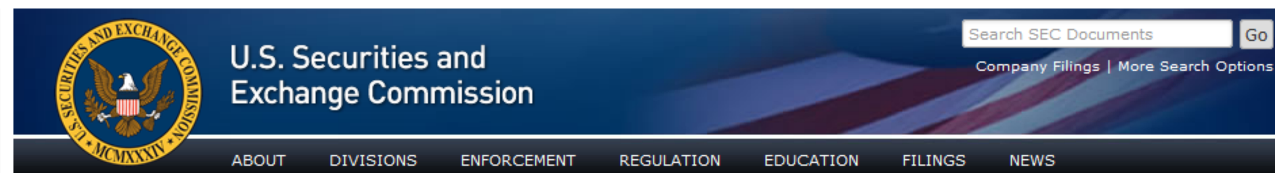

Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College

Commissioner Daniel M. Gallagher

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Thank you, Sy [Lorne] for that kind introduction. And thank you for having shared your wisdom and insight with me at various points over the years; your advice is always reasoned and sound. And thank you to Professor Grundfest for inviting me here today. Joe, you have been a dear friend for a very long time, and I truly appreciate your wise counsel and much-needed support during my tenure on the Commission. I hope this breakfast keynote sets the tone for a productive final day of this conference — or at least doesn't give everyone indigestion. I'm proud for this to be one of my last speeches as an SEC Commissioner.

Today, I'd like to pull together some themes that I have been thinking, speaking, and writing about during my tenure and address them more holistically. Specifically, I'd like to share with you some thoughts about shareholder activism, short-termism, and the SEC.

I. What is activism?

Like many others, I view activism broadly: it is simply the actions of investors who are dissatisfied with management's decision-making and corporate strategy and who, rather than selling their shares, try to force those companies to change.[1] But why bother? Despite the best efforts of certain policymakers over the last six years, the U.S. capital markets are still the deepest and most liquid in the world, and for many investors, it is trivially easy to exit one's investment by selling and walking away. But an index fund manager can't just sell the shares of the companies in the index. A hedge fund manager may see more alpha in driving improvements at a single company than in stock-picking. And a socially-motivated investment fund manager or gadfly can get a platform for idiosyncratic goals.

Are these activists good or bad? Often this question is posed as Manichean: light vs dark, good vs evil. This binary view of the world, divided between those who are either pro- or anti-activism, is convenient, but it is also far too simplistic. We need to break down activism one degree further, and ask: is it aimed at creating long-term shareholder wealth, and does it actually do so?[2] Some activism is, and does; other activism is not, or does not.[3]

II. The SEC's role regarding activism

So how does the SEC determine which is which? Simple: it doesn't, and shouldn't. The various states have been entrusted with determining the substantive rights of shareholders, while the SEC's role traditionally has been to set the proper conditions for investors to be able to make an intelligent, informed determination for themselves — that is, to create a level playing field, chiefly through disclosure.[4] And traditionally, the SEC has been an expert groundskeeper. Unfortunately, that prudent division of responsibilities has been eroded, in some instances through our own actions or inaction in the face of changing markets, and other times through our own overzealous implementation of legislative enactments. As a result, as groundskeepers go, the SEC increasingly has more in common with *Caddyshack*'s Carl Spackler.[5] Maybe this is due to our relentless pursuit of the many gophers in the Dodd-Frank Act over the last five years! I would like to discuss a few

specific areas to illustrate my point.

A. Shareholder Proposals

The first of these areas — shareholder proposals — should come as no surprise. I stated last year that the SEC's shareholder proposal rule, Rule 14a-8, is being abused by special interest groups to advance idiosyncratic goals that may directly conflict with the interests of most shareholders.[6] A proponent, often with little to no skin in the game, can force a company to include in its proxy a proposal, which can touch on any of a wide range of issues, including immaterial social and political matters. Or, the company can expend substantial corporate resources seeking exclusion of the proposal. The recent *Whole Foods* blow-up, in which by fiat a previously-granted no-action letter was withdrawn, and consideration of all similar letters was deferred, shows just how broken the system is for both proponents and companies.[7]

I believe we need a long-term project to get the SEC out of the business of policing shareholder proposals. These proposals are meant to approximate the increasingly antiquated notion of an in-person annual shareholder meeting.[8] It's like listening to a cassette recording of a Victrola, while everyone else is on their iPhones.[9] The states would do a much better job creating and policing such mechanisms.[10]

In the interim — and assuming that no policymakers currently have the will to extricate the Commission from this process — I believe we need to undertake the fixes I advanced last year,[11] but with one significant modification.[12] I believe the shareholder proposal no-action process should be converted to a Commission advisory opinion process. Currently, no-action letters are issued by the staff, with no Commission involvement.[13] By turning these into Commission advisory opinions, we could permit the staff to make the run-of-the-mill decisions, but have the Commission issue opinions implicating major policy issues, such as proxy access, staggered boards, net neutrality, or climate change. The buck should stop with the presidential appointees.[14]

So how does shareholder proposal activism fare against my long-term shareholder value test? At this point, the answer should be obvious: poorly enough that I think we could jettison it entirely. And if there's any baby in with the bathwater, the states would make better parents or guardians than the SEC.

B. Activist Hedge Funds

Hedge fund activism, by contrast, is a much more complex analysis. Unlike shareholder proposal activism, hedge fund activism is at least generally driven by the profit motive.[15] The key question here is whether activist hedge funds drive long-term value creation, or whether short-term gains to activism are at the expense of long-term corporate growth. There is certainly a very robust academic debate over this topic, particularly between academics who claim to show activism increases shareholder value, and those — including practitioners, issuers, and other academics — who claim otherwise.[16] I have to admit that I'm skeptical that the answer to this question can be found in econometrics alone.[17]

So what's the SEC's role here? The most obvious issue presented to the Commission is the Section 13 reporting obligations that we administer. Some argue that the 10-day window, enacted in 1968, is simply obsolete. Computerized trading allows the quick amassing of an activist's stake, and derivatives and other synthetic forms of ownership can mask the size of the stake.[18] As a result, the purpose of the rule — to alert investors in securities markets to potential changes in corporate control — is not being served.[19] Others argue that tightening the timeframe will reduce the profitability of activism, which in turn will make it less likely that these investors will provide beneficial monitoring and disciplining of management, and that there are other structural protections

for incumbent management.[20]

C. Investors & Proxy Advisory Firms

While I am never one to shy away from a controversy, perhaps we should come at this issue from a slightly different direction. Even if an activist or group takes a 5% position in a stock that triggers a 13D filing, that still leaves 95% of the stock held by others.[21] Without a controlling stake, the activist is at the mercy of the other investors in the company. For activism in the form of shareholder proposals, the ratio is even more lopsided. So I believe it is critical to focus on how the other investors are conducting themselves vis-à-vis activists, and whether the SEC has done enough to ensure the integrity of this process.

1. Investors

Institutional investors,[22] who now hold the lion's share of U.S. equities, can make or break an activist intervention — whether through formal votes or through engagement behind the scenes.[23] I am concerned that some institutional investors are paying insufficient attention to their fiduciary obligations to their clients when they determine whether to support a particular activist's activity. And I am concerned that the SEC and state regulators are not sufficiently policing this area. Even if advisers to these funds are not SEC-registered, they are fiduciaries, they are in the markets we oversee, dealing with SEC registrants, and they should be held accountable for their activities.[24]

Some advisers, particularly smaller ones, are still rotely relying on proxy advisory firm voting recommendations, rather than using a proxy advisor's analysis as one input into the fund adviser's own nuanced analysis.[25] Some advisers lend shares to third party proponents without supervising the legality of those shareholder proposals or adequately assessing the impact on their clients' interests. Some public pension funds seem to use their sizeable shareholdings to fight political fights,[26] or prop up their assumed rate of return to avoid a day of reckoning due to unsustainable pension promises,[27] rather than ensuring that the ultimate beneficiary, who put in 30 years driving a bus or fighting fires, continues to get his or her pension check every month.[28]

Better policing of investment advisers and funds is hard, and it is controversial. The individual clients of those advisers may be rationally ignorant of the inefficient use of their funds, or may have a collective action problem that keeps them from doing anything about it. So it falls to the SEC and the states to figure out how to empower the individuals and give them the information they need to hold their advisers to account, and to take action against the institutional scofflaws. The Department of Labor could also be a great asset in this area; unfortunately, they are off hunting snipe with their fiduciary rulemaking.[29]

The forces that keep clients from exercising meaningful discipline over their advisers are some of the same that act to keep retail investors from meaningfully participating in the debate about activism. The SEC does undertake sporadic efforts to promote retail investor participation, but it is hard, and we should do a better job.[30] Here, the idea of permitting advance voting instructions for retail investors seems like a no-brainer to me. If a retail investor wants to "set it and forget it"[31] to vote with management, or for that matter with a certain pension fund, that's completely his or her prerogative.[32] It's a small step, but one that we can easily make happen.

2. Proxy Advisory Firms

Now we come to proxy advisory firms, another perennial favorite of mine.[33] Many forms of activism entail shareholder voting, and proxy advisory firms like to tell investors how to vote. Unfortunately, as I mentioned earlier, too many institutional investors uncritically vote the proxy advisory firm recommendations. And proxy advisory firms in turn seem to have done little to

address the factors that have given rise to poor research, erroneous recommendations, and conflicted advice.[34]

I had hoped that Staff Legal Bulletin No. 20, which was issued a year ago, would have been the catalyst for improvement. But so far it appears like many market participants have taken a "business as usual" approach.[35] That is unfortunate, because these are critical issues. Fortunately, there is still significant attention being given to this issue, including on Capitol Hill. And a lack of progress under the SLB 20 regime could, and probably should, result in more stringent regulation — for example, (1) formal withdrawal of the no-action letters that led advisers to believe they could rotely rely on proxy advisory firm recommendations,[36] (2) a federal registration, inspection, and oversight regime for proxy advisory firms,[37] or even (3) reconsideration of the proxy solicitor exemptions that have been seen as applying to proxy advisory firms.[38]

D. Corporate boards and management

Of course, corporate boards and management also play a role in the activist debate. I saved this group for last, because the issues involved here, particularly with regard to the SEC's role, are different. To be sure, there are some technical questions associated with ensuring that our rules do not unfairly inhibit a company's ability to communicate with its shareholders.[39] But I'd like to focus on corporate boards, and on a broader, philosophical question.

Part of the SEC's tripartite mission is to protect investors. But too often, our concept of "investor protection" reflects a prejudgment that a corporation is a democracy, where shareholders participate directly in the governance of the corporation. But, like the United States itself, a corporation can also be a republic, where shareholders elect directors, who in turn govern the corporation.[40] The choice of a shareholder- or director-centric model is properly left to state law.[41] The SEC increasingly has been disrespecting this distinction by interjecting opportunities for shareholder direct democracy into the securities laws.[42] But the director-centric model is at least equally-well suited to the protection of investors,[43] and so the SEC's rules should provide enough flexibility to accommodate either approach.

I believe much of the pressure for shareholder direct democracy flows from boards that are mismanaged: boards that are stale, full of individuals with irrelevant skills, too chummy with management, and so forth. By contrast, a vigorous, responsive board that takes affirmative steps to drive good corporate governance moots the need for shareholder direct democracy.[44] As a Commissioner, I've heard too many stories about directors thinking that engagement with shareholders is solely management's job. Quite the contrary. If companies are republics, then management and even at times boards need to engage with shareholders with the same vigor that politicians engage with their constituents.[45] Clearly communicating your company's strategy and how the board is overseeing management's execution of that strategy to investors, and in turn hearing what's on your investors' minds, can help demonstrate to the SEC that boards are a tool for investor protection, not an impediment to it. And it's also the best way for boards and management to get out in front of shareholder activism.[46]

III. Short-termism and the SEC

A. The current picture is bleak...

Clearly, there's a way for all the parties I've just spoken about to co-exist peacefully. The SEC sets a level playing field; companies manage themselves for the long-term with the vigorous oversight of the board; and activists put pressure on those companies that fall short of that ideal.[47] Unfortunately, we are not in that happy place. Rather, there seems to be a predominance of short-term thinking at the expense of long-term investing. Some activists are swooping in, making a

lot of noise, and demanding one of a number of ways to drive a short-term pop in value: spinning off a profitable division, beginning a share buy-back program, or slashing capital expenditures or research and development expenses. Having inflated current returns by eliminating corporate investments for the future, these activists can exit their investment and move on. In the current zero interest rate environment brought to us by the mandarins at the Federal Reserve, it is difficult for investment funds to achieve significant rates of return — which hedge funds need to justify sometimes-significant fees and expenses, and public pension funds need to prop up their funded ratios.[48]

Yet is it really all the advisers' fault? Boomers are stuck with underwater mortgages and decimated 401(k)s — both the product of a financial crisis caused by failed federal housing policy that has yet to be meaningfully addressed[49] — and are desperate to rebuild their portfolios. Yet there are precious few places in our severely anemic recovery to find returns. Activism appears to be one such place, thus explaining its continuing climb in popularity.[50] Meanwhile those who should be most interested in investing for the long term, particularly the growing millennial cohort, are too saddled by student loan debt and burnt by the great recession to be significant players in the markets.[51]

If individual and institutional investors are focused on the short-term, it's no surprise that companies are in turn managing themselves for the short-term.[52] Management and boards impose upon themselves substantial and oftentimes unrealistic pressures to make short-term earnings targets.[53] In so doing, they can stave off activists, or avert market over-reaction to a missed earnings announcement and a potential stock-drop lawsuit.[54] These pressures, in turn, mean that new, growing private companies resist going public at least in part because of a feeling of loss of control over the direction of the corporation to the short-termism of the market. And companies that are already public feel that they can't take the steps needed to transform themselves for the long-term.[55]

The SEC has played its part in this tragedy as well. Take staggered boards: lax administration of SEC shareholder proposal rules set the conditions for a very successful shareholder proposal campaign to exert pressure on Fortune 100 companies to destagger their boards.[56] Looking at all of the relevant research, however, it seems that there may be strong benefits to having a staggered board, including that it can promote management for the long-term.[57] Unfortunately, the prognosis for putting Humpty back together again is poor. Similarly, the SEC's corporate governance rules, including say-on-pay, are contributors to short-termism.[58]

Among institutional investors, companies, and the SEC, there is more than enough blame to go around for the current state of affairs.

B. ... but there are glimmers of hope.

Fortunately, within the last year or so, I have seen glimmers of hope that the pendulum is beginning to swing back. Significantly, I see an increasing bipartisan recognition that short-term thinking is dominating long-term thinking, and that it sometimes can be destructive.[59] What is missing, of course, is a bipartisan consensus for what to do about it that does not involve doubling down on past failed policies.[60]

Here again, I am optimistic. There are some key players in the debate that are bringing fresh viewpoints to bear, challenging some of the existing orthodoxy. Chief Justice Leo Strine of the Delaware Supreme Court has of course written extensively on these issues.[61] In particular, he has called for institutional investors to be accountable to their clients, the ultimate investors, for pursuing investment strategies that will result in sustainable, long-term growth.[62] Other solutions, such as assigning greater voting rights to shares that are held for long-term appreciation, dual share

classes, or specifying that directors' duties to shareholders should be specifically taken to mean shareholders with a long-term investment horizon, are a bit more radical, but nonetheless intriguing.[63]

But while all these substantive ideas are worth considering, the $100,000 question is how best to do that. To that end, Professor Subramanian at the Harvard Law and Business Schools has authored a potentially-transformative approach to the corporate governance debate, drawing on negotiation theory to suggest that interested parties sit down with a clean sheet of paper and, starting from three basic principles on which all parties should be able to agree, bargain for a better corporate governance regime.[64] The give-and-take across issues should produce a better substantive result for all than the "incremental meandering" of the current approach to the debate. This antidote to the caustic trench warfare on these issues is refreshing, and the broader community ignores his views at its peril. Indeed, I believe that the SEC should give life to the good Professor's idea and host a roundtable where representatives from interested groups can sit down and try out this approach. Indeed, the SEC is uniquely placed to do so, given the agency's convening power and its ability to be a neutral intermediator. There's no downside, and maybe —just maybe — the outlines of a consensus could start to form. Unfortunately, it does not appear that this roundtable is something that will happen before the end of my tenure, so I will have to leave it to my colleagues to take up this banner and run with it if they so choose.

I fervently hope that all the energy and passion of the activism debate can be translated into examining these issues, which are the real issues at stake for us, for our economy, and for our country.[65]

* * *

Thank you very much for your attention; I hope you enjoy the rest of the conference.

[1] See, e.g., PwC, *Shareholder activism: Who, what, when and how?* (Mar. 2015); Stuart L. Gillan & Laura T. Starks, *The Evolution of Shareholder Activism in the United States*, available at http://ssrn.com/abstract=959670

[2] To be clear, in focusing on the long-term, I do not mean to imply that the short term is wholly irrelevant. Rather, short-term performance should be in furtherance of long-term returns, not in lieu of it. See, e.g., Laurence D. Fink, Letter to S&P 500 CEOs (Mar. 21, 2014) ("It concerns us that, in the wake of the financial crisis, many companies have shied away from investing in the future growth of their companies. Too many companies have cut capital expenditure and even increased debt to boost dividends and increase share buybacks. We certainly believe that returning cash to shareholders should be part of a balanced capital strategy; however, when done for the wrong reasons and at the expense of capital investment, it can jeopardize a company's ability to generate sustainable long-term returns. We do recognize the balance that must be achieved to drive near-term performance while simultaneously making those investments – in innovation and product enhancements, capital and plant equipment, employee development, and internal controls and technology – that will sustain growth.").

[3] To illustrate my point with a couple of obvious straw men: in one company, management is firmly entrenched, and is using the company to extract economic rents for itself, while the board is completely captive to management and fails repeatedly to do anything about it. Here, an activist investor that shakes up this dysfunction likely will benefit all investors in general. In a different company, a high-functioning management, supervised by an independent board, is executing on a strategy that is throwing off a lot of cash in the short-term, but which will decline in the long-term

due to technological shifts. The company has amassed a large cash hoard in preparation for a planned major R&D initiative to better position the company for the future, when an activist swoops in to demand that the company return the cash to shareholders through buy-backs. If the company complies, there might be an increased short-term pop in share value, but at the expense of leaving the company unable to compete in the long-run, which harms long-term investors. Of course, the vast majority of companies exist somewhere in the messy middle: management is decent, the board is decent, returns are mediocre but positive, and so forth. Whether activism is good or bad in this context is much more difficult to determine. See, e.g., Adam J. Epstein, *Shareholder Activism Redux: The Good, Bad and Ugly* (Apr. 30, 2015), available at http://www.corpgov.net/2015/04/shareholder-activism-redux-the-good-bad-and-ugly/.

[4] Most obviously, the SEC has a disclosure regime rather than merit review for its corporate issuers.

[5] William J. ("Bill") Murray, *Caddyshack* (Orion Pictures, 1980).

[6] For example, firms with the largest lobbying expenditures consistently outperform the market. See, e.g., The Economist, *Money and Politics* (Oct. 1, 2011) (discussing Strategas Research Partners' index where the 50 firms that spend most heavily on lobbying had outperformed the S&P 500 by every year since 2002). Shareholder proposals, by contrast, consistently push for greater lobbying disclosures, in an apparent attempt to name-and-shame companies into reducing such expenditures. See, e.g., Proxy Monitor, 2015 Mid-Season Report Finding 2, at http://www.proxymonitor.org/Forms/2015Finding2.aspx (noting that, despite a drop in 2015, shareholder proposals on political spending were a plurality of all proposals in 2012–2014, along with continuing low levels of shareholder support).

Unsurprisingly, public pension funds and labor unions submit statistically greater number of this type of proposal targeting Republican-leaning firms. See Proxy Monitor, Report: Corporate Governance and Shareholder Activism (Fall 2013) at http://www.proxymonitor.org/forms/pmr_06.aspx ("What's more, those corporations that gave at least half of their donations to support Republicans were more than twice as likely to be targeted by shareholder proposals sponsored by labor-affiliated funds as those companies that gave a majority of their politics-related contributions on behalf of Democrats."); Geeyoung Min & Hye Young You, *Active Firms and Active Shareholders: Corporate Political Activity and Shareholder Proposals*, University of Virginia School of Law, Public Law and Legal Theory Research Paper Series 2014-28 (May 2015) ("Public pension funds and labor unions are more likely to target firms that contribute more money to Republican candidates or Republican-affiliated PACs.") These findings raise the question of whether investors' assets are being deployed for the best interest of investors or rather to advance the political goals of the current union leadership.

[7] For background, see, e.g., Andrew Ackerman & Joann S. Lublin, *Whole Foods Dispute Prompts SEC Review of Corporate Ballots*, *Wall St. J.* (Jan. 19, 2015).

[8] Specifically, a shareholder might use his or her state law rights to present a proposal from the floor at an annual meeting. The SEC first determined that companies that were aware of such impending proposals make disclosure of them in the proxy statement, along with how the company intended to vote thereon. In 1942, it first adopted a rule requiring the company to put the proposal in the proxy itself; the "modern" formulation of the rule was issued in 1947. See Amy L. Goodman et al., *A Practical Guide to SEC Proxy and Compensation Rules* at §12.02. It is interesting in this respect that the SEC used its authority over the proxy process to create substantive rights that would otherwise be a matter left to state corporate governance law (namely, the right to attend an

annual meeting and put a topic on the agenda). It is even more ironic that the exception has grown to swallow the rule: annual shareholder meetings increasingly are either a spectacle (e.g., Walmart or Berkshire Hathaway) or completely scripted; some are questioning whether we need them anymore. See John D. Stoll, *Are Annual Meetings Still Necessary?*, *Wall St. J.* (June 9, 2015) (noting the pro forma nature of this year's General Motors Co. annual meeting), available at http://www.wsj.com/articles/are-annual-meetings-still-necessary-1433880226.

[9] I will now wait for the hipsters of the corporate governance community to tell me that my analogy is wrong because the analog nature of the record and cassette recordings makes them preferable to the digital content on an iPhone.

[10] I am certainly not advocating for the removal of shareholder voice in how a company is governed. But we are far from 1942, when the shareholder proposal rule was first adopted, when shareholders had only a very limited direct say in how their company was governed. Better technology and pressure for better governance practices have made companies much more responsive to the demands of their shareholders. In the meantime, shareholder proposals have become more numerous and increasingly dominated by idiosyncratic social or political policy goals. So their benefit has decreased, and their cost has gone up significantly: in their current formulation, the benefits of the SEC-administered shareholder proposal rule do not justify its cost. I will concede that there may be some vehicle by which shareholders should be able to compel corporate votes on matters, but the contours of that mechanism is best left to the states. The states have much more experience in and are better positioned to conduct a more delicate balancing of the relative rights and obligations of shareholders in the corporate governance space to determine what types of questions can be presented, when, by whom, where those would be located, who would pay for them, and so forth. This is not a new idea; the SEC Staff in 1997 distributed a questionnaire to solicit comment for a report on the shareholder proposal process required by NSMIA that outlined some different approaches for a radical overhaul of the rule, including a state-based or issuer-specific approach to shareholder proposal rules. In a 1997 rule proposal containing some incremental changes to the shareholder proposal regime, the results of that questionnaire were discussed. Companies were evenly split on the question of creating their own shareholder proposal regime, while shareholders were very strongly opposed. See Rel. No. 34-39093, *Amendments To Rules On Shareholder Proposals* (Sept. 18, 1997), available at https://www.sec.gov/rules/proposed/34-39093.htm. Of course, the release admits the survey methodology was not scientific; I would not be surprised if few individual or beneficial owners were reflected in those responses. But in any event, the problem of shareholder proposals has only worsened over the past two decades; it would be very interesting to see how shareholders might respond today.

[11] See Daniel M. Gallagher, *Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School: Federal Preemption of State Corporate Governance* (Mar. 27, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370541315952 (proposing (1) to drop the flat dollar portion of the $2000-or-1% eligibility requirement, and to lengthen the 1-year minimum holding requirement; (2) to narrow significantly the scope of significant policy issues that can overcome the ordinary business exclusion; (3) to enhance enforcement of the false-or-misleading grounds for exclusion; and (4) to bring a "three strikes and you're out" philosophy to the reproposal thresholds).

[12] In addition to this modification, I wanted to admit that I was wrong in last year's speech, see id., to be so concerned by proposal-by-proxy. Proposal-by-proxy is, of course, where shareholders "lend" their shares to a third party, who in turn makes the proposal — putatively "on behalf" of the shareholder. Recently, the Commission has been grappling with the impact of the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011) in other

areas of the securities laws. See *In re Flannery & Hopkins*, Rel. No. 33-9689 (Dec. 15, 2014). In thinking more about these issues, it seemed that the Supreme Court appears to have jumped into the fray, however inadvertently, and prohibited proposal-by-proxy. The analysis is as follows:

1. Rule 14a-9, which prohibits material misstatements or omissions in proxy material, applies to proponents of shareholder proposals. Staff from the Division of Corporation Finance have recently reconfirmed this fact publicly. Specifically, a shareholder proposal is a solicitation-within-a-solicitation for purposes of Rule 14a-9.

2. Rule 14a-9 refers to solicitations that are "made" by means of a proxy statement. This should trigger a *Janus* analysis. See *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2301 (2011) (construing Rule 10b-5(b)'s application to "any person, directly or indirectly, ... [t]o *make* any untrue statement of material fact" (emphasis added)).

3. *Janus* tells us that the "maker" of a statement is the person with ultimate authority over the statement. *Janus*, 131 S. Ct. at 2302 ("For purposes of Rule 10b-5, the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.").

4. Reading Rules 14a-8 and 14a-9 together, it seems clear that the person with ultimate authority over the statement, both as a matter of fact and a matter of law, must also be the person holding the requisite number of shares to bring the shareholder proposal — the proponent.

5. If the maker and the shareholder are not one in the same person, then there is no proponent, and the proposal is fatally defective. See Rule 14a-8(b).

6. Thus, proposal-by-proxy is impermissible.

The caveat is that proponents are of course free to hire legal advisers to advocate on their behalf. But that creates a principal-agent relationship: the shareholder-proponent is the principal, and the adviser is the agent. The adviser cannot have ultimate authority over the proposal, must take "settlement" offers from the company (e.g., to implement the proposal through other means) back to the principal for sign-off, and so forth — consistent with traditional principal-agent duties. These advisers should also ensure that their conduct is consistent with Rule 102(e) of the Commission's Rules of Practice, particularly if they are engaged in correspondence with the Staff over a no-action request. Shareholder-proponents in turn cannot delegate away to the agent the responsibility to ensure that the proposal is not false or misleading under Rule 14a-9. Shareholders that are pension funds or other fiduciaries must take special care in this regard. And, because they clearly retain "ownership" of the proposal, these institutional owners must also ensure that they have done the proper diligence to judge whether the proposal, if enacted by the company, would be in the best interest of their shareholders, or risk a breach of their fiduciary duty.

Therefore, if companies receive proposals from individuals who are not themselves shareholders, but are purporting to exercise control over the text of the proposal and statement in support, or the right to compromise or withdraw the proposal, it would seem reasonable for the company to seek exclusion of those proposals, based on *Janus*. In this regard, shareholder-proponents that intend to engage a representative may desire to include with the proposal a notarized letter (signed by the individual shareholder or, if an institutional investor, someone authorized to speak on the investor's behalf on legal matters) that explains that the shareholder has engaged an agent, but that the

shareholder acknowledges his or her ultimate control over the proposal, including for purposes of liability under Rule 14a-9. This should eliminate the likelihood that a company would raise a challenge to the proposal on that ground.

[13] The staff does a heroic job to try to bring some consistency, predictability, and timeliness to a yearly barrage of no-action requests, but the ultimate outcome is just an expression of the staff's opinion — that the Staff of the Division of Corporation Finance would not recommend to the Division of Enforcement that an action be brought if a shareholder proposal is omitted from the proxy.

[14] Currently, if one or more Commissioners disagree with the staff, there's no formal mechanism to call the matter to a vote, as there would be if the staff were proceeding under delegated authority. By contrast, if the Chairman disagrees with the staff, the Chairman can use his or her control over the staff's operations to force a change. We saw that process play it out in this proxy season's Whole Foods debate, and I do not believe that this approach is good for any of the parties involved, nor for the rule of law. We need to vest responsibility for the administration of this rule in the hands of the presidentially-appointed, Senate-confirmed Commissioners, not the staff or the Chairman alone.

In addition, a Commission advisory opinion approach should give registrants more comfort. I'm not sure how much comfort they should be drawing from the existing no-action posture, which does not constrain the Staff from the Division of Enforcement from recommending an action, nor the Commission from pursuing one. This was also one of the key issues in the *Trinity v. Wal-Mart* litigation: whether the position taken by the staff in the no-action letter should be accorded any deference by the reviewing court. The decision whether to grant deference should become simpler if the decision is Commission action. Finally, an appeal from final Commission action may create more organized litigation than ad hoc litigation by proponents against companies where proponents disagree with the position taken by the staff of the Commission, as in *Trinity*.

[15] Here, I refer to activist hedge funds that take a stake in a company. If they can raise the share price of the company, then they can sell their shares and profit. Other shareholders also benefit from such an increase in share price — if it is lasting over time, or if the increase in short-term share price was not achieved at the expense of lowering the long-term returns of the company, e.g., from X+20% to X+10%. This of course is very difficult to show through economic measurements, since the loss of future potential is information that the market may not be very good in pricing, given inefficiencies in disclosing information about R&D or other future projects that are competitively sensitive to the market.

[16] See Lucian A. Bebchuk et al, *The Long-Term Effects of Hedge Fund Activism*, 115 *Colum. L. Rev.* __ (forthcoming June 2015); Martin Lipton, *Empiricism and Experience; Activism and Short-Termism; the Real World of Business* (Oct. 28, 2013); Yvan Allaire & Francois Daupin, *"Activist" hedge funds: creators of lasting wealth? What do the empirical studies really say?* (July 2014) (questioning the conclusions in Bebchuk et al.); Lucian Bebchuk, *Wachtell Keeps Running Away from the Evidence*, Harvard Law School Forum on Corporate Governance and Financial Regulation (July 28, 2014) (responding); Allaire & Daupin, *Hedge Fund Activism and their Long-Term Consequences: Unanswered Questions to Bebchuk, Brav and Jiang* (Aug. 2014); Allaire & Daupin, ***Still** unanswered questions (and new ones) to Bebchuk, Brav and Jiang* (Jan. 2015) (responding to a new version of the Bebchuk et al. paper released on SSRN).

[17] There are, of course, three types of falsehoods: lies, damned lies, and statistics.

[18] IRRC Institute/Rock Center for Corporate Governance, *Identifying the Legal Contours of the Separation of Economic Rights and Voting Rights in Publicly Held Corporations* (Oct. 2010); Henry

T.C. Hu, *Financial Innovation and Governance Mechanisms: The Evolution of Decoupling and Transparency*, 70 *Bus. Law.* 347 (Spring 2015) ("An investor can hold economic-only ownership through cash-settled equity swaps. This ownership is 'hidden' in that, arguably, it is not disclosable. However, this economic-only ownership is sometimes 'morphable.' That is, although the investor holds only these swaps, not shares, and thus has no formal voting rights, the investor may be able to acquire the voting rights when needed, for instance, by simultaneously terminating the swaps and, if the swap dealer is willing, buying from the dealer the 'matched shares' that its swaps dealer had been holding to hedge those equity swaps. Speaking very loosely, this strategy involves an investor's 'soft parking' shares with an accommodating derivatives dealer, receiving the economic rights of share ownership, and asserting that it does not have the voting rights of the parked shares.").

[19] See, e.g., Wachtell, Lipton, Rosen & Katz, *Petition for Rulemaking Under Section 13 of the Securities Exchange Act of 1934* (Mar. 7, 2011).

[20] See, e.g., Lucian A. Bebchuk & Robert J. Jackson, *Commission Examination of Section 13(d) Rules and Rulemaking Petition Submitted by Wachtell, Lipton, Rosen & Katz* (July 11, 2011) ("[T]he desirable design of the Commission's rules under Section 13(d) must be examined in the larger context of the beneficial role that blockholders not affiliated with incumbent directors or managers ("outside blockholders") play in American corporate governance and the broad set of rules governing such outside blockholders."). See also Chairman Mary L. Schapiro, *Remarks at the Transatlantic Corporate Governance Dialogue* (Dec. 15, 2011), available at http://www.sec.gov/news/speech/2011/spch121511mls.htm (summarizing the arguments for and against revision of Section 13(d) obligations).

[21] See, e.g., Gibson Dunn, *Activism Update: 2014 Year in Review* (39% of activist interventions in 2014 commenced with activists holding *less* than a 5% equity stake).

[22] While the discussion here is framed in terms of institutional investors determining whether or not to support activism, they can of course engage in some light activism themselves. Even an adviser to an index fund could determine to take the lead in voting against or withholding support from management's nominees to the board if the company is persistently mismanaged. Obviously, there is a bit of a tension here with regard to the adviser's role in this situation. Investors investing in index funds tend to be passive, so an activist index fund adviser appears to be somewhat of an oxymoron — plus, given thin margins on index fund advising, it's unclear how much index fund advisers would want to engage in this activity, as they're unlikely to be compensated for their troubles. On the other hand, there is a view that index fund advisers should be encouraged to become more active in the governance debate, precisely because they represent passive, long-term money. I suspect the trend, at least in the near term, will be toward a stronger voice. See, e.g., F. William McNabb, Chairman & CEO, Vanguard, to the independent chairs or lead directors of the Vanguard funds' largest portfolio holdings, re Vanguard's principles for corporate governance (Feb. 27, 2015).

[23] See, e.g., Liz Hoffman & Timothy W. Martin, *Largest U.S. Pensions Divided on Activism: A boardroom battle last week at DuPont Co. exposed an emerging split in how the nation's two biggest pensions agitate for change inside corporate America*, *Wall St. J.* (May 19, 2015) (describing how CalPERS's approach to activism has mellowed over the years, from being one of the first funds to embrace activism to a preference to engage management behind the scenes, while CalSTRS is cooperating actively with activist funds).

[24] See Daniel M. Gallagher, *Remarks at The SEC Speaks in 2015* (Feb. 20, 2015), available at http://www.sec.gov/news/speech/022015-spchcdmg.html ("Our limited resources and narrow focus

on traditional registrants has also caused us to large ignore, from a policy perspective, the roles of lesser-known investment advisers and other fiduciaries operating in the securities markets. So when the Commission does bring cases involving breaches of fiduciary duties, those cases are rarely against non-advisers breaching their obligations in securities-related matters. Rather than pursuing an action against the fiduciary, the Commission often takes the path of least resistance and brings an action against the intermediary, oftentimes a broker-dealer.").

[25] See Editorial, *Dimon vs. 'Lazy' Investors*, *Wall St. J.* (May 29, 2015) (commenting on Jamie Dimon's widely-reported anti-proxy advisory firm comments ("God knows how any of you can place your vote based on ISS or Glass Lewis. If you do that, you are just irresponsible. I'm sorry. And you probably aren't a very good investor either. And you do, believe me, I know some of you in here to it because you're lazy.") that "[t]he truth hurts" and that investors should not "rely on any one course to make key decisions about the companies they own."). I fully concur. If adequately supporting an analysis and voting function within the adviser is too expensive, the SEC's Staff Legal Bulletin No. 20 (June 30, 2014) gives small advisers a different option: to prearrange voting with the fund's clients.

[26] See supra note 6.

[27] See Daniel M. Gallagher, *Remarks at Municipal Securities Rulemaking Board's 1st Annual Municipal Securities Regulator Summit* (May 29, 2014), available at http://www.sec.gov/News/Speech/Detail/Speech/1370541936387; Daniel M. Gallagher, *A Watched Pot Never Boils: the Need for SEC Supervision of Fixed Income Liquidity, Market Structure, and Pension Accounting* (Mar. 10, 2015), available at http://www.sec.gov/news/speech/031015-spch-cdmg.html.

[28] See Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 *Bus. Law.* 1, 12 (2010) ("The focus of many of these institutions on quarterly earnings and other short-term metrics is fundamentally inconsistent with the objectives of most of their end-user investors, people saving primarily for two purposes, to put their kids through college and to fund their own retirements. These end-user investors do not care about quarterly earnings or short-term gimmicks. These end-user investors want corporations to produce sustainable wealth that will be there when they need it.").

[29] Snipe hunting may be a poor analogy, as it implies that the DOL's activities are those of a bunch of rubes, zealously tracking down problems that turn out to be non-existent. Here, the DOL and the White House are actively asserting (and may even sincerely believe) that snipe are real, despite all evidence to the contrary. See Gallagher, supra note 24.

[30] See, e.g., Rel. No. 34-62495, *Concept Release on the U.S. Proxy System* (July 14, 2010) (discussing means to facilitate retail investor participation in the proxy process, including investor education, enhanced broker internet platforms, advance voting instructions, investor-to-investor communications, and improving the use of the internet for distribution of proxy materials).

[31] In the immortal words of Ron Popeil, pitching his Showtime Rotisserie on countless late-night infomercials.

[32] It's also a feature that institutional investors already use; it's not clear why we would enforce a disparity between them.

[33] As I have said many, many times, proxy advisory firms possess too important a role in our modern corporate governance debate; a role in part given to them by mistake in an otherwise well-intentioned SEC rule and a pair of staff no-action letters. See, e.g., Daniel M. Gallagher,

Outsized Power & Influence: The Role of Proxy Advisors, Washington Legal Foundation Working Paper (Aug. 2014), available at http://www.wlf.org/publishing/publication_detail.asp?id=2448. That proxy advisory firms suffer from conflicts of interest is by now well-established. Similarly, they seem attracted to the corporate governance avant garde — which may in part be due to their flawed process for soliciting public comment on their voting guidelines, see Tom Quaadman, U.S. Chamber, Letter to Gary Retelny, ISS, re 2015 ISS Policy Survey (Sept. 2, 2014), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/09/2014-9.2-ISS-Survey-Letter-.pdf — rather than proposals with a demonstrated ability to improve shareholder value. Finally, these firms operate tremendously thin profit margins, with an extremely seasonal work flow. As a result, their guidance when it comes to shareholder proposals and say-on-pay is often cookie-cutter or formulaic.

[34] At least the proxy advisory firms tend to bring their "A" game when it comes to an activist hedge fund, as these hotly-contested and often fundamental questions get pushed up to more senior staff for a more thorough analysis.

[35] I do admit, however, that I was encouraged with the outcome of the recent Trian/DuPont proxy battle. I have no opinion as to whether Nelson Peltz deserved a spot on the DuPont board, but I was pleased to see the voting outcome did not result from a rubber-stamping of the ISS and Glass Lewis recommendations in that proxy fight. (ISS had recommended in favor of Peltz and one other activist nominee (see ISS, *DuPont (DD): Proxy contest with Trian Fund Management* (Apr. 26, 2015)) and Glass Lewis for Peltz (see Glass Lewis, *Proxy Paper: E.I. Du Pont de Nemours and Company* (Apr. 29, 2015).) See Nicholas Donatiello & Harvey L. Pitt, Op-Ed, *Protecting Shareholders From Activist Proxies*, *Wall St. J.* (May 29, 2015) (noting that the proxy advisory firms recommendations were rejected by all three of Du Pont's largest institutional shareholders — but that unfortunately such a showing of independence tends to be the exception and not the rule); Editorial, *Capitalism Wins at DuPont*, *Wall St. J.* (May 13, 2015). I am slightly more optimistic; I hope that this is a sign that the largest institutional investors are staffing up their own research and analysis department to bring independent analysis and thought to bear on these critical issues. I am not so optimistic as to think that this is indicative of a sea change — that large institutions will approach all votes with the same degree of care as this very prominent one, or that small institutions are spending money to staff up their in-house analysis — but it was a positive sign nonetheless.

[36] That is, withdrawal of Institutional Shareholder Services, Inc. (Sept. 15, 2004), available at http://www.sec.gov/divisions/investment/noaction/iss091504.htm; and Egan-Jones Proxy Services (May 27, 2004), available at http://www.sec.gov/divisions/investment/noaction/egan052704.htm. See, e.g., Ron Orol, *Top Republican urges more oversight of proxy advisers*, *The Deal* (June 19, 2014), available at http://www.thedeal.com/content/regulatory/top-republican-urges-more-oversight-of-proxy-advisers.php (noting appearance by Congressman Patrick McHenry at an AEI event on proxy advisory firms where he advocated for the withdrawal of the no-action letters).

[37] This solution has some appeal, given the obvious parallelisms between credit rating agencies (formulaic ratings, conflicts of interest) and proxy advisory firms. However, it presents many of the same potential downsides, such as further enshrining the view of proxy advisory firms of having some privileged status or Commission-sanctioned role in corporate governance.

[38] Specifically, the Commission could determine whether the goals sought to be served through the Rule 14a-2(b)(3) exemption have been overshadowed by the drastically changed role of proxy advisory firms in the past decade.

[39] For example, we should ensure that Regulation FD and the proxy solicitation requirements do not unfairly prevent issuers from communicating.

[40] See, e.g., Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, UCLA School of Law Research Paper No. 02-06, available at http://papers.ssrn.com/abstract=300860.

[41] See, e.g., Stephen M. Bainbridge, *Preserving Director Primacy by Managing Shareholder Interventions* (noting that Delaware traditionally had a strong republican model, but that over time has been shifting to include more attributes of direct democracy).

[42] Shareholder proposals are obviously the oldest version of this phenomenon, but as noted above, these are arguably a replication of an existing state-law right: the right to make a motion at an annual meeting. One can, of course, question whether modern abuses of the shareholder proposal rule have long since outstripped its more humble origins. But more modern instances of SEC injecting shareholder direct democracy include the "say-on-pay" and "say-on-frequency" shareholder votes on executive compensation.

[43] See, e.g., Strine, supra note 28 at 4 ("The ability of central management to innovate and pursue risky strategies has been protected by corporate law's adoption of a republican, rather than direct, model of corporate democracy.... If, instead of a republic, corporations become direct democracies, where every action of management is the subject of a stockholder plebiscite, the time and attention of managers will be increasingly diverted from profit-producing activities into more 'political' activities centered on addressing referenda items propounded by particular stockholders, who often have no long-term commitment to remaining as stockholders and who owe other stockholders no fiduciary duties.").

[44] See, e.g., Dominic Barton & Mark Wiseman, *Where Boards Fall Short*, *Harv. Bus. Rev.* (Jan-Feb 2015) (advocating a re-emphasis on board fiduciary duties, accompanied by improvements in selecting the right people to serve on the board; devoting board time to the organization's long-term strategy, in addition to directors simply spending more quality time on board service; engaging with long-term investors; and compensating directors better); PwC, *Trends shaping governance and the board of the future: PwC's 2014 Annual Corporate Directors Survey* (noting that board composition and performance is taking center stage; that "[e]ffective oversight of public companies requires boards to collectively possess the skills to exercise their fiduciary responsibilities" and that "financial expertise" followed by "industry and operational expertise" are described by survey respondents as the most important attributes of board members).

[45] It's astounding, because active engagement with one's shareholder base is a no-brainer: the audience is a captive one. An institutional investor's fiduciary duty mandates that the institutional investor at least hear the company's side of the story. So there's literally no downside to engagement.

[46] Of course, if the strategy and supervision thereof cannot be clearly communicated to investors because the strategy is muddled or not viable, then that's obviously the first step to take towards improvement. And, of course, this communication is also dependent on the message from investors being something other than "short-term pop in share value." See infra notes 47–48 & associated text. See also generally The Conference Board, *Recommendations of the Task Force on Corporate/Investor Engagement* (2014); John C. Coffee, Jr. *The Lessons of DuPont: Corporate Governance for Dummies* (noting that the reason best explaining DuPont's victory over Trian was that DuPont "gained and held the loyalty of its indexed investors" — Vanguard, BlackRock, and State Street collectively held 16.7% of DuPont, and all voted with management, while all the "stock picking" investors (e.g., Fidelity and major banks) sided with Trian; indexers may naturally have a slightly longer-term perspective given some differences in incentives over the stock pickers); PwC, *2014 Annual Corporate Directors Survey — Trends shaping governance and the board of the future:*

Executive compensation and director communications (noting that, compared with 2013, "director communications with stakeholders increased across all constituencies" but that, amazingly, 33% of boards still have no direct communications with institutional shareholders); EY Center for Board Matters, *2015 proxy season insights: shareholder activism — an engagement opportunity* (Mar. 2015) ("When companies engage with long-term institutional investors and demonstrate responsiveness to their concerns, those same investors are better positioned to support the company in an activist situation and may prove to be the company's strongest allies); Martin Lipton et al., *Some Thoughts for Boards of Directors in 2015* (Dec. 1, 2014) ("[I]t is essential that boards not be unduly distracted from their core mission of overseeing the strategic direction and management of the business. Directors should develop an understanding of shareholder perspectives on the company and foster long-term relationships with shareholders, as well as deal with the requests of shareholders for meetings to discuss governance, the business portfolio and operating strategy."); David A. Katz & Laura A. McIntosh, *Engagement and Activism in the 2015 Proxy Season*, *N.Y.L.J.* (Jan. 29, 2015) ("As the 2015 proxy season approaches, the dominant theme appears to be the interaction between directors and investors. Though, traditionally, there was little to no direct engagement, recent experience indicates that communication between these two groups is now on the rise, in some cases resulting in collaboration. This is potentially a beneficial development, particularly insofar as it may help companies and long-term investors work together to resist pressure from activist shareholders seeking short-term profits.").

[47] See, e.g., Joshua Fershee, *Shareholder Activists Can Add Value and Still Be Wrong* (Apr. 28, 2015) (positing that activists can signal to boards when the company's strategy may be inefficient; it is then the board's responsibility to "use the tools before it to make decisions in the best interests of the entity" — that shareholder activists can improve long-term value even if following their recommendations blindly would not).

[48] See, e.g., Yvan Allaire, IGOPP, *The Case* for *and* against *activist hedge funds* (May 2015) ("Institutional investors bear heavy responsibility for the emergence and mushrooming of activist hedge funds.").

[49] See, e.g., Peter J. Wallison, *Hidden in Plain Sight: What Really Caused the World's Worst Financial Crisis and Why It Could Happen Again* (2015); Peter J. Wallison, *Dissent from the Majority Report of the Financial Crisis Inquiry Commission* (Jan. 14, 2011).

[50] It's not clear that even this is the case. See, e.g., Jeffrey Sonnenfeld, *Activist Investors, Sluggish Performance*, *Wall St. J.* (April 2, 2015) at A13 (noting that investing in index funds would have yielded better returns over the past few years than most activist funds: 32.4% versus 16% in 2013, and 13.7% versus 4.8% in 2014).

[51] See, e.g., Scott Gamm, *Why Millennials Don't Trust Wall Street or Investing in Stocks*, *The Street* (May 2, 2015); Mitch Tuchman, *Millennials Are Missing The Retirement Boat*, *Forbes* (Apr. 17, 2015).

[52] See, e.g., Vipal Monga et al., *As Activism Rises, U.S. Firms Spend More on Buybacks Than Factories*, *Wall St. J.* (May 25, 2015); Fink Letter supra note 2. Clearly, if companies have no strategic plan for a cash hoard on their balance sheet, then announcing a dividend or a buy-back is preferable to letting it continue to sit there. But if companies are indeed potentially "underinvesting in innovation" as the *Journal* article suggests — i.e., there is a corporate use for the cash that could pay off big in the long-run, but instead the choice is made to boost shares in the short term through a buy-back — then we do have a serious problem.

[53] See Jonathan Bailey & Jonathan Godsall, Focusing Capital on the Long Term, *Short-termism:*

Insights from business leaders (Dec. 26, 2013). The article notes results of a survey of business leaders that the "most pressure to deliver financial results was 2 years or less. And while 73 percent said their companies should look at least 3 years ahead in their strategic planning, just over half said their management teams actually did so." The survey also highlighted that corporate boards who are under the most pressure from short-term oriented investors and analysts need to be doing a better job to shield management from short-term pressure. Also highlighted was the need for boards to "spend most of their time on long-term issues" (rather than, one supposes, chasing the risk du jour). Most dishearteningly, the survey found that only 49% of respondents at larger companies, and 35% at smaller companies, would miss earnings of up to 5% in the current period in order to pursue an investment that would boost profits by 10% over the next 3 years. Id. at 6.

[54] See Nickolay Gantchev et al., *Governance under the Gun: Spillover Effects of Hedge Fund Activism* (Mar. 2014) (finding that presence of activists in a certain industry drive similarly-situated companies to react as if they were already being targeted).

[55] See, e.g., Michael Dell, Commentary, *Going Private Is Paying Off for Dell*, *Wall St. J.* (Nov. 24, 2014) (noting that, as a public company, Dell faced "an affliction of short-term thinking that drove a wedge between our customer and investor priorities"; "public financial markets that can't see beyond the next trade"; and "shareholders [that] increasingly demanded short-term results to drive returns; innovation and investment too often suffered as a result" — but that, "[a]s a private company, Dell now has the freedom to take a long-term view. No more pulling R&D and growth investments to make in-quarter numbers. No more having a small group of vocal investors hijack the public perception of our strategy while we're fully focused on building for the future. No more trade-offs between what's best for a short-term return and what's best for the long-term success of our companies.").

[56] See Shareholder Rights Project, *About*, at http://srp.law.harvard.edu/index.shtml (last visited June 15, 2015).

[57] E.g., K.J. Marin Cremers & Simone M. Sepe, *The Shareholder Value of Empowered Boards*, 68 *Stanford L. Rev.* __ (forthcoming 2016).

[58] Say-on-pay is one potential culprit, particularly annual say-on-pay votes. If we cannot reconsider this rule, it should be incumbent on companies and issuers to determine whether moving to triennial say-on-pay votes may help reduce short-termism. See generally Joseph E. Bachelder, *A Say on 'Say-on-Pay': Assessing Impact After Four Years*, *N.Y.L.J.* (Mar. 20, 2015) (noting an overwhelming amount of data, required to be processed in a short time frame, means that say-on-pay does "not contribut[e] to the development of sound executive pay standards. Instead, it is creating a 'one-size-fits-all' mentality."). The article argues for biennial or triennial say-on-pay votes instead. Id.

The SEC's recent pay-for-performance propose rule, if adopted without substantial modification, will only make things work by focusing on the most short-term of all metrics for corporate performance: 1-year TSR. This is terribly disappointing. See Daniel M. Gallagher, *Dissenting Statement at an Open Meeting Proposing Mandated Pay versus Performance Disclosures* (Apr. 29, 2015); see also Commissioner Michael S. Piwowar, *Statement at Open Meeting on Pay versus Performance* (Apr. 29, 2015). I was gratified to see substantial support, from many different quarters, for my and Commissioner Piwowar's view that mandating use of TSR for this rule is wrongheaded. See, e.g., Randi Val Morrison, *Pay vs. Performance: Comparability v. Reality*, *TheCorporateCounsel.net* (June 8, 2015) at http://www.thecorporatecounsel.net/blog/2015/06/pay-vs-performance-comparability-vs-reality.html (rounding up several of these sources).

[59] See, e.g., Center for American Progress, *Report of the Commission on Inclusive Prosperity* (Jan. 2015) (co-chaired by Lawrence Summers and Ed Balls, the CIP discusses views that corporations have shifted from long-term profit maximization to maximizing short-term stock-market valuations). The Report quite persuasively argues that "[t]he effects of short-termism are damaging to the economy as a whole. A firm that invests for the long term will make more investments in future productivity, whether that's developing lifesaving medicine; building or buying newer, more efficient machinery; or paying for training for its workforce. All of these investments show up immediately as expenses on the balance sheet and reduce profits in the current quarter but raise future productivity of the firm. Incentivizing a continuing short-term focus lowers future output, reduces long-term competitiveness, and diminishes worker productivity and the higher wages that it can bring." Report at 35. Also highlighted is a seeming paradox: that the shareholder-value movement pushed for a shift to equity-based compensation, seemingly to align executives' interests with those of shareholders, but the result instead has been short-termism. Id. In addition, the Report notes that "some activist investors who are interested in short-term results are able to take large positions in firms rapidly and drive change from the outside, a CEO cannot expect to be able to make long-term investments that are in the best interest of the company without outside interference." Id. at 36; *see also* Dennis K. Berman, *A Radical Idea for Activist Investors*, *Wall St. J.* (Jan. 28, 2015) (noting that Ron Mock, chief executive of the Ontario Teachers' Pension Plan, would love to see the emergence of an activist investor pushing for long-termism).

[60] See CIP Report, supra note 59 at 141 (suggesting limiting the tax deductibility of large compensation packages and lengthening the time between vesting and exercise of options).

[61] See Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law* (114 Colum. L. Rev. 449) (advancing a series of proposals about what a more "sensible system of corporate accountability might involve," including requiring index funds to do independent thinking and precluding them from relying on proxy advisory firm voting guidelines that are not tailored to long-term view of index fund investor; giving 401(k) investors access to private equity investments given the similarly long-term investment horizon; reducing the number of votes taken by shareholders so that those fewer votes can be better-informed; reforming shareholder proposals; improving director elections; providing better disclosure about the economic interests of activists; and reviving the poison pill at companies with unclassified boards); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, Institute for Law and Economics, University of Pennsylvania, Research Paper No. 15-08 ("Under the current legal rules and power structures within corporate law, it is naïve to expect that corporations will not externalize costs when they can. It is naïve to think that they will treat workers in the way we would want to be treated. It is naïve to think that corporations will not be tempted to sacrifice long-term value maximizing investments when powerful institutional investors prefer short-term corporate finance gimmicks. It is naïve to think that, over time, corporations will not tend to push against the boundaries of whatever limits the law sets, when mobilized capital focused on short-term returns is the only constituency with real power over who manages the corporations. And it is naïve to think that institutional investors themselves will behave differently if action is not taken to address the incentives that cause their interests to diverge from those people whose funds they invest.").

[62] See, e.g., Strine, supra note 28 at 18 (setting forth a number of specific recommendations that would help to fix the "misalignment between the interests of end-user investors and society in the long run and the incentives of the institutional investor community to think and act myopically"). Chief Justice Strine is not alone in so doing. For example, the Focusing Capital on the Long Term initiative recently put out a roadmap for a return to long-term thinking that sets out some

incremental suggestions for all interested parties to pursue that, even within the current framework, could help to shift the conversation. See Focusing Capital on the Long Term, *A roadmap for focusing capital on the long term: A summary of ideas for asset owners, asset managers, boards of directors, and corporate management to focus on long-term value creation* (Mar. 2015); Dominic Barton & Mark Wiseman, *Focusing Capital on the Long Term*, *Harv. Bus. Rev.* (Jan-Feb 2014) (setting out some suggested changes that asset owners (e.g., pension funds, insurance funds, sovereign wealth funds, and mutual funds) could make to stop their short-term focus: defining long-term objectives and risk appetite, invest in building relationships with portfolio companies, demand long-term metrics from portfolio companies (e.g., "10-year economic value added, R&D efficiency, patent pipelines, multiyear return on capital investments, and energy intensity of production", and structure their own institutional governance for a long-term approach).

[63] For example, perhaps it is feasible to assign greater voting rights to shares that are held for long-term appreciation. We already privilege long-term holding for tax purposes, but France for example has a formal requirement that shares held for over two years have double voting rights. E.g., Michael Stothard, *French companies fight back against Florange double-vote law*, *FT* (Apr. 16, 2015). I'm not sure this is the right rule, primarily because it's easy to structure around it, see Matt Levine, *FX Pleas and California Activists*, *Bloomberg* (May 20, 2015), but such creative thinking is useful. See also Allaire, supra note 48 at 16 (advocating for dual classes of shares and that voting rights should only be acquired after a one-year holding period). Similarly, Vice Chancellor Laster in Delaware has a line of opinions exploring whether directors' fiduciary duty to stockholders should be specifically taken to mean a fiduciary duty to long-term shareholders, such that directors representing capital with a short-term investment horizon (e.g., a venture capital fund) could have a conflict in voting for example for the same of the corporation. See Bodner et al, *VC Laster, Fiduciary Duties And The Long-Term Rule*, *Law360* (Mar. 11, 2015), available at https://www.cov.com/~/media/files/corporate/publications/2015/03/vc_laster_fiduciary_duties_and_the_long_term_rule.ashx. I'm not sure that removing from directors the discretion to determine the proper time horizon in which the corporation should be managed is the right result, but it's another interesting path to explore.

[64] See Guhan Subramanian, *Corporate Governance 2.o*, *Harv Bus. Rev.* (March 2015). Professor Subramanian posits that that boards should have the right to manage the company for the long term; that boards should install mechanisms to ensure the best possible people in the board room; and that boards should give shareholders an orderly voice. He then builds out some concrete, balanced policy proposals — e.g., staggered boards but also proxy access — that could be achieved if, looking to negotiation theory, interested parties were to sit down and bargain for, rather than the current meandering approach. Id.

[65] One final point: in creating the legal framework for companies to be managed for long-term shareholder wealth creation, let's not get sidetracked. One popular boogeyman has been the requirement that companies be managed for the benefit of their shareholders. E.g., James Montier, *The World's Dumbest Idea*, GMO White Paper (Dec. 2014). By managing them in favor of a larger pool of constituents — bondholders, customers, employees/labor, the citizenry at large — we can ensure long-term success, or so the theory goes. This is a red herring. A properly-managed company focused on long-term shareholder wealth creation will take care of all of those other constituents: it will pay off its debt, to maintain access to the bond market; it will invest in human capital and in fair compensation for employees so they do not take advantage of the flexible U.S. labor markets to decamp for another company; it will invest in improving or creating new products or the customer experience, because that will drive greater returns; and it will pay taxes from those returns that will benefit citizens in general. (If it maintains those profits overseas without repatriating them, that's a failing of tax policy, not corporate governance policy.) Solving short-

termism will solve the issues it has created in our economy writ large, without having to fundamentally alter the relationship of shareholders and corporations.

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