Statement to the House Committee on Financial Services

Hearing:

Proxy Power and Proposal Abuse:
Reforming Rule 14a-8 to Protect Shareholder Value

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Problems with the Shareholder Proposal Process: ESG, Passive Investing, and Proxy Advisors—A Case for Reform

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The Manhattan Institute for Policy Research does not take institutional positions on legislation, rules, or regulations. Although my comments draw upon my long-running research on shareholder regulation and corporate governance as an Institute scholar, my statement before the subcommittee is solely my own, not my employer's.

Written Statement

Chairman Hill, Ranking Member Waters, and Members, thank you for opportunity to testify again before this Committee. My name is James R. Copland. Since 2003, I have been affiliated with the Manhattan Institute for Policy Research, a nonprofit public-policy think tank in New York City, where I have long been a senior fellow and directed the Institute's legal policy research. Although my comments draw upon such research conducted for my employer, my statement before the Committee is solely my own.

I am very pleased that the Committee is looking carefully at the way the SEC oversees the process of introducing and voting on shareholder proposals at publicly traded corporations' annual meetings, asserted through the agency's oversight of corporate proxy statements and currently formalized in the Commission's Rule 14a-8.[1] I have been studying the shareholder-proposal process for more than fifteen years. In 2011, under my leadership, the Manhattan Institute launched our Proxy Monitor database,[2] which contains current and historical data on shareholder proposals introduced at America's largest publicly traded companies, dating back to 2006. I first testified about this particular subject matter before the Committee's Capital Markets and Government-Sponsored Enterprises Subcommittee back in 2016,[3] and I gave the full Committee an update on my views—and intervening trends—in summer 2023.[4]

Some of the material in this testimony is excerpted from prior Congressional testimony, regulatory comment letters, and other writings I have authored, in some cases without self-attribution. I have included a fuller list of relevant writings at the end of this statement.

I. Introduction

Overall, U.S. capital markets continue to lead the world.[5] But we have seen the number of companies listed on U.S. public exchanges decline more than 50% since the mid-1980s.[6] And to the extent that companies are less likely to access the public markets today due to

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[1] *See* 17 C.F.R. § 240.14a-8.
[2] *See* ProxyMonitor.org.
[3] *See* James R. Copland, "SEC Rule 14a-8: Ripe for Reform," Testimony before the House Financial Services Subcommittee on SEC Rule 14a-8, Sept. 21, 2016, *available at* https://media4.manhattan-institute.org/sites/default/files/T-JC-0916.pdf (arguing that "the SEC's outdated and overly permissive standards" had enabled activists "to push policy agendas . . . in an effective end-run around Congress").
[4] *See* James R. Copland, "The Rise of ESG Investing and the Appropriate Regulatory Responses," Hearing before the House Committee on Financial Services: Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation, July 12, 2023, *available at* https://media4.manhattan-institute.org/wp-content/uploads/Copland-Testimony-House-Financial-Services-7-12-2023-fin-rev.pdf.
[5] *See, e.g.*, Ron Surz, *U.S. Stock Market Is Biggest & Most Expensive In World, But U.S. Economy Is Not The Most Productive*, NASDAQ.COM, Apr. 2, 2018, https://web.archive.org/web/20250801221904/https://www.nasdaq.com/articles/us-stock-market-biggest-most-expensive-world-us-economy-not-most-productive-2018-04-02.
[6] *See, e.g.*, Nicole Goodkind, *America has lost half its public companies since the 1990s. Here's why*, CNN BUSINESS, June 9, 2023, *available at* https://www.cnn.com/2023/06/09/investing/premarket-stocks-trading/index.html (observing decline in U.S. number of publicly listed companies on American exchanges to approximately 3,700 from peak of 8,000 in 1996).

inefficient regulatory barriers idiosyncratic to American markets, it impedes capital formation and economic efficiency, to the broader public's detriment.

Unfortunately, there is little doubt that U.S. companies' modern tendency to avoid public offerings has much to do with unique features of the American regulatory landscape. Almost twenty years ago, I began to explore these trends.[7] Many of the factors that have discouraged public stock offerings remain as significant today as they were then, including heightened reporting standards under the Sarbanes-Oxley Act of 2002 and America's singular litigation landscape that imposes a "tort tax" on public corporate offerings, mergers, and disclosures. In addition, the last twenty years have witnessed a confluence of trends in shareholder ownership and voting that have exacerbated the costs of publicly traded equities, including:

- Increasing influence by proxy advisory firms that have historically shown a tendency to support various environmental and social causes in shareholder engagement;[8]
- Increasing concentration of ownership in large passive index fund families that have historically taken "shareholder engagement" stances, especially on environmental or social-policy issues;[9] and
- A relatively new and sizable share of the market invested into ESG (environmental, social, and governance) investment vehicles that exist principally to influence corporate behaviors away from a strict focus on shareholder wealth maximization.

Until 2017, not a single environment-related shareholder proposal received majority shareholder support over board opposition at one of the 250 largest publicly traded U.S. companies (dating back to 2006, the first year tracked in the Manhattan Institute's Proxy Monitor database[10]). As recently as 2023, however, two of the three largest index-fund managers had been supporting a *majority* of ESG-related shareholder proposals:[11]

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[7] *See, e.g.*, James R. Copland, "The Capital Market Crackup," *Chief Executive*, Dec. 1, 2006, *available at* https://manhattan.institute/article/the-capital-market-crackup; James R. Copland, "Are U.S. IPOs DOA?," WashingtonPost.com, Apr. 12, 2007, *available at* https://www.washingtonpost.com/wp-dyn/content/article/2007/04/11/AR2007041101723.html.

[8] *See, e.g.*, Paul Rose, *Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting* (Manhattan Institute 2021), *available at* https://manhattan.institute/article/proxy-advisors-and-market-power-a-review-of-institutional-investor-robovoting; James R. Copland, David F. Larcker & Brian Tayan, *Proxy Advisory Firms: Empirical Evidence and the Case for Reform* (Manhattan Institute 2018), *available at* https://manhattan.institute/article/proxy-advisory-firms-empirical-evidence-and-the-case-for-reform.

[9] *See, e.g.*, James R. Copland, *Index Funds Have Too Much Voting Power: A Proposal for Reform* (Manhattan Institute 2024), *available at* https://manhattan.institute/article/index-funds-have-too-much-voting-power-a-proposal-for-reform.

[10] *See* Proxy Monitor, https://www.proxymonitor.org/.

[11] *See* Theo Andrew, "Vanguard Lags BlackRock and State Street in Support of ESG Issues," *EFT Stream* (blog), June 15, 2023, https://www.etfstream.com/articles/vanguard-lags-blackrock-and-state-street-in-support-of-esg-issues.

- BlackRock supported 55% of all "key" ESG-related shareholder proposals as rated by Morningstar advisors, including 70% related to civil rights and racial equity, 57% related to the environment, and 55% related to other social issues.

- State Street Global Advisors supported 60% of ESG proposals, including 90% related to civil rights and racial equity, 61% related to the environment, and 60% related to other social issues.

- Vanguard supported 28% of ESG proposals, none relating to civil rights or racial equity, 30% related to the environment, and 27% related to other social issues.

The large passive index investors have subsequently scaled back their support for environmental and social shareholder proposals, but shifts in public sentiment and political control could certainly prompt a reversion to form.

The SEC has overseen and to a significant extent encouraged the aforementioned trends through its oversight of shareholder proposals included on the proxy statements of U.S.–listed companies, overseen by the Securities and Exchange Commission through Rule 14a-8.[12] The conclusion I reached in testifying before this Committee two years ago still holds: "the SEC's shareholder-proposal rule exceeds Congress's statutory mandate to the agency, tramples on state corporate law without Congressional authorization, and impedes the efficiency and capital formation that Congress has insisted the agency prioritize."[13] Ideally, Congress should act to clarify that shareholder-board interactions remain an issue of state law—and remind the SEC that its purview lies in facilitating disclosure, not the substance of corporate governance.

Even were the shareholder-proposal process properly returned to the states, however, the concentration of shareholder voting power in a small number of intermediaries who have agency costs that dwarf those of public companies themselves remains a major issue for the

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[12] *See* 17 C.F.R. § 240.14a-8.

[13] Beyond these statutory, federalist, and efficiency concerns, the shareholder proposal rule, at least in its current form, also likely violates the First Amendment. The First Amendment's protections clearly apply to corporate speech. *Cf. Citizens United v. FEC*, 558 U.S. 310 (2010). That said, the First Amendment's reach with regard to commercial speech is more "limited" than in other contexts. *See Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748, 771–72 (1976). A form of "intermediate scrutiny" applies to restraints on commercial speech. *See Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of NY*, 447 U.S. 557 (1980). A lesser standard yet applies to compelled government speech in the professional or corporate context. *See Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 652-53 (1985); *Nat'l Inst. of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361 (2018).

Critically, however, the Supreme Court's precedents limiting the First Amendment's reach in the context of government-compelled commercial and professional disclosures hinge on the government disclosure rules involving "purely factual and uncontroversial information." *Zauderer*, 471 U.S. at 642 (permitting regulation of commercial advertising requiring disclosure of "purely factual and uncontroversial information"); *Becerra*, 138 S. Ct. at 2372 (finding Free Speech violation when regulation required disclosure of "information about state-sponsored services—including abortion, anything but an 'uncontroversial' topic").

Applying this principle to securities regulation, the D.C. Circuit struck down as unconstitutional the SEC's "conflict minerals" rule, Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015); *see* Conflict Minerals, 77 Fed. Reg. 56,274 (Sept. 12, 2012) (codified at 17 C.F.R. §§ 240, 249b)—notwithstanding Congress's express authorization to craft one, *see* 15 U.S.C. § 78(m).

committee to consider.[14] In a 2024 Manhattan Institute paper, I discussed how the rising concentration of investment in passive-investing vehicles—and those fund families' growing ownership share and continuing focus on shareholder engagement—looms large over the equities markets.[15] I have also written extensively on possible reform of the proxy advisory industry in a 2018 paper co-authored with Stanford researchers.[16] Any battery of legislative reform needs to tackle these twin issues, in tandem.

Finally, I would like to emphasize to the committee that the SEC in recent years has badly twisted its disclosure mandate and acted as if it is not constrained by traditional notions of materiality. Indeed, in May 2021, then–Commissioner Allison Lee argued that the SEC has broad authority to require any disclosures "in the public interest," whether or not material. As Bernard Sharfman and I discussed in our comment letter on the SEC's subsequently proposed climate-disclosure rule,[17] Commissioner Lee used an "overly cramped" reading; she purported to infer a lack of required materiality in the statute, despite consistent and longstanding usage, from the fact that Congress did not append the word "material" to various prefatory grants of rulemaking authority in the enacted statute. As we explained:

> Congress's delineation of the information required in annual and quarterly reports in 15 U.S.C. § 78m(b)(1) clearly lists items required for a reasonable investor to make financial decisions regarding an investment in an issuer's securities—precisely the sort of disclosures the Supreme Court has pointed to repeatedly in defining materiality under the securities laws. Similar abutting textual constraints exist in the other chapters, once a reader gets beyond the prefatory language. Moreover, Commissioner Lee's speech fails to grapple with the express, clarifying definitional command Congress added to the securities laws in 1996, which universally requires the Commission to consider in its rulemaking, "in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." This Congressional addition of a prophylactic definition limiting SEC rulemaking was notably after—and implicitly incorporates—the Supreme Court's 1977 and 1988 decisions in *TSC Industries* and *Basic*, which articulated a materiality constraint in the federal securities laws.[18]

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[14] For a fuller discussion of the agency costs inherent in both the proxy advisory and passive investing industries, see Statement of James R. Copland, "Who's Monitoring the Monitors? The Rise of Intermediaries and the Threat to Capital Markets," Hearing before the Senate Committee on Banking, Housing, and Urban Affairs: The Application of Environmental, Social, and Governance Principles in Investing and the Role of Asset Managers, Proxy Advisors, and Other Intermediaries, Apr. 2, 2019, *available at* https://www.banking.senate.gov/imo/media/doc/Copland%20Testimony%204-2-191.pdf; Copland, *Index Funds Have Too Much Voting Power, supra* note 9.
[15] *See id.*
[16] *See* James R. Copland, David F. Larcker & Brian Tayan, *Proxy Advisory Firms: Empirical Evidence and the Case for Reform* (Manhattan Institute 2018), *available at* https://manhattan.institute/article/proxy-advisory-firms-empirical-evidence-and-the-case-for-reform.
[17] *See* Bernard S. Sharfman & James R. Copland, Comment, File No. S7-10-22, Release Nos. 33-11042; 34-94478, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," June 16, 2022, *available at* https://www.sec.gov/comments/s7-10-22/s71022-20131661-302049.pdf.
[18] *See id.* at 3–4 (citations omitted). *See also* NAACP v. FPC, 425 U.S. 662, 669 (1976) (noting that the Supreme Court's "cases have consistently held that the use of the words 'public interest' in a regulatory statute is not a broad

As with passive index voting and proxy advisory firms, some of the legislation noticed before the committee helpfully touches on the materiality issue as well.

In Section II of this written statement, I will give a broader overview of the shareholder proposal process. In Section III, I will discuss proxy advisory firms. In Section IV, I will discuss the rise of passive index investing and ESG investing. In Section V, I will briefly discuss the noticed legislation.

II. The Shareholder Proposal Process: An Overview[19]

The Dubious Legality of the SEC's Shareholder Proposal Regime

American capital markets lead the world in no small part due to what my Yale Law professor Roberta Romano characterized as the "genius of American corporate law,"[20] which distributes authority between federal and state regimes.[21] Under its statutory mandate, the SEC is empowered to promulgate rules and regulations to dictate *disclosure* rules, while *substantive* matters related to the distribution of authority between shareholders and corporate boards are left to state law.[22] As the Supreme Court has long observed, "Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that, except

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license to promote the general public welfare. Rather, the words take meaning from the purposes of the regulatory legislation.").

[19] This analysis is largely derivative of testimony I previously submitted to this Committee in 2023. *See* Statement of James R. Copland, "The Rise of ESG Investing and the Appropriate Regulatory Responses," Hearing before the House Committee on Financial Services: Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation, July 12, 2023, *available at* https://media4.manhattan-institute.org/wp-content/uploads/Copland-Testimony-House-Financial-Services-7-12-2023-fin-rev.pdf.

[20] *See generally* Roberta Romano, THE GENIUS OF AMERICAN CORPORATE LAW (1993).

[21] The American system arose in no small part by accident. As I observed in my 2020 book *The Unelected*:

> Before the Revolutionary War, only a handful of corporate charters had been granted by colonial governments. But the issuing of such charters exploded after the war, with hundreds granted by state governments in the first decade under the U.S. Constitution.
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> As industrialization took off in the new nation, states began relaxing corporate charter requirements. Most enacted statutes allowing incorporation without special legislation. In 1869, the U.S. Supreme Court ruled that a state could not prevent companies chartered by other states from doing business there—essentially destroying the old royal and colonial powers to limit the corporate form. . . .
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> Shortly after his inauguration as president in 1933, Franklin Roosevelt signed into law the Securities Act, as part of his "new deal for the American people." This law regulated the offering or sale of securities using the "means and instrumentalities of interstate commerce." One year later, Congress enacted the Securities Exchange Act, which extended the scope of regulation to trades of securities in secondary markets, rather than merely when initially issued. To enforce the new regulations, the 1934 act established the Securities and Exchange Commission.
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> Notwithstanding the populism of Roosevelt's New Deal, the new securities laws were broadly market-friendly. They did not displace the corporate laws of Delaware and other states, which allocated the rights of shareholders and directors. Nor did they displace the state blue-sky laws.

See id. at 194–96.

[22] *See, e.g.*, CTS Corp. v. Dynamics Corp., 481 U.S. 69, 89 (1987) ("No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."); Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 479 (1977).

where federal law expressly requires certain responsibilities of directors with respect to stockholders, state law will govern the internal affairs of the corporation."[23]

Recent statutory changes have somewhat interfered with the distribution of authority between federal and state securities and corporation law—particularly the Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act of 2002[24] and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[25] But in general, that states rather than the federal government have the "authority to regulate domestic corporations, including the authority to define the voting rights of shareholders," remains what the Supreme Court has called the most "firmly established" principle of American corporation law.[26]

To be clear, under modern conceptions of the Commerce Clause power,[27] Congress almost certainly has the authority to preempt significantly, if not wholly,[28] state corporate law. *But Congress has not done so.* And that is for the best. Federal primacy in the disclosure regime enables investors to price securities efficiently on an apples-to-apples basis with adequate, accurate information. State primacy in allocating the substantive rights of shareholders vis-à-vis boards prevents a one-size-fits-all lock-in of inefficient rules—and facilitates a "race to the top," given shareholders' ability to incorporate variations in state legal regimes into securities pricing.[29]

Under the substantive state corporate law governing most large publicly traded corporations in America, no shareholder has a right, even as a default rule, to speak in a corporate annual meeting or to introduce a proposal for vote at the meeting. Most large publicly traded American companies are incorporated in Delaware,[30] and Delaware's General

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[23] Santa Fe v. Green, 430 U.S. at 479.
[24] Pub. L. No. 107-204, 116 Stat. 745 (2002). For a substantive critique of the Sarbanes-Oxley law, in the context of traditional American securities and corporate law, see generally Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).
[25] Pub. L. No. 111-203, 124 Stat. 1376 (2010). The Dodd-Frank law interjects a federal role into the allocation of shareholder-board authority through, *inter alia*, requiring publicly traded companies to hold shareholder "advisory votes" on executive compensation annually, biennially, or triennially. *See id.* at § 951.
[26] CTS Corp. v. Dynamics Corp., 481 U.S. at 89.
[27] *Cf.* Gonzales v. Raich, 545 U.S. 1 (2005); Wickard v. Filburn, 317 U.S. 111 (1942).
[28] *Cf.* Rice v. Santa Fe Elevator Corporation, 331 U.S. 218, 221-22 (1947) (finding Congress had preempted the field related to grain warehousing, precluding even complementary state regulations of those fields, by vesting with the Secretary of Agriculture "exclusive" authority over federally licensed warehouses).
[29] *See generally* Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977); Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526 (1989). *See also* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (finding the "race to the top" hypothesis more supported than the "race to the bottom" hypothesis in empirical testing).
[30] *See* 8 Del. C. § 101 *et seq.* For a variety of reasons, most large publicly traded companies in the United States are incorporated in Delaware. This phenomenon has long been the subject of academic debate. *Compare* William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J. 663, 663, 705 (1974) (lamenting a "race to the bottom" in U.S. corporate law) *with* Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977) (arguing that, *contra* Cary, the federal structure of corporate law creates a "race to the top"); Winter, *The "Race for the Top" Revisited: A Comment on Eisenberg*, 89 COLUM. L. REV. 1526 (1989). *See also* Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225 (1985) (finding the "race to the top" hypothesis more supported than the "race to the bottom" hypothesis in empirical testing).

Corporation Law details rules governing annual meetings;[31] shareholder voting rights;[32] and shareholder rights to inspect shareholder lists and corporate books and records.[33] But apart from certain matters requiring a shareholder vote by law, or as otherwise specified in corporate bylaws or articles of incorporation, Delaware law—the governing law for most large publicly traded companies—makes whether to take a shareholder vote on a matter wholly an issue of board discretion.[34]

Contrary to this state law, and without foundation in the laws actually enacted by Congress, the SEC through its proxy process rules essentially compels publicly traded companies to hold votes on various subjects demanded by certain shareholders. And the SEC also compels companies to publish those shareholders' statements in support of their ideas, even if controversial and opposed by the company's fiduciary board, and without regard to such statements' accuracy.

To be sure, the SEC's adoption of a "shareholder proposal rule" is longstanding.[35] But at its outset, it was predicated upon a misunderstanding of state corporate law and the Securities Acts enacted by Congress.[36] The section of the Securities Exchange Act upon which Rule 14a-8 is promulgated, § 14(a), is principally designed to ensure corporate disclosures to shareholders to afford investment information and prevent deception. The Supreme Court noted as much in its *Borak* decision in 1964: "The purpose of § 14(a) is to prevent management or others from obtaining authorization for corporate action by means of deceptive or inadequate disclosure in proxy solicitation."[37] It is most certainly not to govern the substantive issues about which shareholders can vote—a creature of state law. The SEC's contrary insistence is an implicit preemption of state law—notwithstanding the Supreme Court's general pronouncement that such would require "a clear indication of congressional intent."[38]

Simply put: there is no statutory justification for the SEC to require any corporation, by virtue of trading securities on a national exchange, to submit various shareholder issues to a vote of all shareholders, absent the consent of the corporate board of directors or a contrary directive under state law. Yet that is precisely what the SEC has long done.

The SEC's Vacillating Oversight of "Social Cause" Shareholder Proposals

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[31] *See id.* at §§ 211, 222, 228.
[32] *See id.* at §§ 212, 213, 216, 217, 218, 225, 231.
[33] *See id.* at §§ 219, 220.
[34] *See id.* at § 146. *See also* Kyle Pinder, *The Non-Binding Bind: Reframing Precatory Stockholder Proposals under Delaware Law*, 15 MICH. BUS. & ENTREPRENEURIAL L. REV. __ (forthcoming), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=5418534.
[35] *See* Securities Exchange Act of 1934 Release No. 3347 (Dec. 18,1942), 7 Fed. Reg. 10,653 (1942).
[36] The original release promulgating the SEC's shareholder proposal rule, *id.*, relies upon an allusion to "fair corporate suffrage" in the House Report for the Securities Exchange Act of 1934, H.R. Rep. No. 1383, 73d Cong., 2d Sess. 14 (1934); the phrase appears nwhere in the actual legislative text. *See* Pub. L. No. 73-291, Ch. 404, 48 Stat. 881 (1934) (codified at 15 U.S.C. §§ 78a–78oo (2006 & Supp. II 2009)), at §§ 78m, 78n & 78u.
[37] J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).
[38] Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 479 (1977) ("Absent a clear indication of congressional intent, we are reluctant to federalize the substantial portion of the law of corporations . . . particularly where established state policies of corporate regulation would be overridden.").

In its role as "shareholder-proposal gatekeeper," the SEC has often modified its substantive approach in diametrically varying ways. Consider the SEC's handling of shareholder proposals that it described in 1952 as "primarily for the purpose of promoting general economic, political, racial, religious, social, or similar causes."[39] The SEC's longtime position was that it "was not the intent of [the shareholder-proposal rule] to permit stockholders to obtain the consensus of other stockholders with respect to matters which are of a general political, social or economic nature."[40] Thus, the SEC permitted companies to exclude shareholder proposals of such a nature from their proxy ballots.[41]

In 1972, however, the SEC modified its substantive screen; its new rule merely permitted companies to exclude shareholder proposals "not significantly related to the business of the issuer or not within its control."[42] And in 1976, the SEC issued an interpretive release recalibrating the new standard in a way that essentially *inverted* the pre-1972 rule: a company could exclude a shareholder proposal related to the "ordinary business" of the corporation only if the proposal "involve[d] business matters that are mundane in nature and do not involve any substantial policy or other considerations."[43]

In November 2021, in Legal Bulletin No. 14L,[44] the SEC staff jettisoned longstanding guidance that socially oriented shareholder proposals had to be material to a company's business to be placed on proxy ballots. Under this new guidance, the staff backed away from the Commission's longstanding insistence that shareholder proposals related to social or policy issues evidence a "nexus between a policy issue and the company"; the agency staff's new approach focuses instead "on the social policy significance of the issue that is the subject of the shareholder proposal." In essence, the SEC staff's 2021 guidance turned the original rules on their head. Now, the SEC purports to force publicly traded corporate issuers to include on their proxy ballots *any* shareholder proposal related to issues of "social policy significance," even if immaterial to the corporation's economic interests.

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[39] Exchange Act Release No. 4775, 17 Fed. Reg. 11,431, 11,433 (1952).
[40] Securities Exchange Act Release No. 3638 (Jan. 3, 1945), 11 Fed. Reg. 10,995 (1946).
[41] *See* Exchange Act Release No. 4775, 17 Fed. Reg. 11,431, 11,433 (1952).
[42] *See* Exchange Act Release No. 9784, 37 Fed. Reg. 23,178, 23,180 (1972).
[43] *See* Adoption of Amendments Relating to Proposals by Security Holders, Exchange Act Release No. 12,999, 41 Fed. Reg. 52,994, 52,997–98 (1976). To be sure, the SEC's reversal of position on shareholder proposals "of a general political, social or economic nature" did not occur in a vacuum. In 1970, a panel decision of the D.C. Circuit Court of Appeals had challenged the SEC staff's application of the rule in issuing a no-action letter to Dow Chemical; the staff's position was that the company could exclude a shareholder proposal from the Medical Committee on Human Rights asking that the company cease manufacturing napalm—as a matter of general political or social concern. *See* Med. Comm. for Human Rights v. Sec. & Exch. Comm'n, 432 F.2d 659, 663 (D.C. Cir. 1970), *vacated as moot*, 404 U.S. 403 (1972); *see also* 17 C.F.R. § 240.14a-8(c) (1970). The circuit court did not overturn the SEC's rule; rather, it remanded the case to the agency for reconsideration so that "the basis for (its) decision (may) appear clearly on the record, not in conclusory terms but in sufficient detail to permit prompt and effective review." Med. Comm. for Human Rights, 432 F.2d at 682. And the decision has no precedential value, having been subsequently vacated as moot by the Supreme Court. 404 U.S. 403 (1972). But the D.C. Circuit's opinion—with its lofty invocation of the "philosophy of corporate democracy," 432 F.2d at 681—very likely influenced the SEC's retreat and indeed U-turn from its prior position.
[44] *See* Staff Legal Bulletin No. 14L (Nov. 3, 2021).

This winter, after a change in executive branch leadership, the SEC again reversed course, issuing a new staff guidance document, Legal Bulletin No. 14M,[45] that went back substantially in the other direction. Perhaps unsurprisingly, "[c]ompanies filed a record 325 no-action requests after [the] new SEC guidance in February," and the number of overall shareholder proposals listed on proxy ballots fell 16%.[46]

Aside from this agency back-and-forth regarding what sorts of "social cause" shareholder proposals companies are required to include on their proxy ballots, the SEC staff has clearly engaged in viewpoint discrimination in assessing how it handles corporate requests for "no action" letters permitting proposal exclusions. In 2022, the SEC staff granted a no-action letter to Kroger permitting the company to exclude from its proxy ballot a shareholder proposal submitted by the National Center for Public Policy Research seeking to add "viewpoint" and "ideology" to the company's Equal Employment Opportunity policy—notwithstanding that it had refused to grant no-action letters to companies facing otherwise identical proposals seeking to add "sexual orientation" and "gender identity" to EEO statements.[47] (The Fifth Circuit refused to review the SEC staff decision, as moot, after Kroger acquiesced to including the proposal.[48] Such viewpoint discrimination clearly implicates the First Amendment.[49]

Who Files Shareholder Proposals?

Large shareholders—including both ordinary institutional investors managing passive stock portfolios and actively managed hedge funds seeking to modify corporate behavior to drive returns—make almost no direct use of the Rule 14a-8 shareholder-proposal process. Rather, the SEC's shareholder-proposal rule in its current form typically enables shareholders with a limited investment interest in the corporation[50]—and/or an investment interest oriented around principles other than share value—to co-opt the corporate agenda for their own purposes.

A small group of repeat filers has accounted for a large share of shareholder proposals over the last twenty years. To date in 2025, a single shareholder—small "corporate gadfly" investor John Chevedden—has filed *one-third* of all shareholder proposals filed at the S&P

[45] *See* Staff Legal Bulletin No. 14M (Feb. 12, 2025).
[46] The Conference Board, Report: Amid Federal Scrutiny and Investor Fatigue, Shareholder Proposals Take a Tumble in the 2025 Proxy Season, Sept. 3, 2025, *available at* https://www.conference-board.org/press/Shareholder-Proposals-Take-a-Tumble-in-the-2025
[47] *See* Petition for Rehearing En Banc, Nat't Ctr. for Publ. Pol'y Res. v. SEC, Case No. 23-60230 (Jan. 29, 2025).
[48] *See* Nat't Ctr. for Publ. Pol'y Res. v. SEC, Case No. 23-60230 (May 14, 2025).
[49] *See* Mark R. Kubisch, *Constitutionally Suspect Interventions In the Shareholder Proposal Forum*, 59 WAKE FOREST L. REV. 1155 (2024).
[50] A company like Apple, with a market capitalization of more than $3 trillion, can be forced to hold annual meeting votes if demanded by owners of a mere $2,000 in stock. Even if that threshold were increased more than fourfold, it would be the functional equivalent of allowing a single U.S. citizen, on demand, to place an item up for consideration as a referendum in a national election.

1500.[51] The next-most-common sponsors of shareholder proposals were investors with a socio-political orientation that is expressly left-wing (As You Sow, Green Century Capital Management) or right-wing (National Center for Public Policy Research, National Legal and Policy Center).[52] Beyond corporate gadflies and social investors, the other common class of shareholder proponent includes those with explicit ties to organized labor, either private (the Carpenters' Pensions) or public (the New York State and City public pension funds).[53]

Other Recent Trends

In 2025, 276 S&P 500 companies received 595 known shareholder proposals (as of mid-June), equal to 72% of all known submissions across the S&P 1500. The average targeted S&P 500 company received 2.2 proposals (down from 2.5 in 2024 and 2.8 in 2023).

In addition to seeing a decline in the number of shareholder proposals filed, the mix of proposals has shifted back toward core governance concerns, such as special-meeting rights, simple-majority voting for directors, and de-staggering board elections. Environmental and social (E&S) proposals declined in both number and support. In this year's corporate voting season, only four such proposals received majority shareholder support, compared with 82 between 2020 and 2022. And each of these involved the disclosure of corporate political spending. For the first time since 2019, not a single environment-related shareholder proposal received a majority shareholder vote. On average, left-leaning environmental and social proposals won support from just 16% of shareholders this proxy season, down from 33% in 2021.

Further Analysis

This drop in support for environmental and social shareholder proposals is a good thing. As I have argued previously, allowing shareholders to exploit the shareholder-proposal process on behalf of far-flung social and environmental causes can be expected to hurt shareholder value.[54] As a general matter, equity ownership through outside common shareholders has substantially *higher* agency costs than alternative forms of ownership, such as employee ownership, customer ownership, or supplier ownership.[55] Yet ordinary common-

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[51] *See* Sullivan & Cromwell, 2025 Proxy Season Review: Part 1 Rule 14a-8 Shareholder Proposals, Aug. 11, 2025, *available at* https://www.sullcrom.com/SullivanCromwell/_Assets/PDFs/Memos/2025-Proxy-Season-Review-Part-1.pdf.
[52] *See id.*
[53] *See id.*
[54] *See, e.g.*, Statement of James R. Copland, "Who's Monitoring the Monitors? The Rise of Intermediaries and the Threat to Capital Markets," Hearing before the Senate Committee on Banking, Housing, and Urban Affairs: The Application of Environmental, Social, and Governance Principles in Investing and the Role of Asset Managers, Proxy Advisors, and Other Intermediaries, Apr. 2, 2019, *available at* https://www.banking.senate.gov/imo/media/doc/Copland%20Testimony%204-2-191.pdf; James R. Copland, *Getting the Politics out of Proxy Season*, WALL ST. J., Apr. 23, 2015, *available at* https://www.manhattan-institute.org/html/getting-politics-out-proxy-season-5461.html.
[55] *See generally* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 35–49 (1996).

stock ownership remains the *dominant* form of organization for large, profit-seeking enterprises in the United States. One reason why is that common-stock ownership minimizes collective decision-making costs.[56] Thus, shareholder voting rights, like state common-law fiduciary duties, exist for the limited purpose of mitigating agency costs—not to facilitate miniature "corporate democracies."[57]

One need not be an expert in public-choice theory to comprehend that aggregating disparate voting interests along multiple factors can make collective action difficult.[58] Democratic and republican institutions have many virtues, but "efficiency" is not among them. Corporations are something else entirely. And for publicly traded companies, the ability to share one's shares is by far the greatest form of "investor protection"—provided investors receive adequate, truthful information upon which to act, which is precisely why the SEC's traditional focus on disclosure has been generally so successful.[59]

In sum, in its current guise, the SEC's shareholder-proposal rule exceeds Congress's statutory mandate to the agency, tramples on state corporate law without Congressional authorization, and impedes the efficiency and capital formation that Congress has insisted the agency prioritize.[60]

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[56] *See id.*

[57] *See* Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006) (arguing that increasing the power of shareholders to hold managers accountable, including through increased disclosure, imposes significant costs in reduced managerial authority).

[58] *Cf.* KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (1963) (articulating Arrow's Impossibility Theorem, which holds that, given certain fairness criteria, voters facing three or more ranked alternatives cannot convert their preferences into a consistent, community-wide ranked order of preferences).

[59] These concerns are theoretical, but the comport with at least some empirical evidence as well. As the SEC staff rightly notes in its analysis, it can be difficult to parse out long-term stock effects of shareholder proposals due to the host of confounding factors. *See* Rel. No. 34-87458 at 113 & n.214. In an effort to assess this relationship, however, the Manhattan Institute commissioned an econometric study of shareholder activism and firm value by Tracie Woidtke, an economics professor at the University of Tennessee. *See* The University of Tennessee Knoxville: Tracie Woidtke, http://finance.bus.utk.edu/Faculty/TWoidtke.asp. In her study, published in 2015, Professor Woidtke examined the valuation effects associated with public pension fund influence, measured through ownership, on Fortune 250 companies. Woidtke found that "public pension funds' ownership is associated with lower firm value" and, more particularly, that "social-issue shareholder-proposal activism appears to be negatively related to firm value." *See* Tracie Woidtke, *Public Pension Fund Activism and Firm Value*, at 16 (Manhattan Institute 2015), *available at* https://www.manhattan-institute.org/html/public-pension-fund-activism-and-firm-value-7871.html.

[60] Beyond these statutory, federalist, and efficiency concerns, the shareholder proposal rule, at least in its current form, also likely violates the First Amendment. The First Amendment's protections clearly apply to corporate speech. *Cf. Citizens United v. FEC*, 558 U.S. 310 (2010). That said, the First Amendment's reach with regard to commercial speech is more "limited" than in other contexts. *See Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council*, 425 U.S. 748, 771–72 (1976). A form of "intermediate scrutiny" applies to restraints on commercial speech. *See Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of NY*, 447 U.S. 557 (1980). A lesser standard yet applies to compelled government speech in the professional or corporate context. *See Zauderer v. Office of Disciplinary Counsel of Supreme Court of Ohio*, 471 U.S. 626, 652-53 (1985); *Nat'l Inst. of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361 (2018).

Critically, however, the Supreme Court's precedents limiting the First Amendment's reach in the context of government-compelled commercial and professional disclosures hinge on the government disclosure rules involving "purely factual and uncontroversial information." *Zauderer*, 471 U.S. at 642 (permitting regulation of commercial advertising requiring disclosure of "purely factual and uncontroversial information"); *Becerra*, 138 S. Ct. at 2372

III. The Role of Proxy Advisory Firms[61]

To manage their proxy voting, institutional investors rely heavily on a pair of proxy advisory firms, Institutional Shareholder Services, or ISS, which today is majority-owned by the German stock market, Deutsche Börse AG;[62] and Glass, Lewis & Co., which is today owned by Peloton Capital Management, a Canadian private equity firm, and its chairman Stephen Smith.[63] Together, these two proxy advisors control more than 90% of the market for proxy advisory services.[64]

As summarized in a 2018 report I co-authored with Stanford's David Larcker and Brian Tayan, a substantial body of empirical evidence shows that proxy advisory firms' recommendations influence institutional investor voting and that publicly traded companies are influenced by proxy advisor guidelines.[65] A 2012 analysis I co-authored showed that an ISS recommendation "for" a given shareholder proposal, controlling for other factors, was associated with a 15-percentage-point increase in the shareholder vote for any given proposal.[66] This observation is consistent with a more recent Manhattan Institute study, authored by Professor Paul Rose, which found significant "robo-voting" of shares consistent with proxy advisor guidelines among many smaller institutional investors.[67] Little wonder that Leo Strine, a former chancellor on the Delaware Court of Chancery, observed: "Powerful CEOs come on

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(finding Free Speech violation when regulation required disclosure of "information about state-sponsored services—including abortion, anything but an 'uncontroversial' topic").

Applying this principle to securities regulation, the D.C. Circuit struck down as unconstitutional the SEC's "conflict minerals" rule, Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518 (D.C. Cir. 2015); *see* Conflict Minerals, 77 Fed. Reg. 56,274 (Sept. 12, 2012) (codified at 17 C.F.R. §§ 240, 249b)—notwithstanding Congress's express authorization to craft one, *see* 15 U.S.C. § 78(m).

[61] This analysis is largely derivative of testimony I previously submitted to the Senate Banking Committee. *See* Statement of James R. Copland, "Who's Monitoring the Monitors? The Rise of Intermediaries and the Threat to Capital Markets," Hearing before the Senate Committee on Banking, Housing, and Urban Affairs: The Application of Environmental, Social, and Governance Principles in Investing and the Role of Asset Managers, Proxy Advisors, and Other Intermediaries, Apr. 2, 2019, *available at* https://www.banking.senate.gov/imo/media/doc/Copland%20Testimony%204-2-191.pdf.

[62] *See* ISS STOXX presentation, Mar. 2025, https://www.deutsche-boerse.com/resource/blob/4346668/0bd1d782062ab9c0a836886f79b1bcfd/data/iss-stoxx-presentation-2025-en.pdf.

[63] *See* Press Release, Peloton Capital Management and Stephen Smith Acquire Glass Lewis, Mar. 16, 2021, *available at* https://www.pelotoncapitalmanagement.com/news/2021/3/16/peloton-capital-management-and-stephen-smith-acquire-glass-lewis.

[64] *See* Congressional Research Service, Proxy Advisor Regulation: Recent Litigation, State Law Developments, and Federal Legislation, Sept. 4, 2025, *available at* https://www.congress.gov/crs_external_products/R/PDF/R48691/R48691.1.pdf.

[65] *See* James R. Copland et al., *Proxy Advisory Firms: Empirical Evidence and the Case for Reform* (Manhattan Institute 2018), *available at* https://media4.manhattan-institute.org/sites/default/files/R-JC-0518-v2.pdf.

[66] *See* James R. Copland et al., Proxy Monitor 2012: A Report on Corporate Governance and Shareholder Activism 22–23 (Manhattan Inst. for Pol'y Res., Fall 2012), *available at* http://www.proxymonitor.org/Forms/pmr_04.aspx.

[67] *See* Paul Rose, Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting (Manhattan Institute 2021), *available at* https://manhattan.institute/article/proxy-advisors-and-market-power-a-review-of-institutional-investor-robovoting.

bended knee to Rockville, Maryland, where ISS resides, to persuade the managers of ISS of the merits of their views about issues."[68]

My report with professors Larcker and Tayan also cites a substantial body of empirical evidence demonstrating that at least some proxy-advisor advice may not be in the average shareholder's interest. The proxy advisory services do not have any "skin in the game" like ordinary investors and are quite small relative to their voting influence—making them susceptible to capture. Their business models contain overt conflicts of interest, as they consult with and work on behalf of both institutional investors and corporate issuers. And of course each of the dominant proxy advisors is foreign-owned.

Little wonder that ISS's voting guidelines have generally shown a propensity to support various social and environmental proposals, much moreso than the median shareholder. Historically, ISS has backed some 70% of shareholder proposals related to political spending, 45% of those related to employment rights, and 35% of those related to human rights or the environment[69]—a sharp contrast to the dearth of average shareholder support for these proposal classes. Although some of these trends have sharply reversed in the 2025 proxy season with the change of administration in Washington, the fundamental issues with the proxy advisory duopoly remain.

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[68] Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 688 (2005).
[69] *See* Copland et al., *supra* note 66, at 22–23.

IV. The Rise of Passive Index and ESG Investing[70]

Two other recent trends are increasingly reshaping American investing: the rise in passive index investing by institutional asset managers; and the rise in environmental, social, and governance ("ESG") investing led by those same institutional asset managers.

In passive index investing, a mutual fund, exchange-traded fund (ETF), or other institutional investing vehicle buys and sells corporate securities to replicate the holdings of an investing "index" determined by a third party to represent some significant swath of the stock market. For example, the investing vehicle might be attempting to replicate the Standard & Poor's (S&P) 500 Index, which tracks 500 large corporate stocks that together constitute some 85% of the total U.S. equities market. Because passive investing strategies can offer a broadly diversified "stock market" return at a low investing cost, they have become favored vehicles for long-term buy-and-hold investors, including individuals, pension plans, insurance companies, and endowments.

Index investing is exceptionally valuable for ordinary investors, who generally lack the resources and sophistication to buy and sell stocks to build their own diversified portfolios of securities, or to assess active investment advisors' stock-market strategies. And because they operate at such a low cost—merely replicating, not analyzing—they pass through the savings to their investors. A wealth of research suggests that it is hard for ordinary stock pickers to best passive investing in the market basket, after expenses, and that an unsophisticated investor choosing among funds is better served by a passive, rather than by an active, portfolio investing strategy.

But precisely because passive index investors do *not* act upon information to buy or sell securities with a view toward any mismatch between current market pricing and underlying value, it is peculiar that the now-large share of investing capital held through passive index investing funds has increasingly been flexing its voting muscle over all of corporate America.

And that voting power is growing. The share of U.S. equities held in passive index funds, whether mutual funds or ETFs, has more than doubled in the past decade. Over that period, these passively managed funds have received more than $2.5 trillion in new cash inflows, while actively managed funds have lost more than $2.3 trillion in cash outflows. By the end of 2021, for the first time, assets in passive investment vehicles exceeded those in actively managed funds among U.S. equities held in mutual funds and ETFs.

But because index-investing funds share the same market-following strategy, no real differentiation marks their offerings. Predictably, the market has consolidated, even as index investing has risen in popularity. Vanguard, BlackRock, and State Street control 51% of U.S. fund assets under management and more than 20% of total U.S. stock market capitalization. One of the Big Three is the largest shareholder in 88% of S&P 500 companies. If these ownership stakes continue to increase—and I expect they will—we will see even greater ownership concentration among these few investment fund families. And it generally strains

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[70] This analysis is largely derivative of my 2024 Manhattan Institute report, Index Funds Have Too Much Voting Power: A Proposal for Reform (Manhattan Institute 2024), *available at* https://manhattan.institute/article/index-funds-have-too-much-voting-power-a-proposal-for-reform. When uncited, please see the fuller report for attribution.

credulity to believe that investment vehicles that by definition eschew *any* discernment in a company's valuation should nevertheless be playing a major role in telling that same company how to reorganize its affairs.

The rise in passive index investing is complicated by the parallel rise in ESG ("environmental, social, and governance") investing. ESG investing is of relatively recent provenance: it traces to a December 2004 report commissioned by the United Nations. Big banks quickly bought in, and by 2006, the New York Stock Exchange and others around the world were adopting ESG principles following the UN protocol.

ESG investing is an offshoot of long-standing "socially responsible investing" that traditionally avoided certain "sin" stocks (e.g., those involving gambling, alcohol, tobacco, or munitions) and/or allocated monies toward industries aligned with investors' idea of the public good. But modern ESG-oriented investment vehicles have embraced something distinct: "impact" investing, in which funds holding diversified portfolios seek to change corporate behavior to match investors' preferred environmental, social, or governance strategies. Obviously, those objectives have been aided and abetted by the SEC's Rule 14a-8 shareholder-proposal regime—and the capture of proxy advisory firms and passive index investors.

ESG funds are a profit center for asset managers, especially those focusing on low-cost passive indexing. At the end of 2020, ESG funds had average fees of 0.2%, while standard ETFs that invest in U.S. large-cap stocks had a 0.14% fee on average—a relative 43% difference. Even such a seemingly small increase in fees can have a big impact when scaled. BlackRock has $10 trillion in assets under management, so the potential for profits is staggering.

Although ESG funds constitute a relatively small minority of shares held in U.S. equities, the relative share of ESG-invested funds, until recently, had been rising rapidly. In 2020, ESG-related investment funds constituted nearly 25% of new U.S. mutual dollar inflows—double the level in 2019 and up from just 1% in 2014. The value of assets held in ESG funds invested in U.S. equities nearly doubled from year-end 2019 through year-end 2021, increasing from $276 billion to $550 billion in two years' time.

Since then, however, we have seen some retrenchment, at least in the United States, as ESG portfolios took a bath. Through the second quarter of 2025, U.S. ESG funds have seen eleven consecutive quarters of net capital outflows. Still, the conflict of interest between ESG investing and both proxy advisors and passive indexers remains. These trends could easily shift back again in the future. The Biden administration changed policy to prod investors toward ESG, and there's every reason to believe a future Democratic administration could do the same.

V. Analysis of Noticed Legislation

The Committee staff has noticed for consideration fifteen pieces of legislation, some of which have already been introduced and some of which are in "discussion draft" format. Each of these legislative concepts bears upon the broader topic of the hearing, proxy power and proposal abuse. But the concepts differ in their reform approach. Essentially, there are five reform approaches contemplated in the noticed legislation:

Reforms targeting principal market actors—proxy advisors and institutional managers

1. *Reforms regulating proxy advisors* (#s 1, 3, 4, 15).
2. *Reforms regulating institutional managers* (#s 2, 6, 10).

Reforms targeting the SEC

3. *Reforms of the SEC's shareholder proposal process* (#s 8, 9, 11, 12).
4. *Reforms limiting the SEC from requiring non-material disclosures* (#s 5, 14).
5. *Other SEC reforms* (#s 7, 13).

While the specifics matter, I think each of these general approaches have merit.

As previously discussed, the **proxy advisory** firm duopoly acts *de facto* as the largest single shareholders in the publicly traded stock markets, notwithstanding thin capitalization, foreign ownership, and a general lack of transparency. There is little reason why these firms should not be registered and subject to SEC oversight.

Passive index investing fund families control a large and growing share of the publicly traded stock markets and exert substantial control over corporate boards, notwithstanding the tension between their investing model (*mirroring* the stock market) and their engagement practices (*directing* changes to corporate behavior). As these investing vehicles continue to grow in market share, Congress should carefully consider the implications of such a large voting bloc of shares, divorced from actual company research, exercising control over corporate decision making.

The **SEC's shareholder proposal process** is legally suspect as a usurpation of substantive state corporate law without Congressional mandate. Despite recent salutary pullbacks in SEC staff guidance in this space, the SEC's approach to overseeing this process is susceptible to viewpoint discrimination and risks placing an unelected federal agency in direct oversight of broad swathes of the economy, far outside its institutional expertise.

Materiality is a bedrock principle of the SEC's disclosure regime, but it has been publicly questioned by some commissioners, and recent SEC rulemakings and guidance have thrown the concept into doubt. Congress could helpfully add clarity here.

To the extent that such approaches do not unduly tax agency resources and commissioner time, facilitating **better input** to the Commission from publicly traded companies and requiring **greater analysis** and reexamination of regulatory processes would be salutary.

Below, I will explore the proposed approaches in greater detail.

1. Reforms Regulating Proxy Advisors

Context. The two dominant proxy advisory firms, ISS and Glass Lewis, continue to hold outsized market power, a point long recognized by GAO,[71] academic work,[72] and my own research.[73] As discussed above, the sizable role of proxy advisors over equity markets should compel Congressional attention.

The noticed legislation includes the following:

(a) H.R. 4098, the *Stopping Proxy Advisor Racketeering Act* (Fitzgerald) (#1):

Bars proxy advisers from issuing voting recommendations where specified conflicts exist (consulting relationships with the issuer, recommendation changes tied to issuer subscriptions, simultaneous "stewardship" for a proponent, or membership in groups backing proposals on which they advise).

(b) H.R. ____, *a bill to amend the Securities Exchange Act of 1934 to provide for the registration of proxy advisory firms, and for other purposes* (Steil) (#3):

Requires SEC registration for proxy advisors; disclosures about procedures, methodologies, conflicts, and staff qualifications; policies for accuracy/reliability; bans "unfair, coercive, or abusive" practices; annual reporting; and SEC censure/suspension authority.

(c) H.R. ____, *a bill to amend the Securities Exchange Act of 1934 to provide for liability for certain failures to disclose material information in connection with proxy voting advice* (Steil) (#4):

Treats failures to disclose (or misstatements of) material information by proxy-advice businesses as false or misleading under Exchange Act §18.

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[71] GAO, Proxy Advisory Firms' Role in Voting and Corporate Governance Practices, Nov. 2016, *available at* https://www.gao.gov/assets/690/682816.pdf.
[72] *See, e.g.*, Aiyesha Dey *et al.*, "Proxy Advisory Firms and Corporate Shareholder Engagement," 37 REV. FIN. STUD. 3877 (Sept. 2024).
[73] *See, e.g.*, James R. Copland *et al.*, "Proxy Advisory Firms: Empirical Evidence and the Case for Reform" (Manhattan Institute 2018), *available at* https://manhattan.institute/article/proxy-advisory-firms-empirical-evidence-and-the-case-for-reform.

(d) H.R. ___, *a bill to amend the Securities Exchange Act of 1934 with respect to prohibitions relating to the solicitation and influence of proxies* (#15):

Prohibits proxy advisors from furnishing to security holders any recommendation, advice, analysis, or rating about voting.

Discussion

Bill #3, calling for SEC registration for all proxy advisors, seems like the sort of modest approach that should command broad support. (A similar bill, H.R. 4015, passed through the House in 2017.) Registration can supply durable, neutral-process oversight and accountability to a highly concentrated market.

Bill #1's effort to remedy significant conflicts of interest infecting the proxy advisory market is salutary, and there can be merit in bright-line conflict prohibitions. Still, the Committee may wish to focus carefully on definitions to avoid overbreadth that might sweep in benign affiliations, such as trade association membership. *De minimis* and safe-harbor provisions should be considered. The committee could also consider more limited approaches, such as the SEC's 2019 guidance treating proxy voting advice subject to antifraud rules.

Bill #4 is similarly pointed in the right direction but could possibly be constructively amended. Given that the Commission has already clarified that proxy voting advice is a "solicitation" subject to Rule 14a-9's antifraud standard, material misstatements or omissions are already actionable. It may make more sense for Congress to reinforce 14a-9–based duties (with examples) rather than reframing adviser communications as §18 filings. The legislation should also probably include safe harbors for good-faith, documented methodologies.

Bill #15 strikes me as overbroad and possibly unconstitutional under modern commercial speech doctrine, although it would depend on the ultimate details. The SEC's traditional treatment of proxy advice as a "solicitation" subject to antifraud, not as unlawful speech to be banned. Although it may be possible to narrow this concept to pass constitutional muster, bills 3, 1, and 4 strike me as more fruitful avenues to pursue.

2. Reforms Regulating Institutional Managers

Context. A number of institutional investors effectively outsource their proxy voting to one of the big proxy advisory firms.[74] In addition, large passive index fund families have a large and increasing share of the market—and influence voting outcomes despite not engaging in any specific *investment*-side company research.

The noticed legislation includes the following:

(a) H.R. 3402, *a bill to amend the Securities Exchange Act of 1934 to require certain disclosures by institutional investment managers in connection with proxy advisory firms, and for other purposes* (Loudermilk) (#2):

Requires managers to file an annual report showing how they voted, the percentage alignment with proxy-adviser recommendations, and their consideration of such advice; adds requirements for managers with >$100B AUM (including clarifying that shareholders are not obligated to vote every item and conducting an economic analysis that a vote is in investors' "best economic interest").

(b) H.R. ____, the *Empowering Shareholders Act of 2025* (Huizenga) (#6):

Requires passive fund managers to (1) implement owner-directed voting, (2) vote in line with board recommendations, or (3) abstain.

(c) H.R. ____, *Protecting American's Savings Act* (Nunn) (#10):

Prohibits institutional investors from outsourcing proxy-voting decisions; clarifies no person can be required to cast votes.

Discussion

Bill #2 makes sense, at least for larger institutional investors. The Committee should explore the *cost* this proposal might impose on smaller institutional investors; we should not want to create barriers to entry in the institutional-investing market. But the principle that sunshine is the best disinfectant should work well here. Disclosure can illuminate "robovoting" and herd effects without dictating outcomes. The "best economic interest" analysis should be calibrated to a reasonableness standard to avoid turning each ballot item into a mini-cost-benefit proceeding—and should probably be permitted at the policy level, not per-item. It would also be salutary for Congress to affirm SEC guidance clarifying that advisers need not vote every proxy and may structure client arrangements accordingly.

[74] *See, e.g.*, Paul Rose, Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting (Manhattan Institute 2021), *available at* https://manhattan.institute/article/proxy-advisors-and-market-power-a-review-of-institutional-investor-robovoting.

Bill #6 builds on existing market experimentation among large passive index families and is parallel to Senator Sullivan's INDEX Act. I worry, however, that as structured here the legislation might create unanticipated problems by pushing most passive shares toward abstention or management support—thus undercutting constructive shareholder activism from true activist investors that add value for average shareholders. As I explained in my 2024 report:

> Retail investors (nonprofessional investors) who invest in corporate securities through mutual funds, ETFs, and comparable investment vehicles—particularly if investing in passive index funds—are implicitly deciding to delegate their analysis of corporate valuations, governance, and performance. At least some retail investors in actively managed funds may retain a belief—misguided or not—that they can outperform market indexes, or at least structure investment strategies more tailored to their idiosyncratic financial needs, through fund selection. But an investor in a passively managed fund is implicitly delegating his investing choices to the broader buy-and-sell decisions of the stock market itself, at least as defined in a market basket selected by S&P or the like.
>
> It is theoretically strange to devolve shareholder voting rights to such retail investors in these cases. Investors who are affirmatively opting not to make their buy-and-sell decisions on securities hardly seem well equipped to evaluate the host of potential governance decisions presented on modern proxy ballots for publicly traded companies. Devolving shareholder voting to individual shareholders owning passive index funds seems as logically incoherent as allowing the managers of such funds to weigh in on such ballot items—even if it would have the salutary effect of breaking up the voting clout of the small number of asset managers with large passive fund holdings. . . .
>
> [If the end result of "pass through" voting were to prompt most passive index shares to abstain or reflexively vote with management, it] could serve, in at least some cases, to entrench existing boards and managers—insulating status quo management from shareholder influence that would enhance share value. While socially oriented shareholder activism tends to be associated with lower share value, hedge-fund investors who deeply research companies and engage in activist investment strategies designed to enhance share value—investing a lot of their own skin in the game—tend, on average, to enhance share value and improve efficient market pricing. [R]equiring passive index fund managers to abstain from voting, absent affirmative voting recommendations from beneficial investors, which could very well wind up being the case for a large percentage of all fund assets. In so doing, the act could work to block shareholder majorities opposing management in all but the "routine" cases exempted by the act's provisions.[75]

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[75] James R. Copland, Index Funds Have Too Much Voting Power: A Proposal for Reform (Manhattan Institute 2024), *available at* https://manhattan.institute/article/index-funds-have-too-much-voting-power-a-proposal-for-reform.

Rather than defaulting to simple abstention *or* management support in the absence of a pass-through voting signal, this legislation should either work through how default abstention rules might need to be adjusted to really have passive indexers "sit on the sidelines" or adopt a "mirror voting" mechanism as the default, such that asset managers of passive-investing vehicles cast their votes in the same proportion as other nonpassive shareholders. Essentially, the large passive funds would be voting the same way they invest: passively, mirroring the votes of those investors actively engaged in price discovery. (I work through these particulars in more detail in my 2024 paper.[76])

In part, Bill #10, like Bill #2, would helpfully codify SEC guidance clarifying that advisors need not vote on every item—and may retain proxy advisers to assist with research and execution (subject to diligence and oversight). Banning outsourcing outright would force thousands of advisers and funds to replicate research and operations at high cost; "robovoting" concerns would probably be best addressed without a prohibition through a disclosure regime as postulated in Bill #2.

3. Reforms of the SEC's Shareholder Proposal Process

Context: The SEC's shareholder proposal process is legally dubious and platforms tiny minority shareholders and shareholders with an interest in things other than share value, to the average investor's detriment.

The noticed legislation includes the following:

(a) H.R. ____, the *Performance over Politics Act* (Fitzgerald) (#8):

Allows exclusion of proposals that substantially implement, duplicate, or are substantially similar to previously included proposals.

(b) H.R. ____, the *Businesses Over Activists Act* (Norman) (#9):

Prohibits the SEC from compelling inclusion or discussion of shareholder proposals and removes SEC preemption over state regulation of proposals and proxy materials.

(c) H.R. ____, *a bill to clarify that an issuer may exclude a shareholder proposal pursuant to section 240.14a-8(i) of title 17, Code of Federal Regulations, without regard to whether such proposal relates to a significant social policy issue* (Rose) (#11):

Allows exclusion under Rule 14a-8(i) without regard to whether the proposal implicates a "significant social policy."

[76] *See id.*

(d) H.R. ____, *a bill to authorize the exclusion of shareholder proposals from proxy or consent solicitation material if the subject matter of the shareholder proposal is environmental, social, or political* (Donalds) (#12):

Permits companies to exclude shareholder proposals with an environmental, social, or political subject matter.

Discussion

Bill #9 is consistent with my viewpoint that the SEC's entire shareholder proposal apparatus is an illegitimate usurpation of authority beyond that explicitly legislated by Congress. That corporate law is state law is a bedrock principle of federalism that has undergirded American capital markets advantage. The Supreme Court has been clear: "No principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations, including the authority to define the voting rights of shareholders."[77]

To be sure, varying legal regimes governing shareholder proposals based on state of incorporation would complicate matters for publicly traded companies, relative to a one-size-fits-all federal solution. But a one-size-fits-all solution is also fraught with error. Rather than serving as a "shareholder proposal reviewer," the SEC staff should be focused on fighting securities fraud. And the SEC's oversight of the proxy statement should be limited to policing fraud—and any specific Congressional mandates—not to weighing the substantive merits and demerits of shareholder ideas, a task fraught with viewpoint-discriminatory concerns that implicate the First Amendment.

While each of the other three bills tackling the shareholder proposal process itself would be a step in the right direction, I do wish to caution that Congress should expressly state in any such bill that it is *not* endorsing the legality of the SEC's current regime. Inasmuch as I think the substantive review of shareholder proposals should be a question of state law not federal regulation, Congress should not implicitly sign off on the process.

That said, Bill #12's express call to permit exclusion of social, political, and environmental questions from publicly traded companies' proxy ballots would be a welcome return to the pre-1970s standard. I have publicly supported such a standard in principle, for years.[78] To be sure, there could be gray areas in which lines may be difficult to draw. But by expressly permitting the exclusion of any policy questions, a bill to this effect would at least get the SEC staff out of the business of picking preferred policy viewpoints.

Bill #11 would not go as far and would still leave open the question of viewpoint discrimination, but it would effectively codify the thrust of the SEC's current guidance

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[77] CTS Corp. v. Dynamics Corp., 481 U.S. 69, 89 (1987).

[78] *See* James R. Copland, "Getting the Politics out of Proxy Season," Wall Street Journal, Apr. 23, 2015, *available at* https://www.manhattan-institute.org/html/getting-politics-out-proxy-season-5461.html.

under Legal Bulletin 14M and prevent the absurd result under the prior rule that shareholders are not permitted to interfere with corporations' ordinary business *except when* the subject is political—effectively turning corporate annual meetings into mini-policy-plebiscites.

4. Reforms Limiting the SEC from Requiring Non-Material Disclosures

Context: Materiality anchors the federal securities regime. In the Supreme Court's view, information is "material" if there's a "substantial likelihood" a reasonable investor would view it as important in the total mix. As discussed above, the SEC has increasingly stretch its mandate to require non-material disclosures, with some SEC Commissioners expressly repudiating the materiality standard in the disclosure context. Recent climate-rule litigation and the SEC's voluntary stay underscore tension over prescriptive, non-financial metrics versus materiality.

The noticed legislation includes the following:

(a) H.R. ____, the *Mandatory Materiality Requirement Act of 2025* (Huizenga) (#5):

Requires that SEC-mandated issuer disclosures be "material," with a limited exception where eliminating non-material items would not lessen the burden overall.

(b) H.R. ____, *a bill to amend the Securities Exchange Act of 1934 to require the Securities and Exchange Commission to disclose and report on non-material disclosure mandates, and for other purposes* (#14):

Requires the SEC to list each non-material disclosure requirement and justify it on the website and to report to Congress every five years; provides that failure to disclose such non-material information is not privately actionable.

Discussion

It would be salutary to codify a materiality cornerstone into the securities laws, as called for in Bill #5. Bernard Sharfman and I discussed this issue in more detail in our comment letter to the SEC discussing its proposed climate disclosure rule.[79]

Bill #14 offers a more modest yet still salutary alternative, requiring an express justification for a non-material disclosure requirement and a safe harbor protecting issuers against private rights of action for non-material disclosure—effectively blocking litigation warfare over non-material disclosure requirements. In this "lighter touch" approach, the Committee might also consider a periodic sunsetting of non-material disclosure rules absent a demonstrated investor utility.

5. Other SEC Reforms

Context. The SEC already has the Dodd–Frank Investor Advisory Committee and a Small Business Capital Formation Advisory Committee; neither systematically reflects the perspective of large public company issuers. In addition, the Commission has rarely studied its processes governing proxy statements and shareholder proposals.

The noticed legislation includes the following:

(a) H.R. ____, the *Public Company Advisory Committee Act of 2025* (Lucas) (#7):

Creates a Public Company Advisory Committee at the SEC to advise on investor protection, market efficiency, and capital formation.

(b) H.R. ____, *the Corporate Governance Examination Act* (Wagner) (#13):

Directs the SEC to conduct recurring five-year studies on proposals, proxy advisers, and the proxy process (including incentives, issuer costs, and politicization).

Discussion

The principal cost burden of these bills would fall on the SEC staff. There is obviously an opportunity cost to any such requirements, but beyond such costs, these ideas would strike me as salutary. I would solicit input from the Commissioners, however, before enacting such legislation. Again, it would be desirable to make sure that in enacting any study of Rule 14a-8, the Congress explicitly states that it is not endorsing the SEC's process. Substantive shareholder rights in this area should be a creature of state law.

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[79] *See* Bernard S. Sharfman & James R. Copland, Comment to the Securities and Exchange Commission, File No. S7-10-22, Release Nos. 33-11042; 34-94478, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," June 16, 2022, *available at* https://www.sec.gov/comments/s7-10-22/s71022-20131661-302049.pdf.

Conclusion

I commend the Committee for thinking so carefully about an issue I have long studied, the SEC's shareholder proposal process, governed through its oversight of the proxy statement; and the broader issues concerning shareholder voting, passive index investor voting, and proxy advisory firms.

I continue to believe that overreaching SEC rulemaking, in this and other areas, has strained the "genius" of American corporate law and, if not remedied, could threaten to imperil our strategic capital markets advantage.

The selected list of writings I have authored or published which follows should be incorporated by reference and can add further details to this statement. I encourage Members of the Committee to ask questions, which I will endeavor to answer to the best of my ability. I am also more than willing to follow up later with Members and staff.

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