ARJUNA CAPITAL
ENLIGHTENED INVESTING

SHAREHOLDER ENGAGEMENT
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As far as investing goes, it's democracy at its best—the right of one share, one vote. That right is under threat.

Democracy—where power is vested in the people—is exercised directly or indirectly through a system of representation and free elections. And while we all know this, now is the time to brush up on our civics. Because our systems of representation are currently under threat on a host of fronts, and not just the political stage.

AN SEC, NOT FOR THE PEOPLE.

The rules that govern investors' right to bring critical issues to the proxy ballot of our nation's public companies have just been gutted. This September, the SEC formalized sweeping changes to eliminate opportunities for shareholders to file and re-file proposals by increasing investment and re-submission thresholds and tying up investors and their advisors in red tape. The rulemaking is expected to reduce the number of investor proposals considered at annual meetings by 37%.

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 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 racial and gender pay practices.

Ironically, while the SEC's mandate is to protect investor rights, that's the opposite of what just happened. The desire of SEC chairman and Trump appointee, Jay Clayton, to "modernize" shareholder rules was buoyed not by the main street investors he purported to defend, but by a cleverly-named, but hopelessly blatant, corporate group—"the Main Street Investors Coalition"—which was ultimately exposed as a fake grassroots campaign—but not before he used their phony letters to promote his agenda.

The SEC rulemaking limits shareholder rights in three ways: 1) it increases the stock-ownership threshold required to file proposals from $2,000 to as much as $25,000; 2) it imposes higher vote thresholds to submit a proposal multiple years in a row; and 3) it supplants investment advisors' right to fully represent their clients by requiring individual filers to be available to speak with company representatives within 30 days.

Let's look at what this means in practical terms: It is typical for first-time shareholder resolutions to get relatively low vote percentages early on, and then a consensus of support emerges over time. Arjuna Capital has been a pioneer in introducing new issue areas for investors to weigh in on. For example, in 2015 we introduced a first-of-its-kind proposal asking eBay to disclose and close its gender pay gap. The first year, it received 8% support from investors. But the next year, a majority of investors (51%) voted in favor of our proposal and the CEO agreed to make the change that day.

The same was true in December of 2016 when we asked Facebook to disclose the extent of fake news and election interference on its platform. When the proposal went to a vote in the spring of 2017, 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. In the spring of 2018, our proposal on fake news, election interference, and content governance received 30% of the independent investor vote. The SEC rule changes would have stopped the re-filing of that shareholder resolution cold, since it did not achieve the arbitrary support threshold required under the new SEC rules. This year, we plan to re-file a proposal asking Facebook to add a human and civil rights expert to their board—which received under 6% of the investor vote this past spring. But under the new rules, we could not ask for that critical governance change. There is no rhyme or reason for the SEC's increased-

support requirement—except to prevent as many shareholder resolutions as possible.

ENTRENCHED POWER.

The new SEC rulemaking may be the latest threat to investor rights, but it is important to examine more entrenched processes that also require reform.

Super-voting shares are one such relic. Awarded at times to founders to protect their ability to execute their strategy without interference, they disproportionately favor insiders' voices 10 to 1 when it comes to matters of corporate governance. In fact, super-voting shares can allow holders to abuse their position through massive executive compensation packages, or worse, through long-term entrenchment where public shareholders' voices are rendered moot.

Facebook offers a morality tale on what not to do, although it is not alone. The use of super-voting shares has become increasingly commonplace in recent years following Google's IPO in 2004, particularly among tech companies. Mark Zuckerberg's entrenchment is increasingly viewed as the source of Facebook's problems, from the Cambridge Analytica Scandal, to this summer's #stophateforprofit advertiser boycott, to controversy over a shoddy political ad policy. Zuckerberg's super-voting shares allow him absolute control, with 51% of the voting rights of the company, but only 14% stock ownership. Over 60% of ordinary shareholders have consistently voted to change Facebook's voting structure to "one-share, one-vote," but without the votes, that decision lies with Mr. Zuckerberg. It also cripples shareholders' ability to achieve a majority vote on any proposal.

One solution offered by the Chartered Financial Analysts (CFA) Institute is to enact time-based sunsets, where super-voting shares automatically convert to a "one-share, one-vote basis," within a 5-year period. This would protect public shareholders from the potentially value-destroying long-term influence of company insiders.

PERSISTENCE.

In the short term, the SEC has given investors a pass for the 2021 proxy season, and the more arduous stock ownership and voting thresholds won't yet apply. As such, we will be filing proposals as per normal and working to garner as much investor support as possible this year, so that those proposals can be re-filed next year, in the absence of company action.
For the 2022 season, fewer of our clients will be able to participate directly in the filing process—using their personal shares to file proposals. But we are fortunate to have clients with substantial assets that will meet the SEC's new stock ownership thresholds. The flip side is that, yet again, the system favors those with the greatest wealth. Not "one-share, one-vote." Of course, we are doing this work on behalf of ALL our clients. Long-term, we will press for new rulemaking that ensures a system of equal representation under the law. For now, I hope you will be patient with us as we navigate the red tape to ensure investors' voices are not silenced.

Natasha Lamb, Director of Equity Research & Shareholder Engagement

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