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a Social Purpose Corporation

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TO:

The Honorable Denny Heck
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House Committee on Financial Services
United States House of Representatives
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CC:

The Honorable Jeb Hensarling
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United States House of Representatives

The Honorable Patrick T. McHenry
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April 26, 2017

Re: Financial CHOICE Act of 2017, April 19th Discussion Draft

Dear Representative Heck:

As a fellow Washingtonian, I write in regard to the discussion draft of the Financial CHOICE Act 2.0 (the "Act") that the House Financial Services Committee commenced consideration of today. In your position as a member of the Committee, please defend the ownership and governance rights of investors by opposing inclusion of **Section 844** in the Act, or otherwise ensuring that it neither modifies nor limits the U.S. Securities and Exchange Commission ("SEC") shareholder proposal rule, Rule 14a-8.

Newground Social Investment[1] is a Washington Social Purpose Corporation ("SPC", the nation's first), and the country's second exclusively SRI/ESG[2] focused Registered Investment Advisor ("RIA"). Since 1994 we have served as a legal fiduciary in managing assets for institutional and individual investors who seek to meet financial objectives while also creating positive social and environmental outcomes; and I am a past Governing Board member of the Interfaith Center on Corporate Responsibility (ICCR), whose members represent more than $200 billion in invested capital.

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[1] www.newground.net
[2] SRI = Sustainable, Responsible, Impact investment; ESG = Environmental, Social, and Governance considerations.

Benefits of the Current Rule 14a-8

In our capacity as an RIA, on behalf of clients we have filed hundreds of stockholder proposals[3] under Rule 14a-8 with the companies our clients own. Historically, roughly two-thirds of those proposals were withdrawn and did not go to a vote because the company in question agreed with the value of our observations and, of their own volition, took constructive steps. Of the remaining ones that did go to at least one vote, nearly all eventually concluded with the company recognizing there was merit in our arguments such that they voluntarily adopted enhanced standards or undertook constructive actions.

In more than two decades, never once did the shareholder client in question own a value in shares that remotely approached 1% of the company's capitalization – even when Investor Voice[4] represented a $70 billion State pension system. Only once during this time did we achieve an outright majority vote; in fact, in the vast majority of instances the proposal earned only single-digit or low-to-moderate two-digit outcomes.

However, I feel confident representing that in essentially every instance where a negotiated outcome was achieved (whether with a vote or without any vote), the company in question would, or actually has, reported that the shareholder engagement process was a positive one that: **(a)** benefitted the company's reputation, **(b)** helped them avoid risk, and/or **(c)** allowed them to achieve more profitable operations.

- **A key takeaway is that the quality of ideas a shareholder may bring to a company bears no relation to the value of their stockholding.** To assert otherwise – that only the wealthy can have worthwhile opinions – would fly in the face of our country's most revered Democratic ideals and assumptions.

- **Less obvious, a second key takeaway is that the quality of a stockholder proposal's ideas bears little relation to the size of vote outcomes.**

  Essentially, in every instance over the past nearly quarter-century our experience has been that companies have found merit in shareholder thinking, which led them to take constructive steps – even when vote outcomes were low.

This history demonstrates the efficacy of the Rule 14a-8 process and the highly generative nature of the ideas that are brought to companies' attention by the existing procedures and protocols that surround shareholder engagement. This is apparent because companies would not otherwise have taken these numerous actions. As small shareholders we have no power to force a company's hand; our only option is to persuade and to be cogently reasonable. Otherwise, companies will not (and legally cannot) take actions that are counter to the best interest of their shareholders.

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[3] Under the auspices of both *Newground Social Investment* and *Investor Voice*, a sister SPC corporation.

[4] *Investor Voice* is a sister company to *Newground Social Investment* : www.investorvoice.net

Representative Heck, if you, other Committee members, or staffers would benefit from reviewing case studies that exemplify the highly beneficial outcomes which result from these kinds of shareholder engagements, please reach out.

We would be happy to share illustrative stories, including how:

- **McDonald's** took pilot steps in pesticide reduction which proved so profitable it has since incorporated these strategies into all of its agricultural production. This lowered measurable pesticides globally, which has benefitted every living being on the planet.[5]

- **DuPont** donated 16,000 acres of land and relocated a planned strip mining operation. Called "the largest land conservation gift in Georgia history", the project saved the Okefenokee National Wildlife Refuge and proved such a success that DuPont also donated $5 million to create a world-class research and education center there.

- **Starbucks**, to great fanfare, launched its first Fair Trade brands of coffee, and also returned historic trademarks to the citizens of Ethiopia (the birthplace of coffee).

- **Champion International** protected an important Tennessee river from significant pulp and paper pollution, and then also took steps which led to the mill becoming a worker-owned cooperative.

- **Costco** adopted comprehensive land-procurement policies that now protect culturally and environmentally sensitive areas worldwide, thus avoiding international controversy.

A Short History of Rule 14a-8

As highlighted in an April 25, 2017 letter submitted by attorney Sanford Lewis, it is important to recognize that SEC Rule 14a-8 (the "Rule") was created to protect the rights of individual investors, and to ensure the ability of all investors to engage in oversight and deliberation on important issues of corporate risk and governance.

Over time, a body of procedures and protocols has purposefully evolved to provide a balanced means by which investors of nearly any size can appropriately engage in the governance process.

This unfolding was not without contest. One battle was fought that led to an SEC rule which required clear notice by companies to all security holders regarding proposals that shareholders intended to bring up at a meeting. This led companies to establish the corporate proxy statement, and to allow investors to authorize management to vote on the shareholder's behalf.

[5] NPR/KUOW feature on this McDonald's story: www.newground.net/docs/KUOW-NPR_Bruce-Herbert.mp3

A critical development – germane to these proceedings – was the eventual clarification of State Law to allow investors to appoint a proxy, **other than the company**, to act on the investor's behalf at stockholder meetings.

Thus, over the course of some 70 years the SEC shareholder Rule 14a-8 has emerged to become a bedrock element of corporate democracy.

- **But through it all, individual investors were the intended and appropriate beneficiaries of the Rule**, which sought to balance the otherwise indomitable might of wealth, power, and influence represented by ever-larger American corporations.

Critique of Section 844 of the Proposed Act

As written, the legislation being considered would fundamentally impair the ownership and governance rights of investors.

It would do this by eliminating the right to file shareholder proposals which, in turn, would eviscerate the ability of essentially any shareholder to offer ideas to or express concern over corporations, their activity, the inadvertent risk that may attend their activities, or the opportunities they may be failing to capitalize on.

The Act would permit a miniscule fraction of the globe's wealthiest investors to file shareholder proposals: only those who own more than 1% of a company's stock. All other stockholders (and every one of Newground's or Investor Voice's clients – including a $70 billion State pension system) would be blocked from using their shareholder rights to address equity, justice, sustainability, risk, and good-governance issues.

These rights-of-property impairments take the form of three specific provisions within Section 844, provisions which infringe on the rights we have used to protect our investments and to enhance their earning potential:

1. **Section 844(b) would impose an unreasonably high 1% ownership threshold in order to qualify to submit a proposal.**

Currently, under Rule 14a-8, stockholders who own 1% or $2,000 worth of outstanding shares for at least one year can submit a proposal to be included in a company's proxy statement. Section 844(b) of the draft Act would eliminate the $2,000 threshold and require investors to hold a minimum of 1% of the issuer's voting securities over a three-year period.

Turning first to the holding period, the current one-year period represents a reasonable and well-working compromise between providing investors adequate flexibility and protection in a time of fast-moving markets, while ensuring that a stockholder has a sufficiently long-term interest in the enterprise to be granted a voice.

Regarding the elimination of the $2,000 threshold and imposition of a 1% requirement, such a threshold is not reasonable and would effectively repeal this critical shareholder right.

To illustrate: at current values, the proposed threshold to file of owning 1% of voting securities or market capitalization ("market cap"), would require a phenomenally large stake in a company in order to qualify to file a shareholder proposal.

The value of a 1% market cap threshold is shown in column (1) of Figure 1 below for a sample of six well-known and widely-held portfolio companies.

In column (2), Figure 1 shows – assuming a 5.0%-of-portfolio position limit on the size of individual portfolio holdings – the smallest size that a portfolio could be and still qualify to hold a 1% market cap stake in each of the named companies.

Typical portfolios utilize much smaller percent-of-portfolio position limits, so Figure 1's column (3) shows the smallest size a portfolio could be with a 1.0% position limit, and still be able to hold a 1% market cap stake in the named company.

Figure 1:

Company:	(1) **Proposed Requirement to file: 1% of Market Cap**	(2) **Portfolio size needed to file, with 5.0% position limit**	(3) **Portfolio size needed to file, with 1.0% position limit**
Apple	$7.4 billion	$148 billion	$740 billion
AT&T	$2.5 billion	$50 billion	$250 billion
Coca-Cola	$1.8 billion	$36 billion	$180 billion
Exxon Mobil	$3.4 billion	$68 billion	$340 billion
JPMorgan Chase	$3.0 billion	$60 billion	$300 billion
Wells Fargo	$2.7 billion	$54 billion	$270 billion

Section 844(b) filing requirement, and its implications

As expressed in an April 25, 2017 statement by New York City Comptroller Scott M. Stringer (whose five NYC pension funds hold $170 billion in assets under management):

> *Despite being among the largest pension investors in the world, we rarely hold more than 0.5% of any individual company, and most often hold less. As a result, the Act, if enacted, would effectively prevent our funds entirely from participating in the shareholder proposal process.*

Though the Act may put forward a 1% threshold under the guise of seeming to be reasonable, the fact that it would disqualify even the fourth largest public pension system in the United States demonstrates that Section 844 of the Act is entirely unreasonable.

- **The proposed CHOICE Act was clearly not written to serve the average (or even quite large) investor. Instead, it harms virtually all shareholders and would universally disenfranchise and prohibit them from exercising a key ownership right.**

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2. Section 844(a) would impose unreasonably large resubmission thresholds on investors.

Proposals must garner increasing support year-over-year in order to qualify for resubmission in the following year. Currently, Rule 14a-8 establishes the first year threshold at 3%, the second year at 6%, while in the third and all subsequent years the resubmission threshold rises to 10%.

Section 844(a) would double the first year threshold to 6%, the second year would more than double to 15%, and year three would triple to 30%.

Change can come slowly to large and complex entities like corporations, and good ideas often require years of consideration before they become accepted and move into the mainstream. In this light, current resubmission thresholds have proven effective in allowing an appropriately deliberative process of education to unfold – for shareholders and companies alike – while this and other aspects of Rule 14a-8 have ensured that frivolous or inconsequential resolutions do get discarded.

Historically, quite a number of proposals that started out with seemingly low votes went on to win majority votes and eventually to be deemed corporate governance best-practices.

Therefore, in our estimation, existing resubmission thresholds are well-functioning, balance all interests, and create an appropriate time-frame within which new and emerging ideas and risks can be surfaced, vetted, and properly evaluated.

Moreover, low votes in the initial years of a proposal's introduction are to be expected for a number of reasons, including:

1. Management, founders, and descendants of founding families often own or control sizable portions of stock. ESOP plans, for instance – though owned by employees – are voted by management, typically as AGAINST all shareholder proposals.

2. A majority of independent shareholders recycle their ballots and do not vote at all.

3. The major proxy reporting services (ISS, Glass Lewis) routinely recommend AGAINST shareholder proposals in their first few years of introduction until they have a chance to become familiar with the topic or issue; and companies lobby diligently to persuade these important trend-setting services to recommend AGAINST all shareholder proposals.

4. Proxy ballots typically offer multiple opportunities to "vote with management on all items" (which will be AGAINST any shareholder proposal), or to follow management's or the Board's exhortations item-by-item through the proxy to vote AGAINST shareholder-sponsored items. Shareholders who don't have time to study the proxy will often fall onto the easy path and side with management by default.

5. Investors typically purchase company shares because they trust or have confidence in management; thus, management enjoys a decidedly powerful '**bully pulpit**' when it comes to recommending a vote AGAINST shareholder items. Only an intrepid or dedicated shareholder will conduct enough study on a proposal or issue to actively support it in the face of management's repeated recommendations to the contrary.

6. Under Delaware State Law (as in most States), companies are allowed to choose the vote-counting formula by which votes are tabulated. When companies include abstentions in the formula for shareholder votes (even though they many not for management-sponsored items), it lowers the vote. Companies routinely report these artificially depressed numbers to shareholders and the press, and even will print them in Form 8-K filings to the SEC.

7. Shareholders are strictly limited to 500 words in their shareholder proposals, whereas a company is not limited at all in the length of its Statement in Opposition. This presents shareholders with limited access to information on the FOR side, but essentially an unlimited amount of information available on the AGAINST side. The asymmetry of information flow frequently works to the disadvantage of shareholders.

8. Companies, watching the count as proxies come in, have been known to initiate special proxy solicitations (at shareholder expense) when a vote is not going as they want. These go to shareholders who have previously not responded, who may be disinterested or too busy to pay attention, but who will eventually send in a vote – typically marking in favor of management. This serves to depress the outcome on shareholder items.

In light of such factors that systemically contrive to hold shareholder votes down, a seemingly small vote may in reality be deemed to be much larger – considering how few shareholders are both truly informed on a proposal topic, and independent of management.

- **Votes that are made small due to a myriad of structural inequities such as these should not be doubly handicapped by the imposition of unreasonably large resubmission thresholds.** Current threshold levels do not require changing, and it would be detrimental to all investors to do so.

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3. **Section 844(c) would prohibit shareowners from appointing an Agent or Proxy to act on their behalf.**

This provision is truly remarkable, in that it seeks to override the State Law of Agency and to eliminate the basic right of a property owner to appoint an agent to handle the disposition of his/her interests.

The proposed Section 844(c) would fully curtail the right of shareholders to rely on agents, lawyers, or experts of any type or description for the purpose of filing a shareholder proposal. Throughout the investing marketplace, investors necessarily and by right rely on and delegate to agents the responsibility of implementing their intentions. The ability to appoint an agent is a matter of State Law; as such, it would be inappropriate, and perhaps not legal, to encroach on State Law by eliminating the right of investors to appoint an agent.

- **What is absurdly imbalanced, as well as grossly unfair about the Section 844(c) restrictions on agency is that companies are granted a free hand to hire outside counsel or agents – of any description, in any number, at any time, for any purpose, and at any cost – to do their bidding (using shareholder dollars to do so).**

  Meanwhile, individual investors would be prevented from seeking any form of aid, assistance, expertise, or counsel in relation to the filing of a proposal.

In Closing

Shareholder proposal Rule 14a-8 was established by the SEC to make it possible for individual investors to participate in corporate governance matters. The process has evolved over a number of decades into being an important element of value in the bundle of rights that are associated with share ownership.

The Rule was created to support the ownership interests of all shareholders – but especially those of minority shareholders – and it has created an efficient means by which corporate management teams and Boards can hear and address shareholder concerns as they relate to equity, justice, sustainability, risk, and good-governance issues.

The Rule is a representational pinnacle that reflects many years of SEC deliberation and guidance which now stands as an important, well-functioning, and integral process for ensuring corporate democracy.

The proposed Section 844 represents a radical and dramatic departure from these established, vetted, and well-functioning norms. It would impose rules that do not just interfere with critical shareholder rights; they would effectively eviscerate the existing Rule and negate its original purpose and investor-focused intent. It would be inappropriate for this Committee or Congress to strip company share owners of the valuable and fundamental rights that attach to their ownership.

In addition, the proposed Act would void the panoply of benefits that have derived over the years from the time-honored process of shareholders bringing their ideas, hopes, aspirations, and concerns into corporate dialogues. The existing proposal process has catalyzed thousands of constructive engagements with companies – engagements whose benefits have accrued to shareholders, corporations, and society at large.

Representative Heck, multiple aspects of the proposed Financial CHOICE Act would radically and dramatically interfere with important shareholder rights and significantly weaken the role investors now play in the good governance of US companies. This, in turn, could jeopardize long-term value-creation, and undermine the collaborative relationship of trust that exists between capital providers and capital recipients – perhaps eroding support for the capital markets themselves.

Therefore, we strongly urge you to reject Section 844, and to oppose any attempt to modify, limit, supplant, or weaken the SEC shareholder proposal rule, Rule 14a-8. Thank you.

Sincerely,

/s/ Bruce Herbert

Bruce T. Herbert, AIF
Chief Executive *and* Accredited Investment Fiduciary

PS: I commend to your attention an in-depth briefing document:
The Business Case for the Current SEC Shareholder Proposal Process[6] as well as:

A letter[7] from organizations representing $65 trillion in assets, who oppose the Section 844 proposals or any changes to SEC Rule 14a-8.

[6] http://bit.ly/Business-Case-for-SEC-Rule-14a8
[7] http://bit.ly/Joint-Letter-Supporting-Rule-14a8