SHAREHOLDER RIGHTS GROUP

Shareholder Rights Group

Arjuna Capital

As You Sow

Boston Common Asset Management, LLC

Boston Trust Walden

Clean Yield Asset Management

First Affirmative Financial Network, LLC

Harrington Investments, Inc.

Jantz Management, LLC

John Chevedden

Natural Investments, LLC

Newground Social Investment, SPC

NorthStar Asset Management, Inc.

Pax World Funds

Sustainability Group of Loring, Wolcott & Coolidge, LLC

Trillium Asset Management, LLC

October 2, 2020

VIA ELECTRONIC FILING

Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: 1210-AB91, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights proposed rule

Dear Assistant Secretary Wilson:

I write in regard to the Department of Labor Employee Benefits Security Administration's proposed rule, *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, Regulatory Identifier Number (RIN) 1210-AB91. The Shareholder Rights Group is an association of investors formed in 2016 to strengthen and support shareowners' rights to engage with public companies on governance and long-term value creation. Our members are a group of leading proponents of shareholder proposals, as well as representatives of clients and beneficial owners on whose behalf many of our members file proposals.

Regulated fiduciaries covered by the proposed rule currently have a set of mechanisms for assessing whether or not to vote in favor of proxy items, including shareholder proposals on ESG and other issues. The existing process provides suitable flexibility for plans to vote proposals that are in the economic interest of plan participants and beneficiaries. These economic interests include the long-term value of a specific stock on which a proxy vote is cast, as well as portfolio-wide success that comes from the environment in which all businesses in the portfolio must operate, and management of systemic risks across the economy.

In addition, regulated fiduciaries represent beneficiaries whose general economic interests *and* First Amendment right to invest and engage with portfolio companies consistent with their values are at issue in the current rulemaking.

In short, the proposed rule is based on fallacious logic regarding both the role of proxy voting in producing *value,* and in the right of plans to express plan participants' and beneficiaries' *values.* The Department should reject the proposed rule.

Combined Effect of Prior and Current Proposal

The current rulemaking proposal compounded with the previously issued rulemaking proposal Department of Labor RIN 1210-AB95, "Financial Factors in Selecting Plan Investments," appears to have the effect of mandating that a regulated plan manage its portfolio investments inconsistent with the values and interests of plan participants and beneficiaries, raising a significant First Amendment objection. The previously issued proposal regarding "Financial Factors in Selecting Plan Investments" would impose more stringent standards on plan sponsors for selecting ESG investments for plans. Such investments would also be barred as qualified default investment alternatives. As noted in correspondence to the Department of Labor from the Members of the Congressional Committee on Education and Labor, July 29, 2020:

> Workers across the country are interested in investing in a way that reflects their values—whether combating climate change or promoting health and labor standards—without sacrificing returns. Environmental, social, and governance (ESG) factors enable them to be informed about potential risks and opportunities when evaluating an investment portfolio. There has been an uptick in assets in defined-contribution plans being directed toward ESG investments. In the United States, "mutual funds focused on sustainable investing attracted more than $20 billion in assets in 2019, more than 4 times the flows in 2018." And there is little to suggest that investing in ESG leads to worse financial outcomes for investors. In fact, "**a growing body of evidence suggests that using sustainable investments generally has not reduced risk-adjusted returns to date**." [1]

Yet, the proposal issued earlier this year would alter the so-called tiebreaker rule to require any investment option a fiduciary wants to choose based (in whole or in part) on non-pecuniary (or collateral benefit) reasons to be identical in every way to an alternative investment except for the non-pecuniary benefit. Because these "identical" alternative investments might be unavailable in the market, our conclusion is that the test is designed to deter fiduciaries from considering investments with collateral benefits. In effect, a plan's choice of an ESG investment because it would be more closely aligned with the values of the participants and beneficiaries would be largely obstructed.

This prior proposal appears intended to preclude an assessment that a particular investment that provides competitive risk-return characteristics may be selected for collateral reasons based on the values and interests of plan participants and beneficiaries. Now it appears that the intended effect of the current proposed proxy voting rulemaking is to eliminate the rights of pension plans to vote in the interests of plan participants and beneficiaries unless such voting passes a burdensome cost-benefit test.

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[1] Letter to Secretary Eugene Scalia, Department of Labor, from the Members of the Congressional Committee on Education and Labor, July 29, 2020.

The current proposal adds inappropriate impediments to voting in the interests of plan participants and beneficiaries. By requiring that each decision as to whether to cast a proxy vote subject to "individual cost/benefit analyses," and a potential source of an ERISA violation, and by establishing a regulatory safe harbor for voting with management or not voting, the proposal would eviscerate the capacity of fiduciaries to vote. In its costly and dangerous approach, it would obstruct voting in favor of proposals understood to implicate systemic or portfolio-wide impact unless a cost-benefit analysis can justify it.

This is poor policy -- it violates any reasoned economic analysis, inappropriately supports corporate management regardless of whether it is taking action that harms company or portfolio value, and constitutes an unconstitutional constraint on plans to express the interests and values of the participants and beneficiaries. As such, it is an abrogation of both the interests of plan participants and beneficiaries in producing *value*, and of their right, in aggregated form as a pension plan, to express their *values*.

The Value Fallacy of the Proposed Rule:
ESG Investments and Universal Investor Proxy Voting

While the evidence is strong that ESG investments and strategies are providing economic resilience for issuers and investors, the proper frame for considering the economic impact of a proxy vote extends beyond the financial returns of an individual investee company and should include analysis of the portfolio-wide impact. To take one example, climate change is known to impose systemic risks across the financial sector. Proxy proposals geared to promoting consistent greenhouse gas reduction measures on a company by company basis have garnered growing support from investors.[1] The support is both because the measures can improve long-term value for the particular stock, but also because greenhouse gas reduction across all sectors of the economy is a necessity in order to avoid catastrophic economic consequences to the entire economy. To constrain favorable votes on a climate change proposal to those instances in which a favorable economic impact can be calculated at the individual company level would thwart the market's effective advancement of measures which collectively improve the environment and reduce systemic risk for all portfolio companies.

Votes taken on issues that reflect "environmental or societal" impact also reflect "economic" impact -- the portfolio-wide impact of systemic concerns. Imposing a case-by-case economic analysis on these issues would create an incoherent context for proxy voting, limiting fundamental rights of plans acting on behalf of their participants and beneficiaries to address issues affecting the entire economy and the resource base in which all businesses must operate. Addressing this economic context of operations is not a deviation of fiduciary duty but rather is part of the fundamental responsibility of investors.

Many ERISA-regulated pension plans are universal investors which are widely and diversely invested across the economy. To the extent that a portfolio company is undermining the natural resource or economic environment in which other companies must operate, it may undermine the long-term economic well-being of participants and beneficiaries as well as the plan's portfolio value. Proxy voting is one place where these issues are discussed and where investors deliberate on externalities.

The proposed rulemaking would essentially impose a tax on ERISA-regulated pension plans and their service providers on any votes in support of a proxy item opposed by management. By allowing regulated plans to defer to a company's board and management as an option to fulfill their proxy voting responsibilities, while not providing similar deference to other fiduciaries more closely aligned with investor interest such as their proxy advisors, the proposal creates an arbitrary and inappropriate constraint on the First Amendment rights of pension participants and beneficiaries, through their plans, to hire and implement the advice of trusted fiduciary advisors.

As we see in trends described in news outlets such as Barrons, Bloomberg, and The Wall Street Journal, interest in ESG factors has led to exponential increases in the number of investors who seek positive returns from ESG considerations. Understanding that the financial return of their portfolios is tied to companies' environmental, social, and governance performance, investors increasingly seek integration of ESG issues into their portfolios due to what they rationally view as the effects of ESG factors and externalities on company performance, and the performance of their portfolios as a whole. For example, signatories of the PRI (Principles for Responsible Investment) seek ESG information to help build portfolios, while PRI also encourages engagement with companies. This necessitates, in some instances, the filing of proposals at companies whose externalities are considered to pose systemic or company risk for investors. ESG considerations, including climate change, are particularly important to the Universal Owner (UO), who, by being

> ... invested in a broadly diversified portfolio, essentially owns shares in the global economy. The UO hypothesis "states that a portfolio investor benefiting from a company externalizing costs might experience a reduction in overall returns due to these externalities adversely affecting other investments in the portfolio, and hence overall market return.[2]

An example of these risks includes systemic climate risks, as documented in the new report[2] from the Commodity Futures Trading Commission's (CFTC) Climate-Related Market Risk Subcommittee, which reports that "Climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy." That report notably warns that Department of Labor policies may interfere with sustainable investment responsive to these systemic risks by making ERISA plans sponsors and managers "believe they could risk violating their fiduciary duties if they integrate sustainability factors into their investment approach."[3] Adam Seitchik of Arjuna Capital cited this in "Climate Change from the Investor's Perspective":

> Therefore, investors have a strong vested interest in public policy and private activity that lowers the global risk of climate-related economic disruption.

[2] Climate-Related Market Risk Subcommittee (2020), *Managing Climate Risk in the U.S. Financial System*, Washington, D.C., U.S. Commodity Futures Trading Commission, Market Risk Advisory Committee.

[3] *Id.* at 107-108.

> Carbon emissions are a classic example of a negative externality, to the extent that the full cost of the pollution is not factored into the price of a barrel of oil but borne by society at large. The key insight from UO analysis is that for a diversified investor, there is no place to hide from these costs: they come back into the portfolio as taxes, insurance premiums, inflated input prices and the physical cost of disasters.[4]

Thus, investor representatives often deploy the shareholder proposal process to address broad public policy concerns of investors, including long-term value at the company *and* companies' impacts to the value of clients' portfolios based on economic and market-wide effects from company action.[3] As the Mercer report, *Investing in a Time of Climate Change: The Sequel* stated:

> Investors such as pension funds, insurers, wealth managers, and endowments and foundations typically have multidecade time horizons, with portfolio exposure across the global economy. The implications of climate change are systemic and are already apparent…Financial regulators, and particularly for pension funds, are increasingly reinforcing this message by formalizing the expectations that investors should consider the materiality of climate-related risks and manage them accordingly, consistent with their fiduciary duties.[5]

The proposed rule, in imposing extraordinary costs on ERISA plans to assess the economic impact of a proxy vote, and in ignoring portfolio-wide and systemic impact, would impose a fundamental constraint on plans ability to protect long-term financial value.

In plain language, the Proposed Rule will require fiduciaries to either expend significant amounts on a cost-benefit analysis for each and every ESG related vote or ignore their fiduciary duty to protect their clients' financial interests by reflexively voting with management (or refrain from voting) to avoid this significant new cost. Neither outcome is rational or in the best interest of plan participants and beneficiaries. There is simply no way to reconcile this proposed rule change with the fiduciary duty or requirements of ERISA or the First Amendment rights of shareholders and their fiduciaries.

The Values Fallacy of the Proposed Rule: Blocking Expression of Plan Participant and Beneficiary Values Violates First Amendment and Would be Arbitrary and Capricious

The proposed rule also violates the First Amendment by imposing a cost-benefit hurdle for ERISA plans to advocate for the interests and values of plan participants and beneficiaries through the proxy voting process. Just as a corporation has free-speech rights, so do ERISA-regulated pension plans. As noted by Aleta G. Estreicher, *Securities Regulation and the First Amendment*:

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[4] http://arjuna-capital.com/wp-content/uploads/2016/07/Climate_Change_from_the_Investor_s_Perspective.pdf
[5] Mercer, *Investing in a Time of Climate Change: The Sequel,* page 6.

> [W]hen a corporation "speaks" it speaks through the voice of its officers and directors, who are agents exercising derivative power on behalf of their widely dispersed shareholder-principals. The state has created a structure to facilitate this delegation of authority so that the enormous aggregation of power and wealth that is the modern corporation can function efficiently, without paralyzing diffusion of decision making. The same state that enables corporations to operate through centralized management has a substantial interest in ensuring that the manager-agents are in fact chosen by and act on behalf of their principals.[6]

The interest of government in ensuring accountability of board and management as agents of the shareholders is amplified by the many forms of imbalance in opportunities and rights of expression, tilted toward board and management. Protections for board and management speech rights abound and have been bolstered over the years: insulated boardroom decision-making, the business judgment rule, the ability to publish unlimited reports and rebuttals, opposition statements many times the length of shareholder proposals, safe harbors, the inefficiency and ineffectiveness of shareholder derivative suits at bringing accountability to the boardroom, the high cost of waging a proxy contest, and the distorted voting power due to insider and dual share ownership — to name just a few examples.

First Amendment jurisprudence endorses the idea of counter-speech. A group that is uncomfortable with the messages or power of another group is permitted to express their own message in opposition. The concept is applicable to corporate interchanges on the big issues facing a company and society. In the face of corporate free-speech rights and entrenched, self-dealing or blindered corporate boards, the "remedy is not to restrict speech but to consider and explore other regulatory mechanisms," as Justice Kennedy stated in *Citizens United v. FE*C, 558 U.S. 310 (2010).

As Karl M.F. Lockhart has written:[6]

> "Thus, a proper response should seek to target the ways in which investor speech in the corporate setting has been limited. Those barriers should be removed. In this way, the "remedy to be applied" for increased managerial control over corporate speech will be "more speech" for shareholders, not "enforced silence."[7]

While shareholders' right to express opposition to a management and board perspective is far from an absolute right, <u>*the established mechanisms of shareholder democracy, including the ability of pension plans to vote in the interests of their participants and beneficiaries through the proxy process are sacrosanct expressive rights*</u>. The shareholder proposal process represents one

[6] Aleta G. Estreicher, Securities Regulation and the First Amendment, 24 Ga. L. Rev. 223, at 275 (1990) ("[I]n the modern corporate world of centralized management and widely dispersed shareholders, shareholder voting by proxy has become indispensable."). at 312.

[7] Karl M.F. Lockhart, 'Corporate Democracy'?: Freedom of Speech and the SEC, Virginia Law Review, Vol. 104, No. 8 (December 2018), pp. 1593-1635. https://www.jstor.org/stable/26790718.

of the few arenas in which shareholders can express their views inside the corporation. Limitations on shareholder speech as imposed by the proposed Department of Labor rule is clearly intended to tip the balance toward CEOs and boards and to neglect the underlying interests of pension plan participants and beneficiaries.

These rights and interests of investors have been confirmed in prior court decisions. For instance, in *Medical Committee for Human Rights v. SEC*, the U.S. Court of Appeals for the District of Columbia has noted:

> In so far as the shareholder has contributed an asset of value to the corporate venture, in so far as he has handed over his goods and property and money for use and increase, he has not only the clear right, but more to the point, perhaps, he has the stringent duty to exercise control over that asset for which he must keep care, guard, guide, and in general be held seriously responsible. As much as one may surrender the immediate disposition of (his) goods, he can never shirk a supervisory and secondary duty (not just a right) to make sure these goods are used justly, morally and beneficially.[8]

The Medical Committee court further established the underlying basis of the rights and responsibilities of those shareholders, despite the discretion afforded board and management in the business judgment rule:

> We think that there is a clear and compelling distinction between management's legitimate need for freedom to apply its expertise in matters of day-to-day business judgment, and management's patently illegitimate claim of power to treat modern corporations with their vast resources as personal satrapies implementing personal political or moral predilections. It could scarcely be argued that management is more qualified or more entitled to make these kinds of decisions than the shareholders who are the true beneficial owners of the corporation; and it seems equally implausible that an application of the proxy rules which permitted such a result could be harmonized with the philosophy of corporate democracy which Congress embodied in section 14(a) of the Securities Exchange Act of 1934.[8]

In more recent years, this responsibility and right of shareholders was amplified and echoed by Justice Anthony Kennedy in *Citizens United*, who described the need and potential for shareholders to use the tools of corporate democracy hold their companies accountable for misdirected corporate political spending.[3]

In short, when investors buy shares of stock in a company, they become part of the economic engine of the company's operations, and those investors also assume a level of responsibility along with board and management for any damage inflicted on the social fabric: corruption, pollution, consumer fraud, etc. Thus, it is both the opportunity and responsibility of investors to use their engagement, proposal filing, and voting power to ensure that investee companies are

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[8] *Medical Committee for Human Rights v. SEC*, 432 F. 2d. 659, 680-681 (1970), vacated and dismissed as moot, 404 U.S. 402 (1972).

deploying investors' funds "justly, morally and beneficially." Investors rightly consider how their investing strategies will affect the well-being of their grandchildren, their communities, and the environment because that is what is in their long-term interests as investors.

The proposed rule, in subjecting such rights to a cost-benefit analysis provides an inappropriate constraint on the rights of ERISA-regulated pension plans to vote in the interests of their participants and beneficiaries. The Department of Labor also has a duty to consider the inconsistency of the proposed rule with other efforts of the Department seeking to protect American workers from the impacts of practices that undercut American workers' competitive capacity.

Example: Slavery and Child Labor In The Supply Chain

A simple example would be investment in a stock of a company whose operations or supply chain use child labor, forced labor or slavery, practices which may either be legal or tolerated by nonenforcement in the jurisdiction in which a company's operations or supply chain are conducted. Numerous shareholder proposals address the issue of child labor or forced labor.

The Department of Labor has been monitoring the issue of child and forced labor globally, most recently issuing a report in 2018, "List of Goods Produced by Child Labor or Forced Labor".[9] The report notes that currently "152 million child laborers and 25 million forced laborers are estimated to still sweat and toil worldwide. These adults and children work in hazardous, abusive, or even slave-like conditions." Of particular concern is the impact on American workers:

> American workers cannot compete with producers abroad who use child labor or forced labor, provide unsafe working conditions, or do not pay workers what they are legally owed. These reprehensible practices undercut the higher standards we maintain to protect the well-being of our workforce here at home.
>
> Amid a proliferation of credible research, consumer attention, and on-the-ground efforts to tackle child labor and forced labor, turning a blind eye is no longer an option. Governments that do not acknowledge or address these problems will confront them in trade negotiations, trade enforcement actions, or multilateral fora. **CEOs who turn a blind eye to labor exploitation will face the issue in shareholder resolutions or face questions from their Boards**. These stakeholders and others who stay on the sidelines of this issue

[9] https://www.dol.gov/sites/dolgov/files/ILAB/ListofGoods.pdf
The U.S. Department of Labor (USDOL) has produced this eighth edition of the List of Goods Produced by Child Labor or Forced Labor in accordance with the Trafficking Victims Protection Act (TVPRA), as amended. The TVPRA requires USDOL's Bureau of International Labor Affairs (ILAB) to "develop and make available to the public a list of goods from countries that [ILAB] has reason to believe are produced by forced labor or child labor in violation of international standards" 22 U.S.C. § 7112(b)(2)(C) (TVPRA List or the List). It also requires submission of the TVPRA List to Congress not later than December 1, 2014, and every two years thereafter. 22 U.S.C. § 7112(b)(3)

could end up in the headlines.

It is hard to reconcile the rulemaking proposal, as well as the Department's prior proposal on ESG, with this clear demonstration by the Department that child labor and forced labor are both material issues for American workers and for investors as expressed in shareholder proposals. The Department's proposed rules on ESG investing and proxy voting appear to prevent *both* the exclusion of stock purchases in companies that are complicit with human rights abuses or voting in favor of a proposal asking the company to take steps to eliminate slavery or child labor in its operations or supply chain in the absence of a cost-benefit analysis.

The compound effect is to coerce the plans to undertake investing without boundaries and standards that reflect the interests of pension plan participants and beneficiaries. This is a major abrogation of plan participants' and beneficiaries' financial interests, as well as the First Amendment rights of ERISA-regulated pension plans. **It also provides powerful evidence that the proposed Department of Labor rules are arbitrary and capricious because they are inconsistent with other policy objectives and analyses of the Department geared to protecting American workers.**

Because the shareholder proposal process directly affects the ability of shareholders to express themselves on these critical issues, and to build affiliation with other investors to influence company behavior, the Department's proposed rulemaking amounts to a very substantial incursion on First Amendment rights of expression and association.

In *Buckley v. Valeo,* 424 U.S. 1 (1976) the Supreme Court held: "[T]he concept that government may restrict the speech of some elements of our society in order to enhance the relative voice of others is wholly foreign to the First Amendment, which was designed to secure the widest possible dissemination of information from diverse and antagonistic sources, and to assure unfettered interchange of ideas for the bringing about of political and social changes desired by the people" (at 48-49.) The *Citizens United* majority wrote that the rights of dissenting shareholders would be protected "through the procedures of corporate democracy." *Citizens United,* 558 U.S. 310 (2010).

<u>Viewpoint Based Restrictions are Unconstitutional</u>

Furthermore, the constraints imposed by the proposed rule are not content neutral, and are therefore unconstitutional. In imposing special burdens on voting *in favor* of ESG proposals, and making it easier for a plan to either abstain or vote with management, the rule imposes a *viewpoint based* prior restraint on speech that distorts the rights and freedom of plans and their beneficiaries to protect value and express values relevant to socially responsible corporate behavior. Viewpoint-based restrictions limit speech based on ideology and perspective, an unconstitutional category of speech restraint. As Justice Thurgood Marshall wrote for the Supreme Court in *Police Department of Chicago v. Mosley,* 408 U.S. 92 (1972), "the First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter, or its content."

The Department of Labor must allow all citizen shareholders, including those whose interests are aggregated through their ERISA-regulated pension plans, the ability to fully convey their views to corporate management through their proxy votes.

Recent SEC Rule Change Compounds the Damage to Investor Interests

If applied in combination with newly adopted changes to Securities and Exchange Commission rules on resubmission of shareholder proposals, which substantially increased the voting thresholds required to resubmit proposals,[10] the proposed rules, by encouraging regulated plans to either decline to vote or to vote with management, would impose concrete harm on investor rights by undercutting their ability to manage long term risks, by preventing emerging issues from achieving vote levels needed for continued deliberation on issues such as climate change, executive compensation and human capital management.

Conclusion

We urge the Department of Labor not to adopt the proposed rule, which would have material negative impacts on the economy, and the rights and ability of investors to ensure corporate social responsibility, control externalities that impose portfolio-wide impacts, and address issues of governance and ethics at portfolio companies. In the event that the Department should nevertheless adopt the rule, it must clarify that portfolio-wide economic and systemic impacts, including externalities from investee companies that may affect the operating environment of other portfolio companies, and the advice of fiduciaries on these impacts, may be considered in proxy voting decisions, and that ERISA-regulated pension plans decisions to conduct proxy voting reflective of the interests and values of participants and beneficiaries are exempt from cost-benefit analysis.

Sincerely,

Sanford Lewis
Director
Shareholder Rights Group

[10] Securities and Exchange Commission, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 1 4a-8, Release No. 34-89964. The rules have increased the thresholds for refiling a proposal at company. While previously a proposal required 3% support of shareholders a first year, 6% a second year and 10% a third year to refile a proposal, now 5%, 15% and 25% are required.