115TH CONGRESS 2d Session | HOUSE OF REPRESENTATIVES | REPORT 115–904

TO REQUIRE THE SECURITIES AND EXCHANGE COMMISSION TO ADJUST CERTAIN RESUBMISSION THRESHOLDS FOR SHAREHOLDER PROPOSALS

AUGUST 24, 2018.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. HENSARLING, from the Committee on Financial Services, submitted the following

REPORT

together with

MINORITY VIEWS

[To accompany H.R. 5756]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 5756) to require the Securities and Exchange Commission to adjust certain resubmission thresholds for shareholder proposals, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

On May 10, 2018, Representative Sean Duffy introduced H.R. 5756 to direct the U.S. Securities and Exchange Commission (SEC) to revise Rule 14a–8(c)(12) to protect the interests of long-term shareholders and allow a company to exclude a shareholder proposal that focuses on substantially the same subject matter as a prior proposal that failed to receive at least six 6 percent of the vote on its first submission, 15 percent on the second submission, and 30 percent on the third submission.

BACKGROUND AND NEED FOR LEGISLATION

The goal of H.R. 5756 is to eliminate burdensome costs on companies by modernizing the shareholder resubmission thresholds.

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Modern corporations are subject to numerous pressures and continuous scrutiny from the respective corporation's many stakeholders—which include its shareholders, management, employees, customers, suppliers, special interest groups, communities, politicians, and regulators. These stakeholders have a broad array of interests in the corporation's operation and success. Although boards are expected to consider these diverse and sometimes conflicting interests of the corporation's stakeholders, the board's primary obligation is to ensure that the corporation creates long-term value for the corporation's shareholders.

Over time, a board's ability to focus on shareholder value has been inhibited by the proliferation of shareholder proposals for public companies' annual meetings. Section 14 of the Securities Exchange Act of 1934, and Rule 14a–8 thereunder, govern the submission of shareholder proposals. The Rule allows any shareholder who holds $2,000 or 1 percent worth of a company's stock for a period of one year to submit a non-binding shareholder proposal on any subject matter. (To put this into perspective, the largest publicly traded company in the United States by market capitalization is Apple, with a current market cap of more than $1 trillion. Rule 14a–8 currently would allow a shareholder who owns .000000002 worth of the stock (or roughly 10 shares of Apple) to offer a proposal, and force Apple (and all other shareholders) to pay for the proposal's dissemination.

Due in part to the extremely low bar for qualification to submit a proposal, as well as the SEC's increasing tendency over the past decade to err on the side of proponents in allowing these proposals access to the corporate proxy, the shareholder proposal process has become one of the favorite vehicles for special interest activists to advance their social, environmental, or political agendas. Proponents largely include activist public pension funds, social, or environmentally-focused funds, as well as so-called "gadfly" investors who own miniscule amounts of a company's stock, often times just so they are able to submit proposals year after year. In other words, the current shareholder proposal rules allow persons to hijack U.S. public companies' proxy processes to advance non-value related goals at the expense of long-term shareholders. The cost of a proposal can run $150,000 per measure, and some companies face 15 or more a year—equating in such instances to $2 million of time and resources being diverted from the core fiduciary responsibility to maximize shareholder value.

Despite the increasing number of proposals at public companies, shareholder support for environmental, social, or political issues remains stubbornly low. According to Proxy Monitor, in the decade they have been tracking proposals at Fortune 250 companies, only two environmental-related shareholder proposals received the majority support of shareholders over board opposition.

In addition to low thresholds for the initial submission of a proposal, shareholders are allowed to resubmit their proposal in subsequent years, even if they receive extremely low levels of support. Current regulations allow a company to exclude a resubmitted proposal from its proxy only if it failed to receive the support of 3 percent of shareholders the last time it was voted on; 6 percent if it has been voted on twice in the last five years; and 10 percent if it was voted on three or more times in the last five years. Thus, in many cases shareholder proposals that have been opposed by over 90 percent of shareholders on multiple occasions are allowed to be resubmitted, forcing companies to spend time and money in deciding how to deal with them.

Data shows that out of 2,341 shareholder proposals submitted to companies that comprise the Russell 200 index from 2001 to 2018 relating to special meeting, environmental and social, political and social and human rights, only 4 percent passed and 29 percent, were zombie proposals (those that failed to gain the majority support after three times). Additionally, the U.S. Department of Treasury's Report on Capital Markets issued pursuant to President Trump's Executive Order 13772 on Core Principles for Regulating the United States Financial System, found between 2007 and 2016, 31 percent of shareholder proposals were a resubmission of a prior proposal, demonstrating that companies have to waste resources on proposals that have continuously been rejected.

Under the leadership of Chairman Jay Clayton, the SEC has begun to focus on the overly burdensome nature of the shareholder proposal process and has offered some new shareholder proposal guidance. The SEC's Division of Corporation Finance published a Staff Legal Bulletin on November 1, 2017, to provide guidance to shareholders and companies for the upcoming proxy season. The guidance addresses the following: (1) the ordinary business exclusion; (2) the relevance exclusion; (3) proposals by proxy; and (4) the use of images in proposals. The updated ordinary business exclusion suggests that the SEC will give greater deference to companies whose board of directors provide detailed analysis on how a proposal may implicate an ordinary business matter, and thus can be excluded. The relevance exclusion provides the same deference to companies if their board can determine that a proposal does not account for more than 5 percent of a company's total assets or net earnings and gross sales. The proposals by proxy guidance would have proposals by proxy to provide documentation describing the shareholder's delegation of authority to proxy. Lastly, the use of images in proposals would prohibit the use of graphs and/or images that are misleading or irrelevant to the subject matter of a proposal.

While the SEC's staff guidance is a step in the right direction, it does not significantly reduce the burdens placed on companies from the current shareholder proposal process. The bill offered by Mr. Duffy is a modest change to the current regulatory structure that would help to reduce unnecessary shareholder proposals and allow companies to focus their resources on getting the greatest returns for investors. The bill would update the resubmissions thresholds for companies to exclude a resubmitted proposal from its proxy if it failed to receive the support of 6 percent of shareholders the last time it was voted on; 15 percent if it had been voted on twice in the last five years and 30 percent if it was voted on three or more times in the last five years. The updated thresholds are based on a 1997 SEC proposed rule.

The U.S. Department of the Treasury's October 2017 Report on Capital Markets included several recommendations to the shareholder submission regime. The Treasury report recommended that the resubmission thresholds be updated from their current form to promote accountability, better manage costs, and reduce unnecessary burdens.[1] Treasury also recommended "substantial revisions" to the $2,000 holding requirement, which was instituted in 1983 and last updated in 1998 to adjust for inflation. Treasury also recommended that the SEC "might also want to explore options that better align shareholder interests (such as considering the shareholder's dollar holding in company stock as a percentage of his or her net liquid assets) when evaluating eligibility, rather than basing eligibility solely on a fixed dollar holding in stock or percentage of the company's outstanding stock."

Further, the campaign to allow persons to hijack public companies to advance political projects that are immaterial to shareholder value has distorted the impact of this modest modernization. First, nothing in this bill eliminates a shareholder's ability to submit a proposal for the first time under the current rules; the bill simply raises the thresholds to levels proposed in 1997 to govern when a shareholder can resubmit the same proposal. The new thresholds provided in this legislation are sensible, and the idea that shareholders' ability to effect change at companies will be mooted disregards basic facts. After all, if these thresholds had been in place since 2001, proposals relating to special meeting, environmental and social, political and social and human rights matters that failed to gain majority support after at least three tries still would have been eligible for a third year on company ballots two-thirds of the time—and a quarter of them would have been eligible for a fourth year. These are sensible ratios because of all the proposals relating to these issues, which often are immaterial to shareholder value, only 4 percent of them pass anyways. This outdated system imposes costs on the investors that have no interest in such proposals, and also serves as a distraction for boards of directors and management, which are trying to focus on long-term performance.

This bill is important for all companies that are incurring unnecessary costs from shareholder proposals that are submitted year after year to push a social or political agenda and are not supported by the majority of shareholders. However, this bill is especially important for small and emerging companies that cannot afford to waste necessary capital on the same proposals every year. The Business Roundtable correctly noted "As the rule currently stands, a proposal that is opposed by 90 percent of a company's shareholders can be resubmitted indefinitely, leading to a "tyranny of the minority" situation."[2] When a company cannot use their capital to grow and create long-term value, shareholders are ultimately the ones who suffer because they cannot get the greatest return on their investment.

HEARINGS

The Committee on Financial Services held a hearing examining matters relating to H.R. 5756 on May 23, 2018.

[1] U.S. Department of the Treasury, A Financial System That Creates Economic Opportunities: Capital Markets, available at: https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[2] https://www.businessroundtable.org/resources/responsible-shareholder-engagement-long-term-value-creation.

COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on June 7, 2018, and ordered H.R. 5756 to be reported favorably to the House by a vote of 34 yeas to 22 nays (recorded vote no. FC–183), a quorum being present.

COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole recorded vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by a recorded vote of 34 yeas to 22 nays (recorded vote no. FC–183), a quorum being present.

Record vote no. FC-183

Representative	Yea	Nay	Present	Representative	Yea	Nay	Present
Mr. Hensarling	X			Ms. Maxine Waters (CA)		X	
Mr. McHenry	X			Mrs. Carolyn B. Maloney (NY)		X	
Mr. King	X			Ms. Velázquez		X	
Mr. Royce (CA)	X			Mr. Sherman		X	
Mr. Lucas	X			Mr. Meeks		X	
Mr. Pearce	X			Mr. Capuano		X	
Mr. Posey	X			Mr. Clay			
Mr. Luetkemeyer	X			Mr. Lynch			
Mr. Huizenga	X			Mr. David Scott (GA)		X	
Mr. Duffy	X			Mr. Al Green (TX)		X	
Mr. Stivers	X			Mr. Cleaver		X	
Mr. Hultgren	X			Ms. Moore		X	
Mr. Ross	X			Mr. Ellison		X	
Mr. Pittenger	X			Mr. Perlmutter		X	
Mrs. Wagner	X			Mr. Himes		X	
Mr. Barr	X			Mr. Foster		X	
Mr. Rothfus	X			Mr. Kildee		X	
Mr. Messer	X			Mr. Delaney		X	
Mr. Tipton	X			Ms. Sinema		X	
Mr. Williams	X			Mrs. Beatty			
Mr. Poliquin	X			Mr. Heck		X	
Mrs. Love	X			Mr. Vargas			
Mr. Hill	X			Mr. Gottheimer		X	
Mr. Emmer	X			Mr. Gonzalez (TX)		X	
Mr. Zeldin	X			Mr. Crist		X	
Mr. Trott	X			Mr. Kihuen		X	
Mr. Loudermilk	X						
Mr. Mooney (WV)	X						
Mr. MacArthur	X						
Mr. Davidson	X						
Mr. Budd	X						
Mr. Kustoff (TN)	X						
Ms. Tenney	X						
Mr. Hollingsworth	X						

COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 5756 will reduce regulatory burden and allow companies to focus their resources on getting the greatest return for investors by raising the shareholder resubmission thresholds.

NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, July 11, 2018.

Hon. JEB HENSARLING,
Chairman, Committee on Financial Services,
House of Representatives, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 5756, a bill to require the Securities and Exchange Commission to adjust certain resubmission thresholds for shareholder proposals.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

MARK P. HADLEY
(For Keith Hall, Director).

Enclosure.

H.R. 5756—A bill to require the Securities and Exchange Commission to adjust certain resubmission thresholds for shareholder proposals

Under current law, shareholders' proposals may be excluded from the proxy statements of publicly traded companies if the proposals are substantially the same as others presented for a vote within the previous five years. If a proposal fails to receive 3 percent support in a first vote, 6 percent on the second, or 10 percent after the third vote in a five-year period, the company may exclude it. H.R. 5756 would raise those thresholds to 6 percent, 15 percent, and 30 percent, respectively.

Using information from the Securities and Exchange Commission (SEC) on the costs of similar activities, CBO estimates that implementing H.R. 5756 would cost less than $500,000 for the agency to amend its rules. However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending would be negligible, assuming appropriation actions consistent with that authority.

Enacting H.R. 5756 would not affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply.

CBO estimates that enacting H.R. 5756 would not increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029.

H.R. 5756 contains no intergovernmental mandates as defined in the Unfunded Mandate Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. If the SEC increased fees to offset the costs of amending its rules, H.R. 5756 would increase the cost of an existing mandate on private entities required to pay those fees. Using information from the SEC, CBO estimates that such an increase would amount to no more than $500,000, falling well below the annual threshold for private-sector mandates established in UMRA ($160 million in 2018, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Rachel Austin (for mandates). The estimate was reviewed by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires one directed rule making within the meaning of such section. The directed rulemaking requires the SEC to revise section 240.14a–8(i)(12) of title 17, Code of Federal Regulations to raise the resubmissions thresholds for companies to exclude a resubmitted proposal from its proxy if it failed to receive the support of 6% of shareholders the last time it was voted on; 15% if it had been voted on twice in the last five years and 30% if it was voted on three or more times in the last five years.

SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

Section 1. Resubmission thresholds for shareholder proposals

This section directs the SEC to raise the resubmission thresholds to at least six 6 percent of the vote on its first submission, 15 percent on the second submission, and 30% on the third submission.

CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

H.R. 5756 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by Clause 3(e)(1)(B) of rule XIII of the House of Representatives.

MINORITY VIEWS

H.R. 5756 harms shareholders by making it easier for companies to exclude shareholder proposals from their proxy materials. The shareholder proposal process, governed by SEC Rule 14a–8, gives shareholders an opportunity to engage corporate management on issues that boards might otherwise be reluctant to address To be eligible to submit a proposal, an investor must have continuously held the lower of $2,000 or 1% of the company's securities for at least one year. To resubmit the same proposal in successive years, an investor must garner an increasing percentage of affirmative votes. Currently, a board can exclude a resubmitted shareholder proposal that received less than 3% of the vote on its first submission, 6% on the second, and 10% on the third. H.R. 5756 would increase the resubmission thresholds to 6% of the vote on the first submission; 15% for the second submission; and 30% for the third.

Proposals related to emerging issues have often taken years to develop enough traction among investors to receive more than 10% of the vote. However, many proposals that received low support in the beginning have facilitated industry-wide changes in the long term. For example, a 1997 shareholder proposal calling upon ExxonMobil to evaluate and report on the business implications of climate change received less than 6% of the vote. In 2017, after decades of resubmissions, similar climate change proposals at ExxonMobil and other energy companies passed with majority shareholder support. H.R. 5756 would have the effect of restricting many important shareholder proposals on the environment, diversity, corporate governance, and other critical issues.

H.R. 5756 is premised on the misconception that shareholders are abusing the shareholder proposal process to promote activist interests to the detriment of public companies. To the contrary, shareholder proposals have benefited public companies in terms of increased shareholder engagement and improved performance. For example, in a letter to the Committee opposing H.R. 5756, New York State Comptroller Thomas DiNapoli noted shareholder success in improving gender diversity on corporate boards, which has enhanced company financial performance and board decision-making. According to Mr. DiNapoli, this progress would not have been possible if H.R. 5756 had been enacted during the early stages of board diversity proposals.

Another misconception is that shareholder proposals routinely force companies to expend significant resources to analyze and answer them. This is false because most public companies never receive shareholder proposals and thus incur no burden whatsoever from the existing process. According to a voting analytics database maintained by Institutional Shareholder Services, Inc. (ISS), only 13% of Russell 3000 companies received a shareholder proposal in any given year between 2004 and 2017. The data also shows that any company that receives a shareholder proposal is likely among the largest corporations, as less than 4% of shareholder proposals in the ISS database were filed at companies with under $1 billion in market capitalization.

When a similar provision was included in H.R. 10, the "Financial CHOICE Act,"—which was unanimously opposed by all House Democrats—several state treasurers and comptrollers signed a joint letter that underscored the importance of preserving shareholder rights as set forth in Rule 14a–8. According to these state officials, "[t]he robust shareholder proposal process, as currently structured and administered under SEC Rule 14a–8, works well for investors, public companies and capital markets."

In addition, several consumer and investor advocates, religious organizations, civil rights groups, organized labor organizations, public company shareholders, pension plans, institutional investors, and other proponents of sound corporate governance wrote to Congress opposing H.R. 5756 and the related provision in H.R. 10. These stakeholders view the existing shareholder proposal process as striking an appropriate balance between management discretion and accountability to shareholders.

For these reasons, we oppose H.R. 5756.

MAXINE WATERS.
WM. LACY CLAY.
STEPHEN F. LYNCH.
CAROLYN B. MALONEY.
DANIEL T. KILDEE.
MICHAEL E. CAPUANO.

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