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August 20, 2021

TO:
Chair Gary Gensler
Renee Jones, Director, Division of Corporate Finance

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 25049-1090

Via email to rule-comments@sec.gov

RE: Exclusion of shareholder proposals implicating the significant policy issue of cost and risk externalization

Dear Chair Gensler and Ms. Jones,

The Shareholder Commons (TSC) is a non-profit organization promoting the interests of long-term, diversified shareholders. Our work includes an investor-protection regime that recognizes investors' fundamental interest in preserving the social and environmental systems in which their investments are embedded. We write because of a concern that shareholder voice is being muted on critical social and environmental issues under the Staff's current application of Rule 14a-8(i)(7), which allows companies to exclude shareholder proposals that relate to ordinary business for reasons that contravene the policy underlying the Rule.

We are aware of and support the recommendations in the June 24, 2021 letter from the Shareholder Rights Group, Interfaith Center on Corporate Responsibility, and Ceres regarding ordinary business and "significance to the company." That letter's recommendations would ease constraints on shareholder voice by clarifying that a) a significant policy issue transcends ordinary business when its impact on the environment, society, or stakeholders, and on investors or the company, is potentially significant and b) a company's potential for significant social or environmental impact would cause a proposal to be "otherwise significantly related" to the company's business for purposes of Rule 14a-8(i)(5). We are writing to emphasize those recommendations are particularly salient to proposals that seek disclosure of significant externalities that will impact the returns of diversified portfolios, and to add our specific recommendations regarding such proposals.

In the 2021 proxy season, the Staff provided no-action relief for five proposals that raised a significant policy issue: the subject companies' reliance on business practices that externalize costs to diversified shareholders—a category that encompasses most investors in publicly traded companies—and stakeholders. These proposals asked each company to provide a report on a specific practice or line of business and the external costs it created, and how those costs affected the company's own diversified shareholders. In two of these instances, the Staff appears to have determined there was insufficient "nexus" between the specific practice on which a report was requested and the issuer's business. The Staff does not appear to have considered cost externalization itself as a significant policy issue in any of these cases, instead focusing on the underlying practice in its consideration of each of the proposals.

We urge the Staff to reexamine its analysis of proposals that address cost and risk externalization. As we discuss below, the issue of whether businesses should profit at the expense of the social and environmental systems that support all the other businesses their diversified investors own, as well as their stakeholders, is under scrutiny in public debate, the business community, state legislatures, and Congress. We also urge the Staff to reconsider its application of the nexus analysis to such proposals.

The purpose of Rule 14a-8 is not served if shareholders cannot bring a proposal regarding company conduct that significantly threatens the interests of diversified shareholders in social and environmental systems under an (i)(7) finding that the conduct does not raise an important policy issue or is of limited importance to the company's business. That exclusion is meant to allow the board and management to function without interference on matters that are peculiarly within their expertise. In contrast, the external effect of practices that burden the systems that serve shareholders and others is not an area where board or management expertise is of particular importance, especially if the effect on the company's financial return itself is limited in scope.

BACKGROUND: THE ORDINARY BUSINESS EXCLUSION, THE PUBLIC POLICY EXCEPTION, AND THE NEXUS TEST

Rule 14a-8 ensures that shareholders have a voice in corporate affairs. The ordinary business exclusion is intended to ensure that voice is exercised on matters appropriate for shareholder action, in contrast to matters that should be confined to an issuer's board or management:

> *Under Rule 14a-8(i)(7), a company is permitted to exclude a proposal that "deals with a matter relating to the company's ordinary business operations." Why? Because the resolution of these types of matters is considered to be more properly the province of management and the board of directors than of the shareholders.*[1]

The Staff provided examples of ordinary business in a 1998 release:

> *Certain tasks are so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter,*

[1] Cydney Posner, *The Economic Relevance and Ordinary Business Exclusion for Shareholder Proposals,* HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE (November 15, 2018), available at https://corpgov.law.harvard.edu/2018/11/15/the-economic-relevance-and-ordinary-business-exclusion-for-shareholder-proposals/.

> *be subject to direct shareholder oversight. Examples include the management of the workforce, such as the hiring, promotion, and termination of employees, decisions on production quality and quantity, and the retention of suppliers.*[2]

While the ordinary business exclusion had been in place since 1954, a social policy exception was introduced in 1976.[3] In its 1998 release, the Staff explained that a shareholder proposal that might otherwise be excludable as relating to ordinary business under Rule 14a-8(i)(7) may not be excludable if it raises significant social policy issues:

> *However, proposals relating to such matters but focusing on sufficiently significant social policy issues (e.g., significant discrimination matters) generally would not be considered to be excludable, because the proposals would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote.*[4]

More recently, the Staff has indicated that shareholder proposals involve significant social policies if they involve issues that engender widespread debate, media attention, and legislative and regulatory initiatives.[5] In addition, the 1998 Release reiterated that the ordinary business exclusion is meant to properly divide corporate authority between shareholders and management, as state corporate law generally provided:

> *The general underlying policy of this exclusion is consistent with the policy of most state corporate laws: to confine the resolution of ordinary business problems to management and the board of directors, since it is impracticable for shareholders to decide how to solve such problems at an annual shareholders meeting.*[6]

A subsequent release addressed considerations relevant to the exclusion of proposals that involved judgments around risk under the ordinary business exclusion. The Staff noted that the standard policy exception rules would apply to such proposals, including an analysis of nexus to the issuer:

> *In those cases in which a proposal's underlying subject matter transcends the day-to-day business matters of the company and raises policy issues*

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[2] Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, (May 21, 1998) ("1998 Release").
[3] See generally, Phillip R. Stanton, *SEC Reverses Cracker Barrel No-Action Letter*, 77 WASH. U. L. Q. 979, 982-983 (1999), available at: https://openscholarship.wustl.edu/law_lawreview/vol77/iss3.
[4] *See* 1998 Release, *supra, n. 2.*
[5] JD Supra, *SEC Staff's Latest Guidance Presents Dilemma for Companies Seeking to Exclude Shareholder Proposals on Environmental and Social Issues* (January 4, 2018) ("In a June 30, 2016 stakeholder meeting, the Staff indicated that significant policy issues are matters of widespread public debate, which include legislative and executive attention and press attention.")
[6] *Id.*

> *so significant that it would be appropriate for a shareholder vote, the proposal generally will not be excludable under Rule 14a-8(i)(7) as long as a sufficient nexus exists between the nature of the proposal and the company.*[7]

THE 2021 EXCLUSIONS

In 2021, shareholders at each of five companies submitted and did not withdraw proposals asking for reports on external costs created by a practice or line of business and the way such costs would affect the majority of the company's shareholders who rely on overall market returns. In each case, the company requested no-action relief on various bases, and the SEC granted relief based on the ordinary business exception.[8] Similar proposals were filed at YUM! Brands, Inc., McDonald's Corporation, and PepsiCo, Inc. YUM! Brands agreed to produce the requested report and the proposal was subsequently withdrawn.[9] McDonald's included the proposal in its proxy materials and it received 12% of the vote,[10] far more than the recently raised threshold for resubmission of a first-time proposal.[11] The Staff declined to provide relief for the PepsiCo proposal,[12] which received a 12.2% vote.[13]

THE APPROPRIATENESS OF EXTERNALIZING COSTS TO INCREASE FINANCIAL RETURNS FOR SHAREHOLDERS IS ONE OF THE CRITICAL PUBLIC POLICY QUESTIONS CURRENTLY UNDER DEBATE

A. The nature of the policy issue

Proposals addressing cost externalization present a highly contentious, contemporary public policy issue that transcends a company's ordinary business and is therefore not excludable under Rule 14a-8(i)(7): business practices that provide internal corporate financial returns but harm a company's own diversified shareholders and other stakeholders. As discussed below, this issue has become a central feature of the policy debate in the United States and beyond.

An individual company can benefit financially by externalizing costs and risks when the return to the business from that free (to it) consumption outweighs any diluted cost it might share as a participant in the economy. But over time, these collective decisions to exploit common resources lead to significant harm to stakeholders and reduction in the value of the portfolios of diversified investors, because the businesses that make up those portfolios rely on these resources. Investors—almost all of whom are

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[7] Staff Legal Bulletin 14E (October 27, 2009) ("SLB 14E").
[8] *See Goldman Sachs Group, Inc., (March 9 and March 19, 2021); JPMorgan Case & Co., (March 26, 2021); State Street Corporation (March 26, 2021); CVS Health Corporation (March 22 and March 30, 2021); Marriott International, Inc., (March 26, 2021).*
[9] Cydney Posner, *The Shareholder Commons offers a new approach to ESG activism,* Cooley PubCo (March 10, 2021), available at https://cooleypubco.com/2021/03/10/shareholder-commons-new-approach-esg/.
[10] McDonald's Corporation, Form 8-K (May 26, 2021).
[11] SEC Rule 14a-8(12)(i).
[12] PepsiCo, Inc. (March 12, 2021).
[13] PepsiCo, Inc., Form 8-K (May 7, 2021).

diversified—can resist this corporate “tragedy of the commons”[14] by exercising their corporate governance rights to stop the companies they own from pursuing this type of profiteering.[15]

To protect the interests of the vast majority of American investors with diversified portfolios and to implement the intent of the investor protection laws and rules it oversees, the Commission and Staff must account for investors’ financial interests in protecting systems and common resources, not just the interests of a hypothetical shareholder whose sole interest is in the financial performance of a single company.[16] This context should be considered when applying Rule 14a-8(i)(7).

B. Corporate Law and Shareholder Primacy

The directors of U.S. corporations have long focused their efforts on improving the financial return their corporations deliver to their shareholders. While there has been a fierce, ongoing debate as to whether corporations should in fact be managed for the benefit of only shareholders or for a broader group of stakeholders, the concept of shareholder primacy has dominated corporate law.[17] This doctrine eschews consideration of the external costs of a business unless those costs affect the corporation’s own financial return to its shareholders. A series of decisions by the Delaware courts cemented shareholder primacy in the United States.

The most important of these was the famous *Revlon* case decided by the Delaware Supreme Court in 1985.[18] Other Delaware authority has established that corporations exist primarily to generate shareholder value.[19] *eBay Domestic Holdings, Inc. v. Newmark*[20] is a more recent example of the focus on shareholder wealth maximization, even outside the sale context. The court embraced shareholder primacy, finding that it was a violation of the directors’ fiduciary duties to make decisions primarily for the benefit of users of the corporation’s platform:

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[14] *See* Elinor Ostrom, GOVERNING THE COMMONS: THE EVOLUTION OF INSTITUTIONS FOR COLLECTIVE ACTION, Cambridge University Press (1990).

[15] *See generally,* Jon Lukomnik & James P. Hawley, MOVING BEYOND MODERN PORTFOLIO THEORY: INVESTING THAT MATTERS, Routledge (April 2021), Chapter 5.

[16] From the point of view of a single company (or a shareholder invested in just that single company), depleting the commons may be a bargain, because it will reap 100% of the benefit of the “free” resource but only suffer its proportionate share of the damage as an actor in the economy.

[17] Frederick Alexander, BENEFIT CORPORATION LAW AND GOVERNANCE: PURSUING PROFIT WITH PURPOSE, Berrett-Koehler Publishers (2018) at 21-26.

[18] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*., 506 A.2d 173 (Del. 1986) (holding that when a corporation is to be sold in a cash-out merger, the directors’ duty is to maximize the cash value to shareholders, regardless of the interests of other constituencies, because there is no long term for the shareholders).

[19] *See Katz v. Oak Indus. Inc*., 508 A.2d 873, 879 (Del. Ch. 1986) (“It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation’s stockholders; that they may sometimes do so ‘at the expense’ of others [*e.g.*, debtholders] . . . does not . . . constitute a breach of duty.”); Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any “There” There?*, 75 S. Cal. L. Rev. 1169, 1170 (2002) (“The predominant academic answer is that corporations exist primarily to generate stockholder wealth, and that the interests of other constituencies are incidental and subordinate to that primary concern.”)

[20] 16 A.3d 1 (Del. Ch. 2010).

> *Having chosen a for-profit corporate form, the craigslist[21] directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid… a corporate policy that specifically, clearly, and admittedly seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders.[22]*

Former Chief Justice Leo Strine of the Delaware Supreme Court has explained that the law clearly favors shareholders, stating that "a clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end, and that other interests may be taken into consideration only as a means of promoting stockholder welfare."[23] Toward the end of the 20th century, many jurisdictions in the United States adopted "constituency statutes," fully or partially opting out of shareholder primacy.[24] None of those states mandates consideration of stakeholder interests, however.[25]

Beyond the damage it does to companies' own diversified shareholders, the prevailing model of company-first shareholder primacy has raised great consternation regarding the harm it imposes on stakeholders and the public.[26] In response, the benefit corporation option was created to provide a corporate form where directors could prioritize interests other than those of shareholders. Beginning in 2010, U.S. jurisdictions began to adopt benefit corporation provisions, which created a corporate form that required directors to consider other stakeholder interests.

Chief Justice Strine described how this new form fit into the policy debate:

> *[T]he benefit corporation movement represents a refreshing and substantial step forward for those who believe that corporations—and all business entities—not only can, but should both do well by their investors, but also their workers and the societies in which they operate.[27]*

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[21] eBay owned a minority stake in craigslist at the time.
[22] *Id*. at 34-35 (referring to corporate justification for a shareholder rights plan meant to forestall a change in control that might threaten platform users' interests).
[23] Leo Strine, *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law* 50 WAKE FOREST LAW REVIEW 761 (2015), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2576389.
[24] Alexander, *supra n. 17*, at 135–148.
[25] *Id.*
[26] *See generally,* Lynn Stout, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS AND THE PUBLIC, Berrett-Koehler Publishers (2012).
[27] Leo Strine, *Forward,* in Alexander, *supra,* n. 17.

The clearest signal of the significance of the policy issue is legislative action to address the issue around the nation and the world. Legislatures have acted in 39 U.S. jurisdictions, the Canadian province of British Columbia, and the countries of Italy, Colombia, and Ecuador over the last decade to make this new form available. In addition, legislation was introduced in the last U.S. Congress in both houses that would have imposed benefit corporation duties on the directors of all billion-dollar companies.[28] The issue even surfaced in the most recent U.S. presidential election, as one candidate decried "the era of shareholder capitalism."[29] In response, critics argued that favoring shareholders was the best recipe for a successful economy:

> *In reality, corporations do enormous social good precisely by seeking to generate returns for shareholders.*[30]

More recently, on June 16, 2021, the U.S. House of Representatives approved a bill that would require the Commission to report on the status of collective action taken by shareholders to address these types of externalized costs and the need to provide legal protection for such action. The report would include:

> *(C) recommendations on regulatory safe harbors for engagement with respect to sustainability guardrails and similar restrictions on portfolio company conduct with a goal of—*
>
> > *(i) preserving economic justice, environmental systems, and social institutions; and*
> >
> > *(ii) otherwise protecting the common interests of corporate shareholders and stakeholders.*[31]

Protecting the common interests of shareholders from corporate cost externalization by individual companies is clearly at the forefront of legislators' minds.

C. Trust Law

This policy issue has also appeared in recent regulatory and legislative activity relating to trustees for retirement plans and other investment advisors. In 2020, the Department of Labor proposed a Rule that would have made it more difficult for trustees to account for environmental and social costs, but, after receiving public comments, revised the final rule in a manner that gives trustees the ability to address

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[28] Copies of the legislation are available here: https://www.congress.gov/bill/116th-congress/senate-bill/3215?q=%7B%22search%22%3A%5B%22accountable+capitalism+act%22%5D%7D&s=1&r=1 (Senate) and here: https://www.congress.gov/bill/116th-congress/house-bill/6056?q=%7B%22search%22%3A%5B%22accountable+capitalism+act%22%5D%7D&s=2&r=2 (House)

[29] *Biden says investors 'don't need me,' calls for end of 'era of shareholder capitalism,'* CNBC (July 9, 2020), available at https://www.cnbc.com/2020/07/09/biden-says-investors-dont-need-me-calls-for-end-of-era-of-shareholder-capitalism.html.

[30] Andy Pudzer, *Biden's Assault on 'Shareholder Capitalism,* (Wall Street Journal) (August 17, 2020), available at https://www.wsj.com/articles/bidens-assault-on-shareholder-capitalism-11597705153.

[31] H.R.1187, Corporate Governance Improvement and Investor Protection Act, 117TH CONGRESS (2021-2022).

corporate activity that imposes the type of social costs described in the above-referenced externality proposals when the trustees believe that those costs would affect their diversified portfolios—exactly the type of costs on which the proposals sought reports:

> *In addition, Final Rules should also permit stewardship that discourages portfolio companies from engaging in behaviour that harms society and the environment, and consequently the value of shareholders' diversified portfolios. (For example, plan fiduciaries might vote to encourage all companies to lower their carbon footprint, not because it will necessarily increase return at each and every company, but because it will promote a strong economy and thus increase the return of their diversified portfolio).*[32]

Moreover, in 2020, a bill was introduced in the U.S. House of Representatives that included an express finding that plan fiduciaries should consider the costs that corporations in their portfolios impose on the financial system:

> *The Congress finds the following:*
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> *(1) Fiduciaries for retirement plans should…*
>
> *(D) consider the impact of plan investments on the stability and resilience of the financial system; …*[33]

While the bill related to costs to the financial system, rather than other systemic concerns, it was clearly focused on the same policy concern: costs that a company's profit-seeking activities impose on stakeholders.[34]

D. The Business Roundtable Statement

In addition to the activity noted in the prior section regarding political and legislative activity around the issue of external costs to stakeholders, the business community has raised the profile of the consideration of externalities, with the adoption of the Business Roundtable (BRT) Statement on the Purpose of a Corporation (the "BRT Statement"), which purports to make significant commitments to

[32] Frederick Alexander, *The Final DOL Rules Confirm That Fiduciary Duty Includes 'Beta Activism,'* RESPONSIBLE INVESTOR (December 15, 2020) available at https://www.responsible-investor.com/articles/the-final-dol-rules-confirm-that-fiduciary-duty-includes-beta-activism.

[33] H.R. 8959 (116th): Retirees Sustainable Investment Policies Act of 2020

[34] *See also* Frederick Alexander, Holly Ensign-Barstow, Lenore Palladino, and Andrew Kassoy, *From Shareholder Primacy to Stakeholder Capitalism: A Policy Agenda for Systems Change*, Harvard Law School Forum on Corporate Governance (October 26, 2020), available at https://corpgov.law.harvard.edu/2020/10/26/from-shareholder-primacy-to-stakeholder-capitalism/. (Arguing that fiduciary duties of trustees should incorporate external costs of individual companies that harm portfolios).

stakeholders.[35] The CEOs of each of the five companies where an externalities report proposal was excluded signed the BRT Statement. Here we quote the BRT Statement, as makes a strong case for the critical nature of the policy issue raised by the excluded externalities proposals:

> *Americans deserve an economy that allows each person to succeed through hard work and creativity and to lead a life of meaning and dignity. We believe the free-market system is the best means of generating good jobs, a strong and sustainable economy, innovation, a healthy environment and economic opportunity for all…*
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> *While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:*
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> - *Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations…*
> - *Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses…*
> - *Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.*[36]

Thus, the BRT Statement demonstrates exactly why the externalities report proposals raise a critical policy question: they ask companies to report on externalized costs of their business activities, which fall upon "Americans," "customers," "people in our community," and "our country," the very stakeholders to whom the companies that received the proposal publicly committed less than two years ago, and whose interests they are expressly prohibited from considering in cases where addressing those interests might reduce the individual companies' internal financial returns.

The reaction to the BRT Statement's issuance (as well as the 181 companies signing on) in August 2019 demonstrated the policy significance of addressing external costs. One dubious commentator noted in the Harvard Business Review that "For many of the BRT signatories, truly internalizing the meaning of

[35] https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.
[36] *Supra,* n. 1 (emphasis added).

their words would require rethinking their whole business."[37] Others noted the importance of the change, but also that it was meaningless without ending company-first shareholder primacy:

> *Ensuring that our capitalist system is designed to create a shared and durable prosperity for all requires this culture shift. But it also requires corporations, and the investors who own them, to go beyond words and take action to upend the self-defeating doctrine of shareholder primacy.*[38]

Other commentators were worried not that the Statement did not go far enough, but rather that it went too far:

> *Asking corporate managers to focus more on improving society and less on making profits may sound like a good strategy. But it's a blueprint for ineffective and counterproductive public policy on the one hand, and blame-shifting and lack of accountability on the other. This is a truth Milton Friedman recognized nearly five decades ago — and one that all corporate stakeholders ignore today at their peril.*[39]

Another writer agreed, linking the issue to the same essay by Milton Friedman:

> *The issue of which constituency – or "stakeholder" – has the highest priority has long been a classic corporate governance conundrum. Still, the prevailing consensus, as espoused by Milton Friedman in his September 13, 1970 New York Times Magazine article, has been corporate executives work for their owners (i.e., shareholders) and have a responsibility to do what those owners desire, which is to make as much money as (legally) possible. That all changed on August 19, 2019.*[40]

While exploring the commitments to corporate social responsibility, the authors of the latter two articles each returned to Friedman's famous article, which stated:

> *[T]he doctrine of 'social responsibility' taken seriously would extend the scope of the political mechanism to every human activity. It does not differ in philosophy from the most explicitly collectivist doctrine. It differs*

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[37] Andrew Winston, *Is the Business Roundtable Statement Just Empty Rhetoric?* HARVARD BUSINESS REVIEW (August 30, 2019), available at https://hbr.org/2019/08/is-the-business-roundtable-statement-just-empty-rhetoric.

[38] Jay Coen-Gilbert, Andrew Kassoy, and Bart Houlihan, *Don't believe the Business Roundtable has changed until its CEOs' actions match their words,* FAST COMPANY (August 22, 2019), available at https://www.fastcompany.com/90393303/dont-believe-the-business-roundtable-has-changed-until-its-ceos-actions-match-their-words.

[39] Karl Smith, *Corporations Can Shun Shareholders, But Not Profits,* BLOOMBERG OPINION (August 27, 2019), available at https://www.bloomberg.com/opinion/articles/2019-08-22/corporations-should-keep-their-focus-on-profit-not-on-doing-good.

[40] Christopher Carosa, *Did Business Roundtable Just Break A Fiduciary Oath?*, FiduciaryNews.com (August 27, 2019), available at http://fiduciarynews.com/2019/08/did-business-roundtable-just-break-a-fiduciary-oath/.

> *only by professing to believe that collectivist ends can be attained without collectivist means. That is why, in my book Capitalism and Freedom, I have called it a 'fundamentally subversive doctrine' in a free society, and have said that in such a society, 'there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.*[41]

Showing that the controversy is long-lived, the 50th anniversary of the essay in 2020 set off another round of commentary.[42]

THE EXCLUDED PROPOSALS ADDRESS THE POLICY ISSUE OF EXTERNALIZING COSTS AND RISKS TO STAKEHOLDERS AND DIVERSIFIED SHAREHOLDERS

The outpouring of legislative activity around benefit corporations, regulatory and legislative activity around trustee obligations to consider external corporate costs and safe harbors for shareholder activity to address externalities, and commentary around the BRT Statement revolve around the ability of companies to profit in ways that harm both diversified shareholders and stakeholders. The proposed externality reports squarely address this issue.

In a recent study, a leading asset manager determined that publicly listed companies imposed social and environmental costs on the economy with a value of $2.2 trillion annually—more than 2.5% of global GDP and more than half of the profits those companies earned.[43] These costs have many sources, including pollution, water withdrawal, climate change, and inequality. The cost externalization proposals ask companies to examine their own contribution to this dangerous phenomenon. Cost externalization by corporations has already been documented in numerous areas:

[41] Milton Friedman, *A Friedman doctrine: The Social Responsibility of Business Is to Increase Its Profits,* NEW YORK TIMES, (September 13, 1970), available at https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html.

[42] See, e.g., *Friedman 50 Years later,* PROMARKET (November 17, 2020), available at https://promarket.org/2020/11/17/ebook-milton-friedman-50-years-later/. (Collecting 27 essays about Friedman's article and its legacy)

[43] Andrew Howard, *SustainEx: Examining the social value of corporate activities,* Schroders (April 2019), available at https://www.schroders.com/en/sysglobalassets/digital/insights/2019/pdfs/sustainability/sustainex/sustainex-short.pdf.

- *Climate change.* According to Economist Intelligence Unit projections, the world economy will be 3% smaller in 2050 due to lack of climate resilience.[44] Moreover, just 100 companies are responsible for 71% of industrial global greenhouse gas emissions.[45]

- *Obesity.* The World Health Organization assesses the unpriced social burdens of obesity as equaling almost 3% of global GDP annually.[46] The food and beverage business bears significant responsibility for this issue.[47]

- *Inequality.* It has been estimated that inequality has reduced demand by 2-4% of GDP in recent years.[48] In the United States, corporate depression of wages for low-income workers and exploding executive pay are expanding inequality.[49]

- *Racial and gender disparities.* Gender and racial gaps created $2.9 trillion in losses to U.S. GDP in 2019,[50] and a Citigroup report projected that racial disparities will cost the U.S. economy $5 trillion over the next five years.[51] The Citigroup report cited in the margin details how corporations can address this issue.

- *Antimicrobial Resistance.* The World Bank projects that antimicrobial resistance will decrease global GDP by as much as 3% by 2030 and almost 4% by 2050; at an intermediate discount rate,

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[44] *Global economy will be 3 percent smaller by 2050 due to lack of climate resilience,* The Economist Intelligence Unit (November 20, 2019), available at https://www.eiu.com/n/global-economy-will-be-3-percent-smaller-by-2050-due-to-lack-of-climate-resilience/; *see also* Kahn, M., Mohaddes, K., Ng, R., Hashem Pesaran, M., Raissi, M, and Yang, J.*, Long-Term Macroeconomic Effects of Climate Change: A Cross-Country Analysis*, IMF Working Paper (October 11, 2019), available at https://www.imf.org/en/Publications/WP/Issues/2019/10/11/Long-Term-Macroeconomic-Effects-of-Climate-Change-A-Cross-Country-Analysis-48691. (abstract) ("Our counterfactual analysis suggests that a persistent increase in average global temperature by 0.04°C per year, in the absence of mitigation policies, reduces world real GDP per capita by more than 7 percent by 2100. On the other hand, abiding by the Paris Agreement, thereby limiting the temperature increase to 0.01°C per annum, reduces the loss substantially to about 1 percent.")

[45] Swann Bommier & Cécile Renouard, *Corporate Responsibility in the Climate Crisis,* PUBLIC BOOKS and LA VIE DES IDÉES (January 21, 2019), available at https://www.publicbooks.org/corporate-responsibility-in-the-climate-crisis/#:~:text=Although%20states%20are%20largely%20responsible,global%20industrial%20greenhouse%20gas%20emissions.

[46] *See* Andrew Howard, *supra,* 43.

[47] *See, e.g.,* https://www.hsph.harvard.edu/nutritionsource/healthy-drinks/sugary-drinks/.

[48] Josh Bivens, *Inequality is slowing U.S. economic growth: Faster wage growth for low- and middle-wage workers is the solution,* Economic Policy Institute (December 12, 2017), available at https://www.epi.org/publication/secular-stagnation/.

[49] Sam Pizzigati, *Putting the Brakes on Corporate America's Inequality Engine,* Inequality.org (November 15, 2019), available at https://inequality.org/great-divide/putting-the-brakes-on-corporate-americas-inequality-engine/#:~:text=Corporations%20are%20contributing%20to%20inequality%20on%20two%20fronts.&text=The%20legislation%20%E2%80%94%20the%20Tax%20Excessive,the%20higher%20the%20tax%20rate. *See generally*, Heather Boushey, UNBOUND: HOW INEQUALITY CONSTRICTS OUR ECONOMY AND WHAT WE CAN DO ABOUT IT, Harvard University Press (October 15, 2019).

[50] Shelby R. Buckman et al., *The Economic Gains from Equity,* Federal Reserve Bank of San Francisco (January 19, 2021), available at https://www.frbsf.org/our-district/files/economic-gains-from-equity.pdf.

[51] Dana M. Peterson and Catherine L. Mann, *Closing the Racial Inequality Gaps: The Economic Cost of Black Inequality in the U.S.*, Citi GPS (September 2020), available at http://citi.us/3olxWH0.

> this will amount to economic losses by 2050 with a current value of $54 trillion.[52] A study commissioned by the U.K. government puts the figure at $100 trillion.[53] Scholarship links this increasing resistance in part to commercial pressures in agriculture and consumer packaged goods industries.[54]

These examples clearly demonstrate the risk to the public of cost externalization, but they also demonstrate a particular risk borne by the diversified shareholders who constitute most public-company investors. First, it has been established that overall stock market performance, not the outperformance of individual companies, is by far the most important element of return for a diversified investor: "[V]irtually all investors have permanent exposure to systematic market risk, which will still determine 75-95% of their return."[55] Second, it has been established that overall economic performance is a critical determinant of stock-market value.[56]

Cost externalization is a significant social policy issue in which diversified shareholders have an important stake. The externality report proposals specifically addressed this issue by asking companies to describe the external costs they impose on society and the environment—and thus on the economy as a whole—providing context to its shareholders and permitting them to understand whether the companies' value proposition were truly sustainable, or whether their profits rely on the corrosive exploitation of common resources and vulnerable populations.[57] Each company that received such a proposal in the 2021 proxy season had itself recognized the critical nature of the relationship between corporations and stakeholders by executing the BRT Statement.

THE STAFF ANALYSIS

The specific practices the externality report proposals addressed differed among the six proposals on which the Staff acted. The proposals addressed the external costs of (1) an asset manager focusing on individual company materiality (State Street); (2) food and beverage businesses related to public health (CVS and PepsiCo); (3) underwriting multiclass share offerings (Goldman and JPMorgan Chase); and (4) an inequitable compensation policy (Marriott). It appears that in analyzing whether each individual

[52] Drug-Resistant Infections: A Threat to Our Economic Future, World Bank Group (March 2017), available at http://documents1.worldbank.org/curated/en/323311493396993758/pdf/final-report.pdf.

[53] *Antimicrobial Resistance: Tackling a crisis for the health and wealth of nations*, UK Government Review on Antimicrobial Resistance (December 2014), available at https://amr-review.org/sites/default/files/AMR%20Review%20Paper%20-%20Tackling%20a%20crisis%20for%20the%20health%20and%20wealth%20of%20nations_1.pdf.

[54] Carolyn Anne Michael, Dale Dominey-Howes, and Maurizio Labbate, *The Antimicrobial Resistance Crisis: Causes, Consequences, and Management,* Frontiers in Public Health vol. 2 145 (September 16, 2014), available at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4165128/.

[55] *Supra note 15 at 43*.

[56] Richard Mattison et al., *Universal Ownership: Why Environmental Externalities Matter to Institutional Investors, Appendix IV,* UNEP Finance Initiative and PRI (2011), available at https://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf. ("[T]he relationship between GDP and the price of the portfolio of a Universal Owner is linear in the long term.")

[57] *Compare,* Engine No. 1 and Witold J. Henisz, *A New Way of Seeing Value* (June 2021), available at https://engine1.com/wp-content/uploads/2021/06/Engine-NO1_TV-whitepaper_060721.pdf. ("By measuring the financial value of these externalities, in terms of both positive and negative corporate impacts, the Total Value Framework allows much better comparisons between the performance of firms over time and across industries.")

proposal related to a public policy issue that would take the proposal out of the ordinary business exception, the Staff analyzed the underlying practice rather than the larger question of externalizing costs. Furthermore, in so doing, the Staff then appeared to apply the nexus test by considering how that practice related to the business of the company and found insufficient nexus where the practice constituted a small part of the business.

To illustrate, the Staff did not provide no-action relief to PepsiCo, but it did provide relief to CVS on an almost identical proposal. The PepsiCo proposal read as follows:

> *RESOLVED, shareholders ask that the board commission and disclose a report on the external public health costs created by the food <u>and beverage</u> business of our company (the "Company") and the manner in which such costs affect the vast majority of its shareholders who rely on overall market returns.*

The CVS proposal read as follows:

> *RESOLVED, shareholders ask that the board commission and disclose a report on the external public health costs created by the <u>retail</u> food business of our company (the "Company") and the manner in which such costs affect the vast majority of its shareholders who rely on overall market returns.*

Except for the underlined words, these proposals were identical. In response to a request to reconsider the relief granted to CVS, the Staff noted:

> *[A] proposal related to the external public health costs created by the food and beverage business of a company may raise a significant policy issue that transcends a company's ordinary business operations (see, e.g., PepsiCo, Inc. (March 12, 2021)). However, in our view, the Proposal does not demonstrate how external public health costs created by the Company's retail food business are <u>sufficiently significant to the Company</u>, such that they transcend the Company's ordinary business operations and would be appropriate for a shareholder vote.*[58]

Similarly, in its letter granting no-action relief to JPMorgan Chase, the Staff stated:

> *[T]he Proposal does not demonstrate how underwriting equity offerings with different class <u>structures is a significant policy issue for the Company</u>, such that it transcends the Company's ordinary business*

[58] *Supra, n. 8* (emphasis added).

operations and would be appropriate for a shareholder vote.[59]

It thus appears that the Staff analyzed the specific practice as a policy issue on its own and did not analyze the externalization of costs as a separate policy issue. In addition, in applying the nexus test, the Staff appears to have considered the magnitude of the practice as compared to the company's entire business—that would explain the distinction between the outcome in PepsiCo and CVS with respect to identical proposals and the decision to exclude the proposals at Marriott, Goldman Sachs, and JPMorgan Chase (which addressed practices that raise significant social policy issues.)

A PROPOSAL ASKING A COMPANY TO ADDRESS COST OR RISK EXTERNALIZATION SHOULD NOT BE EXCLUDED IF THE COMPANY CONTRIBUTES SIGNIFICANTLY TO A SOCIAL OR ENVIRONMENTAL COST OR RISK

In light of the developments detailed above with respect to public and legislative focus on the impacts that companies have on stakeholders, the issue of cost externalization falls squarely within the public policy exception to the ordinary business exclusion, engendering widespread debate, media attention, and legislative and regulatory initiatives.[60] Rather than analyzing the specific practice that underlies such externalization, the Staff should recognize that a request to address company-generated costs and risks that are borne by the company's own diversified shareholders and other stakeholders is a critical policy issue, regardless of the source of the costs and risks. This is entirely consistent with the underlying purpose of the exclusion, which is to exclude proposals where management is best positioned to make decisions. In the case of external risks and costs not borne by the company, management has no greater expertise or interest than do shareholders in addressing such questions. Indeed, as the owners of the company, it is shareholders who are the most appropriate body to address such questions, which involve the ultimate purpose and impact of the corporation, rather than its day-to-day operation.

For the same reason, the nexus test for such a proposal should not compare the practice in question to the size of the company's overall business, because the important question from the point of view of the shareholders is whether the company is a significant contributor to the externalized cost or risk, and, in particular, how that cost or risk will affect their diversified portfolios. As the owners of the company, shareholders should have the opportunity to understand whether a company they own is profiting from practices that harm their other investments.

For all the reasons expressed above, we ask the Staff to adopt the following polices with respect to requests for no-action relief under Rule 14a-8(i)(7):

1. Otherwise proper requests for proposals addressing costs and risks that a company externalizes to stakeholders and diversified shareholders implicate an important public policy and should not be excluded as ordinary business; and

[59] *Id.* (emphasis added).
[60] *See supra, n.5.*

2. Such proposals should be considered to have a proper nexus to the company if the company makes a significant contribution to the costs or risks in question.

We would welcome the opportunity to discuss this question with members of the Staff at their convenience. I can be reached at rick@theshareholdercommons.com or +1-302-593-0917.

Sincerely,

Frederick H. Alexander
CEO, The Shareholder Commons

cc: John Coates, General Counsel
Satyam Khanna, Senior Policy Advisor for Climate and ESG
Kristina Wyatt, Senior Counsel for Climate and ESG

COSIGNATORIES (US$72.7 BILLION IN AGGREGATE ASSETS UNDER MANAGEMENT)

U.S. State Treasurers

Sarah A. Goldlewski
Wisconsin State Treasurer

Deborah L. Goldberg
Massachusetts State Treasurer

Henry E.M. Beck
Maine State Treasurer as sole trustee of state trust funds

Investors

Debby Blakey
Chief Executive Officer
HESTA

Marcela I. Pinilla
Director of Sustainable Investing
Zevin Asset Management

Lauren Compere
Managing Director
Boston Common Asset Management

John C. Harrington
President and CEO
Harrington investments, Inc.

Chris Meyer
Manager of Advocacy and Research
Everence and the Praxis Mutual Funds

Dominic Burke
Investment Director
Lankelly Chase Foundation

Tom McCaney
Associate Director, CSR
Sisters of St. Francis of Philadelphia

Dorrit Lowsen
President & COO
Change Finance

Margaret Weber
Corporate Responsibility Director
Congregation of St. Basil

Sister Ruth Battaglia, CSA
Sustainable Investing Representative
Congregation of Sisters of St. Agnes

James McRitchie
Shareholder Advocate/Publisher
CorpGov.net

Diana Kearney
Senior Legal and Shareholder Advisor
Oxfam America

Tina Ngo
Manager, Credit & Financial Analysis

Other Stakeholders

Dave Wallack
President
For the Long Term

Scott E. Kalb
Director
Responsible Asset Allocator Initiative at New America

Bethan Livesey
Director of Policy
ShareAction

Dr. Ellen Quigley
Advisor to the Chief Financial Officer (Responsible Investment)
University of Cambridge

John Lukomnik
Managing Partner
Sinclair Capital

Katherine Venice
CEO
The Ethical Capitalism Group

Bill Baue
Senior Director
r3.0

SRI Committee
Socially Responsible Investment Committee of the Dominican Sisters of Racine, WI

Fr Seamus Finn OMI
Director
U.S Missionary Oblates of Mary Immaculate

Seamus Finn
FCI Director
Missionary Oblates, OIP Trust

Yoka Verdoner
Retired