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GOLIATH VERSUS THE SHAREHOLDER

The rules that govern investors' right to bring critical issues to the proxy ballot of our nation's public companies are under threat. Shareholder "proposals," or "resolutions," ensure shareowners have a voice in how companies are run, gently cracking open the echo-chamber that exists between the C-Suite and the board and allowing a diversity of views. Proposals not only highlight the concerns of individual investors, but put those concerns in front of all investors to vote on at the companies' annual meetings. As far as investing goes, it's democracy at its best—the right of one share, one vote. It is a right we have utilized efficiently and effectively on our clients' behalf, pressing portfolio companies to improve everything from climate performance to pay practices. So, if it ain't broke, why fix it?

On November 5th, the Securities and Exchange Commission (SEC) voted 3-2 to propose amendments to "modernize" the rule governing shareholder proposals. The expected outcome? To reduce the number of investor proposals considered at annual meetings by 37%. Perhaps a win for CEOs and Boards who seek to avoid investors' dissenting and public views, but almost certainly a loss for the investors who have played a pivotal role to keep companies transparent, proactive, and accountable. To keep them well-governed and well-performing.

Our multi-year engagement with Facebook is a striking example towards that end. In December 2016, right as Facebook's head of security was privately alerting Mark Zuckerberg and Sheryl Sandberg that the Russians were hacking their platform, our clients submitted a first-of-its-kind shareholder proposal publicly asking the company to review the impact of fake news flows on the company and our electoral process. When the proposal went to a vote at the annual meeting that spring, it received less than 6% support from investors, and management dismissed our concerns. But six months later, Facebook testified before Congress that 126 million Americans viewed Russian propaganda on the platform in the lead up to our presidential election. Fast forward another four months, and Facebook CEO Mark Zuckerberg found himself before Congress testifying about the Cambridge Analytica scandal—a revelation that 87 million Americans' data was compromised and used to manipulate Facebook users during the US election. In response, Facebook's market value fell $1 billion. And that spring, our proposal on fake news, election interference, and content governance received 30% of the independent investor vote.

If the SEC's newly proposed proxy rule changes were in place at the time, neither of those votes would have been possible—our clients wouldn't have owned enough stock to file, and the low vote the first year would have precluded a follow-up vote the following year. But more importantly, investor concerns would have been muted.

In 2013, Malcolm Gladwell reinterpreted the story of David and Goliath—Goliath as a fumbling giant with poor vision, and David as an outsider, who approached Goliath on his own, more visionary, terms—and won. This interpretation holds true when we examine the role of the independent investor and the corporation. Large corporations tend not to be bustling centers of innovation. And so often it is investors who bring to light new ideas, emerging threats and future opportunities, on issues as broad as climate change and diversity. Issues that may be getting short shrift in the executive ranks. And while the echo chamber of homogenous boards and executive management teams remains, so too the divergent investor voice is alive and well. And therefore, the exchange between companies and their investors is not only an important governance measure, but a material value add to how companies manage their business.

Despite this virtuous circle, the SEC is threatening to render speechless the very investors it is mandated to protect.

The SEC proposal would limit shareholder rights in three ways: 1) it would increase the stock-ownership threshold required to file proposals; 2) it would impose higher vote thresholds to submit a proposal multiple years in a row; and 3) it would expose proxy advisory firms to potential liability when issuing recommendations in favor of shareholder proposals.

These "modernization" reforms have been pushed, not by investors, but through a coordinated corporate lobbying campaign. That campaign has been supported by groups like the Business Roundtable, an association of US businesses chaired by Jamie Dimon—himself a vocal critic of the shareholder proposal process. Of course, the SEC does not tout the corporate interests behind the reforms. Instead, they hide behind "Main Street investors." In an embarrassing turn of events, SEC Chairman Jay Clayton justified the proposed changes by referencing fictitious letters from "long-term Main Street investors…all of whom expressed concerns about the current proxy process." It turns out, however, that those letters were ginned up by a corporate lobbying group, not actual people. An inconvenient truth uncovered by Bloomberg News two weeks later.

On February 3rd, the 60-day public comment period will end and the SEC will hold a vote to seal the fate of one of the most critical corporate reform processes available. And it can only go two ways: in favor of further consolidating corporate control or in favor of the investors the SEC is charged to protect.

The irony is what the corporate giants fail to see. That the shareholders' voice is critical to their own business interests. A healthy tension between management and investors is just that—healthy. Innovation comes from the margins, and just as David brought a fresh perspective to the rules of engagement in the form of a slingshot, investors bring a new view, which can often serve as a shot in the arm. So often it is investors who prove the prescient minority on emerging risks and opportunities—asking companies to make reforms in favor of less risk and better performance.

Our investors were not waiting for the next shoe to drop at Facebook in 2016—we asked the right questions, early and often. Our investors did not stand on the sidelines as ExxonMobil faced the biggest existential threat to their business this century. We pressed them to disclose climate risks. Our investors did not wait for greater diversity and the financial benefits it affords—we asked for it. Perhaps the only "modernization" necessary is how to enable more investors to speak up.

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