiring them to include a prominent mention of any material conflicts or other interests in the proxy materials themselves, rather than just on their websites.[141] Glass

137. GARY SHORTER & MICHAEL V. SEITZINGER, CONG. RESEARCH SERV., R40613, CREDIT RATING AGENCIES AND THEIR REGULATION 6–8 (Apr. 9, 2010).

138. Concept Release, Exchange Act Release No. 62,495, 75 Fed. Reg. 42,982, 43,013 (July 22, 2010). Note also that the parent company of Egan–Jones Proxy Services is a registered NRSRO.

139. *See* Letter from Gary Retelny, President & Chief Exec. Officer, ISS, to Brent J. Fields, Sec'y, U.S. Sec. & Exch. Comm'n (Nov. 7, 2018), https://www.issgovernance.com/file/publications/iss-roundtable-comment-letter.pdf; *Conflict of Interest Statement*, GLASS LEWIS, http://www.glasslewis.com/conflict-of-interest/ (last visited Mar. 10, 2020).

140. ISS's conflict disclosures are available on their website. *See Due Diligence Materials*, ISS, https://www.issgovernance.com/compliance/due-diligence-materials/ (last visited Mar. 10, 2020).

141. Proposing Release, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518 (Nov. 5, 2019).

Lewis believes that the new substantive disclosure requirements largely codify their current practice.[142]

Another complaint is that proxy advisors' reports contain too many inaccuracies. These errors may lead to suboptimal voting decisions that critics argue harm shareholder value. The assumption underlying this view—sometimes stated and sometimes not—is that executives and directors know what is best for their companies and, in many instances, shareholders do not. Almost by definition, this means that recommendations that do not align with the views of management are regarded as inaccurate, uninformed, and value destroying. No one denies that proxy advisors sometimes make mistakes. Mistakes are inevitable in any process involving human input and judgment. But perfection is not now, nor ever was, the relevant standard of care for providing research or advice. Regulators cannot improve registrants' performance by diktat.[143] Were it so easy institutional investors would be calling for greater oversight and control of corporate executives to improve their performance and their companies' stock prices, and of registered investment advisers to improve the quality of their security selections and investment performance. Unfortunately, the quality of outcomes is not easily improved by increased regulation. Regulation is a poor tool for improving the quality of professional services.

The SEC's preferred approach is to require mandatory company review of all proxy voting materials. There is reason to doubt whether company review will lead to better proxy voting advice. At a minimum, it would create serious timing challenges.[144] As it is, proxy advisors have only limited time to process millions of ballots. Giving companies a right to review would only further foreshorten the time proxy advisors have to process proxies and make recommendations, potentially leading to more errors committed in the rush. Further, giving companies an additional say in the process could have a chilling effect on proxy advisors' willingness to issue truly independent advice. If they believe that every disagreement over a sub-

142. Letter from Kevin Cameron, Exec. Chair, Glass Lewis, to Vanessa Countryman, Sec'y, SEC (Nov. 7, 2019), https://www.glasslewis.com/wp-content/uploads/2020/02/GL-Comment-Letter-Final.pdf.

143. *See* Dent, *supra* note 56, at 1329.

144. *Id.*

jective determination like a say-on-pay vote is likely to lead to a messy confrontation with management, they may be less inclined to issue negative advice.

Institutional investors continue to use proxy advisors because they continue to perceive value from the services. Increasing the regulation of proxy advisors will increase the cost of proxy advisory service, which may lead to fewer institutional investors using those services or using them less. If the increased costs or decreased value of third-party proxy advice were to lead institutional investors to do more of the proxy voting research themselves, that would not necessarily lead to better voting outcomes. The proxy would still need to be voted, and someone would have to bear the costs of managing it. Institutional investors do not have an obvious advantage in producing better or more accurate proxy voting research than the professional proxy advisory firms. Placing more of the burden on their already resource-constrained back offices is unlikely to improve the information quality of proxy votes, and more likely to make it worse. ISS and Glass Lewis at least face market discipline from mutual competition if clients believe that one of them is making too many mistakes or too often making recommendations that fail to promote shareholder value. Institutional investors have little choice but to seek help from somewhere.

One potential consequence of the mandatory review period required by the Proposed Amendments is that proxy advisors will cover fewer companies and issue fewer proxy voting reports. There are only so many days on the calendar in April and May, and proxy advisors are only able to rely so much on temporary seasonal staffing. Some clients need proxy advisors to cover the biggest, most widely held names, such as the companies in the S&P 500; while others need them to provide auxiliary research and recommendations on the less well-known and thinly traded small- and mid-cap companies. The extreme timing pressure imposed by the mandatory review period may force proxy advisors to focus their efforts on the most profitable (i.e., widely-held) names. The days of ISS covering upwards of 40,000 different companies may be over. That means institutional investors voting with management more frequently for smaller and more thinly traded companies.

To the extent that any of these proposed changes were to lead to the breakup of the ISS-Glass Lewis duopoly, the Corporate Lobbyists would likely applaud. But to the extent that they make the business of providing proxy advisory services economically less attractive, they may lead to further consolidation by discouraging potential new entrants from joining the market. Increase the regulatory requirements enough and there is a risk of driving participants out of the industry. That is what happened to certain segments of the broker-dealer industry following the enactment of global financial reform after the Global Financial Crisis.[145] Some Corporate Lobbyists would certainly welcome a similar fate for proxy advisors.[146]

B. *The Proxy War Against Proxy Advisors*

In his delightful little book *Wait, What?: And Life's Other Essential Questions*, former Harvard Graduate School of Education Dean and current University of Virginia President James E. Ryan makes the case that asking the question "Wait, what?" is one of the most effective ways to seek clarification and greater understanding.[147] It is a useful question to ask before drawing conclusions, as it provides an opportunity for thoughtful reflection and inquiry over advocacy. In the spirit of Jim Ryan's call for inquiry, it is well worth asking: If the proposals for fixing the supposedly broken proxy advisory industry are not well suited to the task, what is really going on? What are the Corporate Lobbyists trying to accomplish by pushing for proxy advisor reform?

If proxy advisory services were really as riddled with errors, transparency problems, and conflicts as their critics allege, one might expect their clients to be leading the charge for reform. After all, they are the ones paying for the supposedly faulty research and it is their shareholder value that is being harmed. But institutional investors and asset managers are not complaining.[148] By in large, institutional investors have come out in favor of the present proxy services model and

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145. Rey Mashayekhi, *The Death of Trading: Why More Big Banks Think the Business Is a Losing Bet*, FORTUNE (Aug. 12, 2019, 9:54 AM), https://fortune.com/2019/08/12/trading-citigroup-deutsche-bank/.

146. GLASSMAN & VERRET, *supra* note 21; IGOPP, *supra* note 82.

147. JAMES E. RYAN, WAIT, WHAT?: AND LIFE'S OTHER ESSENTIAL QUESTIONS (2017).

148. Dent, *supra* note 56, at 1308.

have defended ISS and Glass Lewis publicly.[149] According to CII, institutional investors believe that proxy advisory services are a critical, cost-effective part of the shareholder voting process and that many of the proposed reforms, including giving issuers a mandatory right to review, would threaten proxy advisors' independence and increase costs without any real benefit.[150] If there were strong dissatisfaction among clients with the services being provided by proxy advisors, they wouldn't be lobbying in support of the status quo, and one would expect market forces (i.e., competition) to arise to exploit it.[151]

The attack on proxy advisors is not about the quality of proxy advisors' recommendations. It is a maneuver to wrench back control from shareholders. It is these measures, not the proxy advisors' errors or conflicts, that are the real source of the corporate insiders' consternation. Corporate Lobbyists know that the alternative to shareholders voting on the basis of recommendations from proxy advisors is not shareholders doing more proxy research themselves. It is shareholders more frequently voting with management, which is exactly the point.[152] While investment managers face pressure from institutional investors to vote all or substantially all proxies,[153] they face similar if not greater pressure to control costs. The proponents of increased proxy advisor regulation are making a strategic wager that, if the costs of proxy advisory services increase enough, many institutional investors will rethink their approach. Without the services of the proxy advisors, institutional investors would be forced to choose between the similarly unattractive options of casting uninformed votes or not voting at all. And activists, meanwhile, faced with the prospect of even more daunting odds, would be less likely to bring proposals in the first place.

149. *See* Egan–Jones Proxy Servs., *supra* note 29; Letter from Paul Schott Stevens, Sec'y, SEC, to Brent J. Fields, President & Chief Exec. Officer, Inv. Co. Inst. (Nov. 14, 2018), https://www.ici.org/pdf/18_proxy_rountable_ltr.pdf.

150. *See supra* note 55.

151. Dent, *supra* note 56, at 1302.

152. *Id.* at 1288.

153. In addition to their fiduciary duty discussed *supra* note 27 and accompanying text, managers of registered investment companies are required to disclose how they vote proxies each year on form N-PX. SEC Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 17 C.F.R. pts. 239, 249, 270, 274 (2020).

The campaign for proxy advisor regulatory reform coincided with a number of other changes that have served to increase the influence and visibility of shareholder voting. What follows is a sampling of recent events or trends that have led to a greater emphasis on shareholder voting.

In the early 2000s a number of shareholder groups and pension funds, supported by academic research, began a push for the adoption of majority voting in director elections.[154] Advocates of majority voting believe that it makes directors more responsive to shareholders and improves companies' overall governance.[155] In response to broad support for this effort, both the Delaware General Corporation Law and the Model Business Corporation Act were revised to provide for majority voting of directors. By 2014, 86% of companies in the S&P 500 index had adopted some form of majority voting.[156] ISS's and Glass Lewis's proxy voting guidelines generally recommend in favor of majority voting proposals.[157]

Around the same time, a movement developed pushing for the declassification of corporate boards.[158] Among the most prominent advocates of declassification was the Harvard Shareholder Rights Project, led by Professor Lucian Bebchuk of Harvard Law School (the "Shareholder Rights Project").[159] The Shareholder Rights Project used shareholder proposals to

154. *See Spotlight on Proxy Matters – The Mechanics of Voting*, SEC (May 23, 2012), http://www.sec.gov/spotlight/proxymatters/voting_mechanics.shtml.

155. Under a plurality voting system, director nominees need only one more vote than their opponent to be elected. For uncontested elections, which most are, that meant that a nominee could win with a single vote.

156. *See* SULLIVAN & CROMWELL LLP, 2014 PROXY SEASON REVIEW 2 n.4 (June 25, 2014), https://www.sullcrom.com/siteFiles/Publications/SC_Publication_2014_Proxy_Season_Review.pdf.

157. ISS, UNITED STATES PROXY VOTING GUIDELINES (Nov. 18, 2019), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf; GLASS LEWIS, 2020 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE, https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf.

158. Daniel Gallagher & Joseph A. Grundfest, *Did Harvard Violate Federal Securities Law? The Campaign Against Classified Boards of Directors* 4 (Rock Ctr. for Corp. Governance at Stanford Univ., Working Paper No. 199, 2014), https://ssrn.com/abstract=2536586.

159. S'HOLDER RIGHTS PROJECT, http://www.srp.law.harvard.edu/index.shtml.

pressure boards to de-classify.[160] From 2010 to 2014, the Shareholder Rights Project contributed to the declassification of boards at about one hundred S&P 500 and Fortune 500 companies.[161] Due to initiatives by the Shareholder Rights Project and others, the number of S&P 500 companies with classified boards decreased by 80% between 2000 and 2013.[162] Both ISS and Glass Lewis recommend in favor of proposals to repeal classified boards.[163]

In 2009, the SEC approved an amendment to New York Stock Exchange ("NYSE") Rule 452 that eliminated broker discretionary voting in uncontested elections.[164] Previously, brokers were allowed to exercise discretionary voting authority over shares held in "street name" accounts on "routine" matters for which they did not receive voting instructions.[165] This change made it more difficult for directors to receive majority support on many proxy matters, as the unvoted ballots reduced the number of affirmative votes received.

The next year, 2010, was the watershed year of the Dodd–Frank Act. The Dodd–Frank Act gave shareholders greater say on executive pay ("say-on-pay" votes) and the proxy access rule. The say-on-pay rule required companies to hold nonbinding shareholder votes on their executive compensation plans at least once every three years. It also required more disclosure around and sometimes a shareholder vote on, executive compensation payments related to a sale, merger, or acquisition of the company (so-called "golden parachutes"). Broker discretionary voting on executive compensation issues,

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160. Following the corporate takeover boom of the 1980s, many corporations had adopted classified board structures that provided for staggered director elections on three-year cycles. The three-year cycles meant that potential activist buyers would have to wage two separate proxy contests to take control of a board. Opponents of classified boards argued that they made directors less accountable to shareholders than directors who were elected each year and discouraged hostile corporate takeovers and the potentially lucrative offers they might bring.

161. *News Alert*, S'HOLDER RIGHTS PROJECT (Mar. 11, 2014), http://srp.law.harvard.edu/newsletters/3-11-2014_SRP_newsletter.shtml.

162. Gallagher & Grundfest, *supra* note 158.

163. ISS, *supra* note 157; GLASS LEWIS, *supra* note 157, at 23.

164. Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452, Exchange Act Release No. 60,215 (July 1, 2009), https://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf.

165. COEC REPORT, *supra* note 33, at 29–30.

such as say-on-pay and golden parachutes, was specifically prohibited.[166]

Shortly after the passage of the Dodd–Frank Act, the SEC adopted a market-wide proxy access rule in the form of Exchange Act Rule 14a-11.[167] This followed many years of unsuccessful efforts to clarify the SEC's authority to adopt a rule to allow long-term shareholders to nominate alternative candidates to a company's board of directors.[168] Rule 14a-11 gave shareholders holding 3% of a company's shares for at least 3 years the ability to nominate director candidates.[169] After a legal challenge by The Business Roundtable and the U.S. Chamber, Rule 14a-11 was vacated by the D.C. Circuit in *Business Roundtable v. SEC*.[170] Since the *Business Roundtable* decision, shareholders have used Rule 14a-8, as amended in 2011, to make proposals seeking proxy access.[171] In 2014, the New York City Comptroller and the New York City Retirement Systems, supported by the CII, began using 14a-8 to launch their "Boardroom Accountability Project" to pressure companies to amend their bylaws to allow proxy access. Since 2014, the number of companies with meaningful proxy access provisions increased from just 6 to over 600, including over 70% of the S&P 500.[172] Scott Stringer, the New York City Comptroller, has called the campaign a "groundbreaking" effort that allowed shareholders to "flip the script" on management.[173] ISS and Glass Lewis have generally supported proxy access proposals.[174]

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166. *Id.* at 30.

167. Facilitating Shareholder Director Nominations, 17 C.F.R. pts. 200, 232, 240, 249 (2020) [hereinafter Rule 14a-11].

168. Gregory, Grapsas & Holland, *supra* note 19, at 1.

169. Rule 14a-11, 17 C.F.R. pts. 200, 232, 240, 249.

170. Bus. Roundtable v. SEC, 647 F.3d 1144, 1146 (D.C. Cir. 2011).

171. Gregory, Grapsas & Holland, *supra* note 19. Rule 14a-8 requires holding at least $2,000 in market value, or 1%, whichever is less, of the company's shares for at least one year.

172. *Id.*

173. Press Release, N.Y.C. Comptroller Scott M. Stringer, Comptroller Stringer's Boardroom Accountability Campaign Delivers 10,000% Growth in Proxy Access over Just Five Years (Sept. 19, 2019), https://comptroller.nyc.gov/newsroom/comptroller-stringers-boardroom-accountability-campaign-delivers-10000-growth-in-proxy-access-over-just-five-years/.

174. Gregory, Grapsas & Holland, *supra* note 19.

The last decade has seen a marked increase in the number of shareholder proposals relating to environmental and social issues. Such resolutions have included proposals to increase climate risk reporting,[175] limit political spending,[176] report on gender pay disparities,[177] and stop certain practices considered unethical to animals.[178] Companies frequently object to these types of proposals under the "ordinary business" exception in Rule 14a-8(i)(7) on grounds that they relate to matters not significant enough to rise to the level of shareholder oversight or constitute micromanagement.[179] Perhaps the best known of the successful ESG proposals to get through the SEC vetting process were the 2017 ballot measures brought by the New York State Comptroller and the Church of England to Exxon Mobil and by CalPERS to Occidental Petroleum. The resolutions called for the large oil and gas companies to perform a scenario analysis to study the impact of climate change on their businesses. The companies originally sought to exclude the proposals under the Rule 14a-8(i)(7) exceptions, however, no-action relief was not granted and the proposals were allowed to proceed.[180] The measures were noteworthy because they survived the SEC challenge and were ultimately supported by a majority of shareholders, following favorable recommendations by ISS and Glass Lewis.[181] Al-

175. *See* Callan & DeNicola, *supra* note 8.

176. *See* Jon Hale, *Proxy Season Shows ESG Concerns on Shareholders' Minds*, MORNINGSTAR (Aug. 22, 2019), https://www.morningstar.com/articles/943448/proxy-season-shows-esg-concerns-on-shareholders-minds.

177. *Id.*

178. Matteo Tonello, *Shareholder Voting in the United States: Trends and Statistics on the 2015–2018 Proxy Season*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 26, 2018), https://corpgov.law.harvard.edu/2018/11/26/shareholder-voting-in-the-united-states-trends-and-statistics-on-the-2015-2018-proxy-season/.

179. SEC Staff Legal Bulletin No. 14K (Oct. 16, 2019), https://www.sec.gov/corpfin/staff-legal-bulletin-14k-shareholder-proposals.

180. Mary Beth Gallagher, Notice of Exempt Solicitation Pursuant to Rule 14a-103 to ExxonMobil (Apr. 21, 2017), https://www.sec.gov/Archives/edgar/data/34088/000121465917002667/t421170px14a6g.htm; Simiso Nzima, Notice of Exempt Solicitation Pursuant to Rule 14a-103 to Occidental Petroleum (Apr. 12, 2017), https://www.sec.gov/Archives/edgar/data/797468/000114036117015624/formpx14a6g.htm.

181. James R. Copland & Margaret M. O'Keefe, *Climate-Change Proposals Break Through*, PROXY MONITOR, https://www.proxymonitor.org/Forms/2017Finding1.aspx; Cydney S. Posner, *Are Shareholder Proposals on Climate*

though the resolutions themselves were non-binding, both companies issued enhanced climate change reports in 2018. (Neither of the companies' analyses found that a hypothetical two-degree Celsius temperature rise would negatively impact its business prospects.)

More recently, a number of prominent institutional investors have announced plans to vote against certain board nominations if the companies fail to nominate more diverse candidates for their board seats. In 2017, CalPERS, which manages over $300 billion for more than 1.6 million California public employees, retirees, and their families, sent letters to more than 500 public companies regarding the diversity of their board of directors.[182] As of July 31, 2018, CalPERS had voted against 438 directors at 141 companies that had not shown sufficient improvement following the 2017 diversity engagement.[183] Big Three investment manager SSgA launched its Fearless Girl campaign, named after the eponymous statue erected on Wall Street, also in 2017. In the first year of the campaign, SSgA voted against 512 directors for failing to take action on diversity; in 2018 they voted against 581.[184] As a result of the campaigns of CalPERS, SSgA, and others, by July 2019 the last member of the S&P 500 with an all-male board of directors announced that it would be appointing its first female director.[185]

If corporate executives feel under attack, to a degree they are right. Institutional investors are bringing more share-

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Change Becoming a Thing?, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 21, 2017), https://corpgov.law.harvard.edu/2017/06/21/are-shareholder-proposals-on-climate-change-becoming-a-thing/.

182. Press Release, CalPERS, CalPERS Expands Engagement for Greater Diversity on Corporate Boards to More Than 500 U.S. Companies (Aug. 22, 2017), https://www.calpers.ca.gov/page/newsroom/calpers-news/2017/engagement-corporate-board-diversity.

183. CALPERS, CALPERS COMMITMENT TO DIVERSITY & INCLUSION REPORT (2017–18), https://www.calpers.ca.gov/page/forms-publications/diversity-inclusion-report-2017-18.

184. *State Street Global Advisors Reports Fearless Girl's Impact*, STATE STREET GLOBAL ADVISORS (Sept. 27, 2018), https://newsroom.statestreet.com/press-release/corporate/state-street-global-advisors-reports-fearless-girls-impact-more-300-companie.

185. Ruth Umoh, *The Last All-Male Board On The S&P 500 Just Added A Female Member*, FORBES (July 25, 2019), https://www.forbes.com/sites/ruthumoh/2019/07/25/the-last-all-male-board-on-the-sp-500-just-added-a-female-member.

holder proposals and voting with management less frequently today than in earlier periods. During the heyday of the Wall Street Rule, the default was for shareholders to vote with management on proxies.[186] As recently as 1997, mutual funds were still voting with management on routine matters, on average, more than 86% of the time.[187] On certain types of votes, such as executive compensation, the rate was over 90%.[188] Even on non-routine matters, shareholders on average voted against management proposals less than 12% of the time and voted for shareholder proposals only 15% of the time (and only six percent for shareholder proposals on social issues).[189] Fast forward to the mid-2010s, and you see a very different picture. "For" votes on shareholder proposals relating to ESG issues are on the rise.[190] In 2019, resolutions relating to disclosure on diversity received "for" votes 44% of the time, up from 13% in 2015; resolutions on human rights received "for" votes 30% of the time, up from 9 percent in 2015; and resolutions relating to gender pay equity disclosure received supporting votes 26% of the time, up from seven percent in 2015.[191] In addition to the prominent proposals at ExxonMobil and Occidental Petroleum that received majority support in 2017, ten environmentally or socially-themed shareholder proposals received the support of a majority of the voting shares in 2018 and 14 received majority support in 2019.[192] Also in 2018, 53 executive compensation plans failed to receive the support of a majority of shareholders.[193] Nearly all of those companies had had successful say-on-pay votes just the year before, suggesting that executive compensation plans are being scrutinized more closely. About twice that many, 5.7%, passed say-on-pay proposals with the support of less than 70% of the votes cast, the

186. Bayless Manning, *The Shareholder's Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 261 (1962).

187. Jennifer E. Bethel & Stuart L. Gillan, *The Impact of the Institutional and Regulatory Environment on Shareholder Voting*, 31 FIN. MGMT. 29, 29–54 (2002).

188. *Id.*

189. *Id.*

190. It is important to note for the following discussion that a "for" vote on a shareholder proposal is effectively a vote *against* management. If management favors a proposal, it reaches an agreement with the filing shareholder to withdraw the proposal.

191. Hale, *supra* note 176.

192. *Id.*

193. Tonello, *supra* note 178

rate at which the proxy advisors consider making a negative recommendation in the future.[194]

First, shareholders demanded majority voting and the declassification of staggered boards, making directors more vulnerable to attacks by activists. Then shareholders began asking for a greater say on matters that corporate executives hold dear: Executive pay and board nominations. And now management teams must respond to a perpetual series of shareholder proposals asking them for unnecessary (in the eyes of management) reports and useless policies. Individually, these developments, occurring over a twenty-year period represent a series of modest incremental changes in shareholders' influence in corporate governance; but collectively, they signify a shift in the balance of power between institutional investors and corporate management. What was once the sole domain of corporate executives has gone through a period of democratization—albeit a modest one—and the corporate executives do not like it. It has not gone unnoticed that votes against management became much more common after the proxy advisors appeared, and corporate executives and directors have reacted accordingly.[195]

This is one battlefield in what has become a multi-front conflict. In addition to the push for increased proxy advisor regulation,[196] the Corporate Lobbyists have also targeted shareholder access. In 2017, a Republican-backed bill in the House dubbed the "Financial CHOICE Act" would have provided for a significant rollback of Dodd–Frank Act reforms, including a repeal of the proxy access rule and substantial increases to the resubmission thresholds for shareholder proposals.[197] A similar bill the following year would have required the SEC to raise the resubmission thresholds for shareholder proposals that failed to receive majority support in the prior year.[198] Both bills failed to pass. In September and October 2019, the SEC announced a series of changes to how it will

194. *Id.*

195. Dent, *supra* note 56.

196. *Id.* at 1289 ("[Corporate executives] and their allies are waging a massive campaign to hobble the proxy advisors.").

197. Financial CHOICE Act, H.R. 10, 115th Cong. (2017).

198. Dimitri Zagoroff, *Legislative Threat to Shareholder Rights*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 12, 2018), https://corpgov.law.harvard.edu/2018/06/12/legislative-threat-to-shareholder-rights/.

respond to public companies' no-action requests for excluding shareholder proposals pursuant to Rule 14a-8. The first announcement stated that the SEC staff may decline to state a view on a particular request to exclude a shareholder proposal from its proxy, and starting with the 2019–2020 proxy season, may respond orally rather than in writing.[199] These changes represent a departure from the staff's past practice of responding to most requests in writing. The CII believes that these changes will reduce transparency and accountability in the Rule 14a-8 review process.[200] On October 16, 2019, the SEC staff issued a bulletin providing additional guidance to companies on the process for excluding proposals under the "ordinary business" exception of Rule 14a-8(i)(7).[201] Then on November 5, 2019, the same day that it voted on and released the Proposed Amendments to the proxy solicitation rules, the SEC voted on and approved a proposal for a series of amendments to modernize the shareholder proposal rule (the "14a-8 Amendments").[202] It would raise the ownership threshold for shareholders to be eligible to submit a proposal from $2,000 or 1% for a company's shares for at least one year to $2,000 for at least three years; $15,000 for at least two years; or $25,000 for at least one year.[203] The proposal would also raise the current resubmission thresholds of 3%, 6% and 10% for matters voted on once, twice or three times in the prior five years to 5%, 15% and 25%, respectively.[204] The amendments would allow companies to exclude proposals that had been voted on three or more times in the past five years and (i) received less than 50% of the votes cast and (ii) experienced a decline in support of 10% or more since the prior vote, whether or not it

199. *Announcement Regarding Rule 14a-8 No-Action Requests*, SEC (Sept. 6, 2019), https://www.sec.gov/corpfin/announcement/announcement-rule-14a-8-no-action-requests.

200. Letter from Kenneth A. Bertch, Exec. Dir., Council of Institutional Inv'rs, to William Hinman, Dir., Div. of Corp. Fin., SEC (Sept. 6, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/Final_no_action_orgs_letter.pdf.

201. SEC Staff Legal Bulletin No. 14K (Oct. 16, 2019), https://www.sec.gov/corpfin/staff-legal-bulletin-14k-shareholder-proposals.

202. Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, Exchange Act Release No. 87,458, 84 Fed. Reg. 66,458 (proposed Nov. 5, 2019) (to be codified at 17 C.F.R. pt. 240).

203. *Id.* at 66,463.

204. *Id.* at 66,471.

clears the 25% resubmission threshold.[205] If passed, the rule changes would represent another victory for corporate lobbyists, who have for years advocated increases to the shareholder voting resubmission thresholds.[206]

IV.
IF YOU REALLY WANT TO IMPROVE THE QUALITY OF PROXY VOTING

In focusing on conflicts disclosure and mandatory company review, the SEC's Proposed Amendments prioritize improving the accuracy of proxy voting information over other considerations. The Proposing Release states that the goal of the amendments is to "address certain specific concerns about proxy voting advice businesses and . . . help to ensure that the recipients of their voting advice make voting determinations on the basis of materially complete and accurate information."[207] Improving the accuracy, transparency, and completeness of proxy advice is a fine goal, but it is a peculiar thing for the SEC and Corporate Lobbyists to be fixated on. No one is advocating for more error-prone, opaque, and misleading proxy advice. Investors and executives receive information every day from a variety of sources, such as investment consultants, management consultants, data providers, buy-side analysts, sell-side analysts, journalists, TV pundits, and various industry-specific experts, to name a few. But none of these information providers has been the subject of a multi-decade lobbying campaign.[208] The thing that matters at the end of the day is not the quality of the proxy voting information that institutional investors receive, but the quality and consistency of

205. *Id.*

206. *See, e.g.*, CTR. FOR CAPITAL MKTS. COMPETITIVENESS, SHAREHOLDER PROPOSAL REFORM: THE NEED TO PROTECT INVESTORS AND PROMOTE THE LONG-TERM VALUE OF PUBLIC COMPANIES (2017), http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/023270_CCMC-SEC-Shareholder-Proposal-Reform-Report_Online_Report.pdf.

207. Proposing Release, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518, 66,521 (Nov. 5, 2019) [hereinafter Release No. 87,457].

208. Sell-side analysts are subject to regulation and oversight by Finra, and as a group were subject to enhanced scrutiny after the dot-com bubble burst, but it generally wasn't the companies who were complaining. The worst cases involved analysts issuing "buy" recommendations for stocks based on lucrative business generation by another part of the firm.

the proxy *votes*. The SEC correctly requires investment advisors to exercise reasonable care in the discharge of their proxy voting duties, including when selecting a proxy advisor, and holds them to an obligation to make voting determinations in the best interests of clients and disclose any conflicts of interest.[209] To the extent that inaccurate information is leading to faulty proxy voting outcomes, the fault ultimately lies with the institutional investors, not their intermediaries.

The unfortunate reality is that institutional investors often have very little at stake on the outcome of any particular proxy vote and face weak incentives to get the voting right. As discussed *supra* Part I, institutional investors tend to be well-diversified and are often holding the shares passively, leaving them uninformed about the companies they own. As Professors Stephen Choi, Jill Fisch, and Marcel Kahan put it, most institutional investors have little or no economic incentive to engage in the research necessary to make informed proxy voting decisions:

> According to conventional wisdom, these institutional investors generally do not care enough about their votes to cast an informed ballot. They hold shares in too many companies, so any particular stake represents a small fraction of their portfolio, and how they vote is unlikely to affect the outcome and even if it did, the effect on the value of their portfolio would be minimal. Researching the issues on a company's annual meeting agenda is costly, and institutions may also lack the necessary expertise to evaluate these issues adequately.[210]

Institutional investors hire proxy advisors because they cannot perform the same services better or more cheaply themselves. The proxy advisor industry developed because dedicated specialists, pooling resources across a wide client base, can process and vote proxies more efficiently than the back offices of thousands of different institutional investors, not because they are inherently better at making determinations that affect shareholder value.

Meanwhile, the group with the best information and most expertise on a particular business are the ones making the cor-

209. *See* Release No. 86,721, *supra* note 42.
210. Choi, Fisch & Kahan, *supra* note 83, at 870 n.3.

porate decisions—the company executive officers and directors. Unlike most shareholders and proxy advisors, corporate insiders are involved in the day-to-day business of their companies and care a great deal about the outcome of shareholder votes. It is their pay on which shareholders exercise their say, it is their board elections that are contested, and it is their business activities (or inactivity) that activist shareholders target with their proposals. They stand to lose when a say-on-pay vote or director election does not go their way. They are highly incentivized in most circumstances to act prudently and in the best interests of the company. As the corporate lobbyists are quick to point out, directors, too, have a fiduciary duty to act in the best interests of shareholders, no less solemn than that of investment managers.[211] In the vast majority of cases, their business judgment leads to outcomes as good as or better than those recommended by shareholders and proxy advisors. Also, although less relevant, it is their time, energy, and effort that is wasted when shareholders elect a proposal contrary to management's intention.

But that does not mean they are immune from error either or that their recommendations should be taken as sacrosanct. Both corporate managers and shareholders should be open to alternative solutions that would address the tension between the sometimes-competing interests of shareholders making informed voting decisions and controlling the costs of procuring and managing the information necessary to make those decisions.

A. *A Market Solution*

The proxy advisory industry developed as a market solution to the problems of institutional investor proxy voting.

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211. One commentator has gone so far as to suggest a kind of business judgment rule for shareholder proposals as a solution to the problem of proxy advisor research inaccuracies:

> Directors have duties to act with a view to the best interest of the corporation and to exercise the care, diligence and skill and to devote sufficient time when contemplating matters submitted to the shareholders' vote. Therefore, if a proxy advisor is to recommend against a matter put forward by the board, it should be required to allocate sufficient qualified resources to analyze the matter.

IGOPP, *supra* note 82, at 16 (quoting an executive of Power Corp.).

Before endorsing regulatory intervention, it is worth first asking if there are other potential market solutions to address the existing deficiencies. The standard market-based response to a market failure is to promote competition. As we have seen, one of the primary drivers of the growth in proxy advisory services is the pressure on institutional investors to reduce costs. Therefore, an obvious path for a would-be competitor to ISS and Glass Lewis would be to offer a similar service at a reduced cost. From the customer's perspective, the ideal price of a service is always free.

The idea of a service provider offering its services to customers for free, or nearly so, is not as outlandish as it might seem at first. There are many examples of products or services offered to end-users for free and supported by alternative revenue sources. Most government data is supported through tax revenue and provided to the public for free. The equivalent in the proxy research space would be if the NYSE or Nasdaq used a portion of its revenue to support independent proxy voting research. Many non-profits and think-tanks produce research that is offered for free and financially supported by donations and foundation grants. An alternative for-profit financial model would be one in which the seller of the research data, in this case, the corporations, pays for the service. While the buyer-pay model has been pervasive in the proxy advisory industry since its inception, a seller-pay model has prevailed in elsewhere in the financial industry, most notably in credit ratings.

In fact, alternative revenue models have been tried before in the proxy services industry. In 2005, Proxy Governance, Inc. ("PGI") began offering proxy research, recommendation and voting services.[212] PGI was initially funded with a large bulk subscription paid for by the members of The Business Roundtable.[213] In 2010, PGI attempted to convert into a not-for-profit enterprise.[214] The statement announcing the shift declared that the purpose was to serve those investors, particularly individual and small- to medium-sized firms, that were underserved by the existing model. The new entity would "offer basic corporate governance and proxy voting services for free

212. COEC Report, *supra* note 33, at 37.
213. *Id.*
214. *Id.* at 38.

and reduced cost."[215] Ultimately, PGI's effort to transform into a non-profit quasi-public utility was unsuccessful. The firm closed down in 2011.[216] But that does not necessarily mean that the idea of a seller-pays or non-profit proxy research provider cannot work. The investment research industry is in the process of a seismic shift, as new entrants and alternative data providers disrupt the landscape. Advances in crowdsourcing and artificial intelligence in the last decade stand to significantly reduce the ongoing costs associated with gathering information and making recommendations. If the conflicts of interest and quality of research of ISS and Glass Lewis are really as problematic as the Corporate Lobbyists contend, there should be a strong appetite from institutional investors for a superior alternative. And a service offered for free or at a significant discount to the current offerings could be quite attractive to investment managers even if the quality of the research is merely on par with and not clearly superior to that of the incumbents.

Alternative financing models are not without their own challenges. Non-profits face the perpetual challenge of running a sustainable business model. A seller-paid proxy advisory service, even if financially viable, would mean swapping out one set of conflicts of interest for another. A proxy advisor supported by a seller-pays subscription model would face at least as much, if not more, pressure to appease its fee-paying members—the corporates themselves—as ISS and Glass Lewis do their institutional investor clients today. As previously mentioned, the NRSRO model, the best example of a sell-pays model for financial research, is not without its own flaws and critics. But conflicts can be managed, and a diversity of opinions is one of the chief virtues of a market-based solution. A viable third (or fourth or fifth) competitor would push all of the industry participants to improve their offerings and reduce costs.

B. *Dual-Class Shares, Poll Taxes, and Literacy Tests, Oh My*

A persistent thread across the complaints against shareholder activism and proxy advisors is that too many of their recommendations are either ill-informed or contrary to the

215. *Id.* at 38.
216. *Id.* at 49.

goal of maximizing shareholder value.[217] These complaints have more than a grain of truth. In reality, the quality of many shareholder proposals and proxy voting research leaves much to be desired. But it does not follow that increased regulation of proxy advisors is the appropriate response. There are of course other ways of improving the quality of shareholder voting than raising the bar on shareholders' third-party service providers. The most obvious way is to limit the voting rights of uninformed or disinterested voters. In the extreme, that takes the form of full shareholder disenfranchisement.

Questions about the value of shareholder voting date back to the origins of corporate theory.[218] So too do the founders' and controlling shareholders' efforts to strip passive and minority shareholders of voting rights.[219] Although the right to elect directors and vote on other important corporate matters is often taken for granted, it need not be so. Ford Motor Company, The New York Times Co., CBS and News Corp. all have dual-class structures that give founders or a controlling family super voting rights.[220] More recently, prominent technology companies such as Google (now Alphabet Inc.), Facebook, LinkedIn, and Snap held initial public offerings with dual-class shares, attracting renewed interest in the practice.[221] Dual-class share companies offer one class of shares to the public and another with greater voting rights to founder(s) or controlling shareholders. The differential voting rights can be perpetual or sunset upon a certain triggering event, such as the sale of all or substantially all of the

217. This is true even putting aside issues of stakeholder capitalism, which is the idea that the purpose of a corporation is to serve the interests of all of its major stakeholders, not just shareholders. Other stakeholders may include employees, customers, suppliers and the local community. The issue received international attention following the release of a revised Statement on Corporate Purpose by the Business Roundtable in August 2019. *See* Bus. Roundtable, *supra* note 65.

218. *See* Adolf Berle & Gardiner Means, The Modern Corporation and Private Property (1932).

219. *Id.*

220. *See* Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Va. L. Rev. 585 (2017).

221. Benjamin Robertson & Andrea Tan, *Dual-Class Shares: Second-class Investors?*, Bloomberg (Jan. 14, 2019), https://www.bloomberg.com/quicktake/dual-class-shares.

supermajority shares or upon the death of the founder.[222] (Shares with more than two voting classes are known as multi-class shares).

Supporters of dual-class shares justify the practice on two grounds. First, that the empowered leader or leaders are uniquely suited to lead the company and therefore deserving of the additional control.[223] An example of this kind of visionary leader is Mark Zuckerberg, the founder of Facebook. Second, that dual-class structures insulate management from undesirable short-term market forces and pressure from activist shareholders.[224] The evidence supporting these claims is mixed.[225] In a series of papers, Lucian Bebchuk of Harvard Law School and Kobi Kastiel of Tel Aviv University have warned of the perils of dual-class structures.[226] The major index providers have also voiced their disapproval by enacting rule changes to exclude companies with several classes of stock from certain indexes.[227]

Both the arguments in favor of dual-class shares and the arguments in favor of proxy advisor regulation call for greater deference to existing management and greater barriers for interference by intransigent shareholders (and their proxies). Both of these lines of reasoning take for granted the dual presumptions that management knows best and that shareholders are less likely to act in the long-term best interest of the com-

222. Bebchuk & Kastiel, *supra* note 220.

223. *Id.*

224. Rick Fleming, Inv'r Advocate, SEC, Dual-Class Shares: A Recipe for Disaster (Oct. 15, 2019), https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster.

225. *Id.*

226. Bebchuk & Kastiel, *supra* note 220; *see also* Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453 (2019); Lucian A. Bebchuk & Kobi Kastiel, The Perils of Dell's Low-Voting Stock (Mar. 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3285296.

227. Press Release, S&P Dow Jones Indices, S&P Dow Jones Indices Announces Decision on Multi-Class Shares and Voting Rules (July 31, 2017), https://www.prnewswire.com/news-releases/sp-dow-jones-indices-announces-decision-on-multi-class-shares-and-voting-rules-300496954.html; FTSE RUSSELL, FTSE RUSSELL VOTING RIGHTS CONSULTATION – NEXT STEPS (July 2017), http://www.ftse.com/products/downloads/FTSE_Russell_Voting_Rights_Consultation_Next_Steps.pdf; MSCI, TEMPORARY TREATMENT OF UNEQUAL VOTING STRUCTURES IN THE MSCI EQUITY INDEXES (Jan. 2018), https://www.msci.com/documents/1296102/5603800/TemporaryTreatment.

pany. However, the proponents of proxy advisor regulation generally do not argue for the complete abolition of shareholder voting. They at least pay lip service to the important role of shareholder voting in corporate governance. Instead, they call for reform measures intended to improve the quality of proxy voting information shareholders receive and, ultimately, the quality of the votes themselves. This is the argument that a majority of the SEC Commissioners found convincing,[228] so it is worth taking seriously. But proxy advisor regulation is a highly attenuated way of improving shareholder voting outcomes.[229] It is costly and time-consuming to research and cast informed votes, and while shareholders collectively have an interest in value-maximizing voting outcomes, very few institutional investors have an economic incentive to invest the resources necessary to be fully informed on any particular proxy vote.[230] This leads to underinvestment in proxy voting and many uninformed votes being cast, which is a bad result from the shareholders' perspective and an even worse result from the perspective of management, who tend to have more at stake on individual voting outcomes. To corporate officers, it means too many sheep grazing in their pasture.[231] The traditional solution to this collective action problem is to require financial intermediaries to exercise a reasonable standard of care in the voting of proxies on behalf of their clients.[232] This is the approach that has been blessed into law by the SEC and Department of Labor.[233] Another solution would be to use pricing mechanisms to incentivize institutional investors to seek the best and most reliable information, or, if they make a rational determination that the cost of procuring the information does not exceed the benefit, not to vote at all.

Two pricing mechanisms that have been used in other contexts to improve voting outcomes (from the perspective of the entrenched leadership) and discourage marginal voters

228. *See* Release No. 87,457, *supra* note 207 and accompanying text.

229. Dent, *supra* note 56, at 1295–96; *see also id.* at 1307 ("Only if we want to rescind shareholder democracy does it make sense to forbid reliance on proxy advisors.").

230. *See* Choi, Fisch & Kahan, *supra* note 83.

231. *See* Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243 (1968).

232. Dent, *supra* note 56.

233. *See supra* notes 26–27.

from voting are poll taxes and literacy tests. A poll tax is a tax or fee that must be paid as a prerequisite for voting. A literacy test is a test used to assess a voter's fitness for voting. Both devices have deservedly bad reputations due to their historical use to disenfranchise African American voters in the South, but, if one can put that ugly history aside, it is easy to imagine how the devices might be used to eliminate the problem of bad proxy research and uninformed voting in the context of shareholder voting. For example, companies could adopt a bylaw that requires any shareholder wishing to cast a proxy vote in favor of a shareholder proposal to pay a nominal voting fee. Raising the cost would discourage the most disinterested and least informed shareholders from voting and result in a more engaged and better-informed pool of voters. Only the shareholders truly interested in the voting outcome, who happen to be the shareholders most likely to do their own independent research or to closely scrutinize third-party research, would be inclined to vote. Alternatively, or in conjunction, a company could adopt a policy eliminating electronic proxy voting on certain types of voting matters. Requiring all votes in favor of shareholder proposals to be cast in person or using old-fashioned paper ballots would make so-called robo-voting more difficult, thereby discouraging marginal voters from voting. Or it could require shareholders that wish to vote by mail-in or electronic ballots to fill out a unique questionnaire—a kind of CAPTCHA for proxy voting.[234] The SEC considered the similar idea of prohibiting pre-populated or automatic voting mechanisms but ultimately decided against it on the grounds that it would discourage shareholders from voting and make it difficult for companies to meet quorum requirements.[235] Both mechanisms would effectively increase the cost of proxy voting, which would discourage shareholders from voting for the less credible shareholder proposals.

Each of these solutions have problems of their own. In some cases, they would require majority shareholder approval to adopt, which would likely face stringent opposition, and

234. CAPTCHA is a program that protects websites against bots by generating and grading tests that humans can pass but current computer programs cannot. *See* THE OFFICIAL CAPTCHA SITE, http://www.captcha.net (last visited Mar. 22, 2020).

235. Proposing Release, Exchange Act Release No. 87,457, 84 Fed. Reg. 66,518 (Nov. 5, 2019).

they may run afoul of existing SEC rules, Delaware Corporations Law or exchange listing rules. They also run counter to the general interests of the company in achieving greater shareholder voting turnout on most routine matters. Nonetheless, if the proxy voting problem is ultimately a problem of shareholders making uninformed or misinformed proxy votes, there are other potential mechanisms that might improve the information quality of shareholders' voting besides further regulation of proxy advisors.

Conclusion

The SEC's Proposed Amendments represent the latest, but undoubtedly not the last, development in a long-running battle between corporate executives and shareholder activists. It is the culmination of a concerted, decade-long effort by corporate interests to convince regulators to reign in the influence of proxy advisors. Once the two top proxy advisors were viewed as complicit in the shareholder activism renaissance, most notably with their research and recommendations on say-on-pay votes, they became natural targets of the Corporate Lobbyists.[236] Effective proxy campaigns require independent shareholder voting, and independent voting requires independent inquiry and research, which today is performed in part—and for some institutional investors, in toto—by third-party proxy advisors. Institutional investors do not need independent research for the large majority of votes that are straightforward and uncontested. Institutional investors subscribe to proxy advisory services for voting guidance on the proxy votes that are difficult and not obvious, at least not without supplementary research. If institutional investors are not able to get this guidance and research, because proxy services become too expensive, too slow, or provide too narrow research coverage, investors will be less likely—and in some cases legally prohib-

236. Letter from Kenneth A. Bertsch, *supra* note 55 ("Issuers and their paid advisors have been lobbying the Commission for years to adopt regulatory policies designed to hamper proxy advisors because they view proxy advisors as the "engine" behind successful 14a-8 campaigns to reform corporate governance and investors' attempts to restrain excessive or ill-designed executive compensation.").

ited from—voting for independent shareholder proposals and director nominations.[237]

Taken to their logical conclusions, the arguments for enhanced proxy advisor regulation and for raising the requirements for proxy access are not about leveling the playing field or maximizing shareholder value. They are arguments to reduce or eliminate the influence of shareholders on corporate decision-making. At the core of the battle between corporate managers and shareholders is a disagreement over the fundamental role and value of shareholder voting.[238] Shareholders and shareholders rights advocates believe that shareholder voting provides an effective means for holding managers accountable to shareholders.[239] This belief is reflected in the widely-supported—and followed—principle of one share, one vote. But the right to vote is only as good as the voter's ability to vote. To the extent that institutional investors are unable to effectively exercise this right, whether due to direct efforts to disenfranchise them, such as through dual-class shares, poll taxes and literacy tests, or indirect efforts, such as the SEC imposing onerous requirements on proxy advisors, the result will be the same, fewer votes going against management and a reversal in the trend towards greater corporate accountability.

237. An institutional investor is required to conduct a reasonable investigation before making a voting determination under the duty of care prong of its fiduciary duty to clients. *See* 2019 Proxy Voting Guidance, *supra* note 36.

238. Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445 (2008).

239. Dent, *supra* note 56; *see also* Brian D. Bell & John Van Reenen, *Extreme Wage Inequality: Pay at the Very Top*, 103 AM. ECON. REV. 153, 153–57 (2013) (showing that CEO pay is more correlated with performance when ownership is concentrated among institutional investors).