

Social Investment Forum

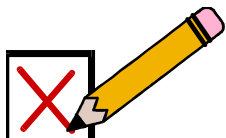
Shareholder Rights Analysis:

The Impact of Proposed SEC Rules on the Resubmission of Shareholder Resolutions

SIF Industry
Research Program

December 10, 1997

Social Investment Forum
1612 K Street NW, Suite 650
Washington, DC 20006
Phone (202)872-5319
Fax (202)822-8471



**Shareholder Rights Analysis:
The Impact of Proposed SEC Rules on the Resubmission of
Shareholder Resolutions**

Publishers

Social Investment Forum
Social Investment Forum Foundation
Co-op America Foundation

Authors

Alisa Gravitz
Elizabeth Elliott McGeveran

Research Director

Rafael Salomon

Project Advisors

Tim Smith, Chair, Project Advisory Board,
Interfaith Center on Corporate Responsibility
Conrad MacKerron, As You Sow Foundation
Steve Schueth, Social Investment Forum
Thomas Van Dyck, Piper Jaffray, Inc.

Project Sponsors

As You Sow Foundation
Calvert Group
Citizen's Trust
George Gay
John Hunting
Jessie Smith Noyes Foundation
Parnassus Investments

Special thanks to Dieter Waizenegger and Chris Bohner at the AFL-CIO,
Trish Feth at Co-op America, and the Investor Responsibility Research Center
for research assistance.

December 10, 1997

CONTENTS

PAGE

I. Executive Summary	1
II. The Shareholder Process: Background	5
III. Methodology	9
IV. Major Findings	12
V. Additional Analysis	17
VI. Recommendations	21
Appendix: Additional Concerns with the SEC's Proposed Rules	22

I. Executive Summary

On September 26, 1997 the United States Securities and Exchange Commission (SEC) proposed new rules to govern the shareholder resolution process.¹ This study examines the impact of the proposed rules governing shareholders' ability to resubmit proposals, a key component of the shareholder resolution process.

This study concludes that the SEC proposed rules for resubmitting shareholder resolutions would debilitate the shareholder resolution process.

The following analysis focuses on the resubmission threshold because it is the only section of the SEC's proposed rules that can be quantitatively tested. In addition to the new resubmission thresholds, the SEC has proposed a number of other changes that will seriously curtail shareholder access to the resolution process. The resubmission thresholds are only one part of a broader package of great concern to the shareholder community. (See Figure I-2, pg.4 and the Appendix.)

This study back tests what would have happened had the proposed resubmission thresholds been in place from 1986 - 1995.² It examines both the increased failure rate and the declining cumulative survival rate of shareholder proposals. This study found:

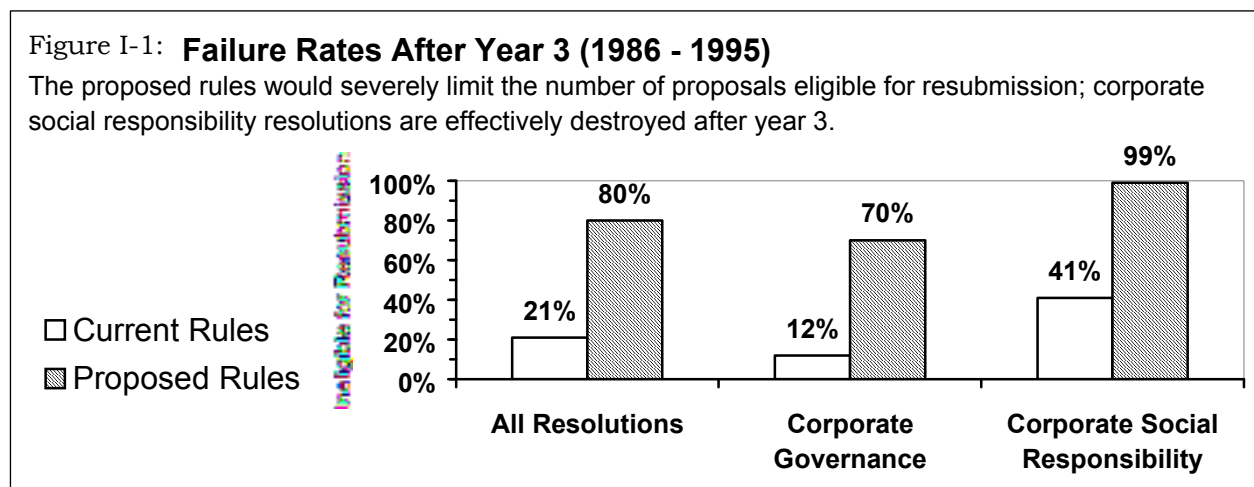
- Overall, **80%** of all shareholder resolutions would not have been eligible for resubmission after year three under the new rules, compared to **21%** under the current rules. This is a **quadrupling** of the failure rate for shareholder resubmissions. (See Figure I-1, pg.2.)
- Of all corporate governance resolutions, **70%** would have failed under the proposed resubmission rules after year three, compared to only **12%** under current rules. In other words, the failure rate for corporate governance resolutions addressing important shareholder issues such as

¹ "Proposed Rule: Amendments to Rules on Shareholder Proposals;" U.S. Securities and Exchange Commission, Release No. 34-39093; IC-22828; File No. S7-25-97.

² This study is based on data from the Investor Responsibility Research Center (IRRC). 1986 to 1995 is the most recent ten-year period for which complete data on both corporate governance and corporate social responsibility were available. Corporate governance resolution data covers the nation's 1,500 largest companies; corporate social responsibility resolution data include virtually all corporate social responsibility resolutions in this ten-year time period.

board structure, voting rights and executive compensation would have increased **six-fold** under the SEC's proposed new rules.

- Corporate social responsibility resolutions would have been totally destroyed; **99%** would have failed after year three, compared to **41%** under current rules. After year two, **91%** would have failed, compared to **28%** under the current rules. Corporate social responsibility resolutions address shareholder concerns on issues such as environmental liabilities, race and gender, tobacco and sweatshops.



- Had the proposed rules been in place from 1986 to 1995, the cumulative survival rate – the number of resolutions that would remain after three years – would have been worse than the year-by-year failure rates:
 - For each 100 new resolutions that came to a vote for the first time in a given year, only **5** would have survived after year three.
 - Of 100 new corporate governance resolutions brought to a vote for the first time, only **15** would have survived after year three.
 - Of 100 new corporate responsibility resolutions, **none** would have survived.
- Under the SEC's proposed rules, shareholders would have been virtually shut out of discussion of key issues that have enormous impact on the reputation and bottom line profitability of a company. After year three under the new rules:
 - 87.3% of cumulative voting resolutions would have failed.
 - 100% of the executive compensation resolutions would have failed.

- 100% of all environmental resolutions would have failed.
 - 100% of all resolutions addressing race and gender issues would have failed.
 - 100% of the South Africa anti-apartheid resolutions would have failed.
- By curtailing the shareholder resolution process, the proposed SEC rules would seriously harm the current climate of healthy dialog, negotiation and compromise between corporations and shareholders. Knowing that shareholders have diminished access, management need only refuse to negotiate and then wait one or two years until the issue dies through the shareholder process.
 - Several years of resubmissions are often required to educate other shareholders and to allow investors, especially larger institutional investors, time to research issues. As shareholders gain a greater understanding of what is at stake, votes have historically increased on both corporate governance and corporate social responsibility resolutions. For example:
 - The average first year vote on classified board voting grew from 13.4% in 1986 to 43% in 1995.
 - The average first year vote on South Africa divestment grew from 4% in 1982 to 13% in 1991.
 - An examination of a range of thresholds, finds that threshold sets of 5%, 10%, 20% and of 5%, 10%, 15% for the first, second and third year votes, are nearly as destructive to the shareholder process as the SEC's proposed rules.
 - A sensitivity analysis demonstrates that small increases in first and second year resubmission thresholds would have doubled and tripled the failure rates for both corporate governance and corporate social responsibility resolutions. It also shows that in order to prevent the majority of corporate social responsibility resolutions from failing, third year thresholds cannot be set higher than 10%.
 - Only a small number of companies face shareholder resolution votes. Of the nation's 1,500 largest companies, an average of 226 companies per year - only 15% - faced votes on shareholder proposals.

- The cost of a shareholder resolution does not appear to be a major burden to a sizable company. According to the SEC, the average company spends \$36,603 to address a shareholder proposal.

Shareholder resolutions – both corporate governance and corporate social responsibility - are of key financial interest to shareholders. When companies fail to address their corporate governance, social issues and environmental performance, the bottom line feels the impact and shareholders suffer. The entire package of proposed rules must meet the mandate of the SEC's mission to protect shareholder rights and the mandate of Congress to increase access to the shareholder process. This study clearly demonstrates that the SEC should not implement the proposed resubmission thresholds.

Figure I-2: Additional Concerns with the SEC's Proposed Rules

- (1) **Resubmission Thresholds (c)(12):** Would more than double the votes needed to resubmit shareholder proposals, from the current 3% after the first year, 6% after the second year, and 9% after the third year, to 6%, 15% and 30%.
- (2) **Personal Grievance (c)(4):** The SEC would withdraw from enforcing its shareholder proposal rule if companies claim a shareholder proponent has a personal grievance. This would allow management to force shareholders to bear the cost and delay of litigation as the price of proxy access.
- (3) **The Relevance Test (c)(5):** Would eliminate the significant policy issue portion of the relevance test that allows issues like child labor and business practices in Northern Ireland to be raised through shareholder resolutions.
- (4) **Reversal of Cracker Barrel (c)(7):** Though the SEC claims it is reversing its controversial 1992 Cracker Barrel ruling barring all proposals on employment and discrimination, the footnotes and explanatory language appears to radically narrow the reversal.
- (5) **Override (c)(5) and (c)(7):** Would require proposals submitted with the support of 3% of the shareholders to appear on the proxy even if they would have been omitted by management. While the 3% level is too high in large cap companies, the principle of an override is vital to maintaining shareholder access to the proxy.
- (6) **Shareholder-Funded Proposals (Rule 14(a)(4)):** Would allow management to seek proxies without giving shareholders the opportunity to vote for proposals that management knows are being brought to the meeting in a solicitation paid for by other shareholders.
- (7) **Review of Company Statements (Rule 14(a)(8)(e)):** The SEC would no longer review management statements in opposition to shareholder proposals for false and misleading content.

II. The Shareholder Process: Background

This section takes a brief look at what the shareholder process and shareholder resolutions are, how they work, how many resolutions there are annually and who utilizes the process.

The Resolutions: What They Are and How They Work

As stockholders and owners of the company, shareholders have both a right and a responsibility to take an interest in the company's performance, policies and practices. The shareholder resolution process provides a formal communication channel from shareholders to management on important matters.

The Securities and Exchange Commission (SEC) regulates the shareholder resolution process. Shareholders who own at least \$1,000 of stock in a given company for one year may file **shareholder resolutions**³ requesting information from management or asking management to consider changes in practices or policies. Resolutions appear on the company's proxy ballot and are voted on at its annual meeting by all shareholders.

Most resolutions are *non-binding requests or recommendations* by shareholders to management. Even with a majority vote, a resolution does not become company policy without management approval.

Proxy voting is not like electoral politics. If an individual or institution does not actively vote their proxies, the votes default to management. Most large institutional investors vote only if they have researched the issues involved. Also, investors who own stocks through mutual funds do not have the ability to vote their shares. Therefore, even relatively low votes through the proxy process often indicate real interest among shareholders.

Many **shareholder proponents**, those who bring shareholder resolutions forward, find that it takes time to educate management, boards of directors and other shareholders about issues of concern. It also often takes time for other shareholders, especially large institutional investors, to research the issues and determine a position. Therefore, SEC rules allow shareholder

³Shareholder resolutions are also known as **shareholder proposals**.

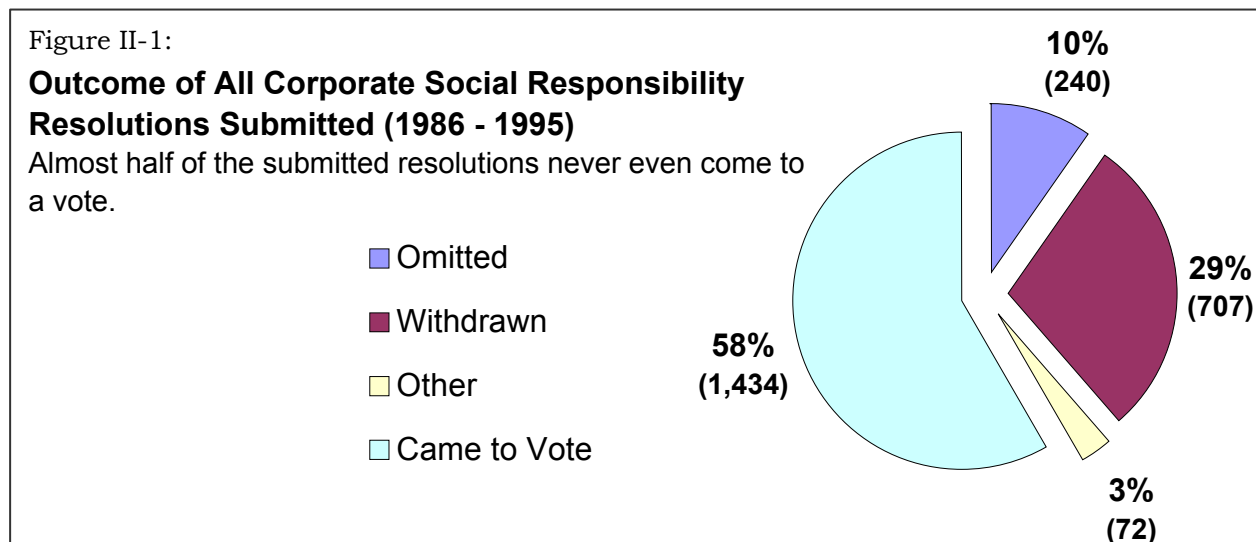
proponents to continue to bring an issue forward as long as **resubmission thresholds** are achieved.

It is interesting to note that many issues never become shareholder proposals because management, knowing that investors have access to the shareholder resolution process, often agrees to discuss issues with investors in order to avoid a proposal.

Even when shareholder proponents decide to file a resolution, they often withdraw proposals when productive discussions with management are underway. The fact that a shareholder resolution has been filed often sparks a fruitful, ongoing dialog between shareholder proponents and management.

Companies also have the right to omit a resolution on a number of grounds, and if a dispute arises, the SEC determines whether to uphold or overrule the omission.

Thus, between withdrawals by proponents and omissions by management or the SEC, many resolutions never come to a vote. In the ten-year period of this study, 2,453 *corporate social responsibility* resolutions were submitted. Of these, 1,434 or 58% came to a vote and are analyzed in this study, 707 or 29% were withdrawn and 240 or 10% were omitted.⁴ (See Figure II-1, below.)



⁴ Due to the larger number of corporate governance resolutions, IRRC only tracks resolutions that come to a vote. A similar analysis of the outcome of all corporate governance resolutions is impossible to produce.

In short, not only is the shareholder process a right and responsibility of shareholders, the existence of the shareholder resolution process also creates a healthy climate of dialog between investors and management. Management-shareholder dialogs have led to many creative outcomes that have provided bottom-line benefits to the performance of the company and thus added value to all shareholders.

The Process: Votes and Costs Faced by Companies

On average, 371 shareholder resolutions came to a vote each year. An even smaller number of companies actually face shareholder resolution votes in any given year. Of the nation's 1,500 largest companies, an average of 226 companies per year, or 15%, faced votes on shareholder proposals from 1986 to 1995.

Over the past ten years, an annual average of 196 new shareholder proposals came to a first-year vote at these 1,500 companies. Of these, 129 per year addressed corporate governance issues and 68 addressed corporate social responsibility issues.

For a sizeable company, the cost of handling a shareholder resolution is reasonable and inexpensive. According to a 1997 SEC survey, an average company that receives shareholder proposals spends \$36,603 per proposal.⁵

The Proponents: Who They Are and What They Care About

The shareholder resolution process is used by individual investors and the nation's largest institutional investors, such as public pension funds and foundations. Investors have an enormous financial stake in a healthy shareholder resolution process.

Traditionally, analysts have classified shareholder resolutions into two categories, corporate governance and corporate social responsibility.

- Corporate governance resolutions address issues such as confidential voting, board of director qualifications, compensation of directors and executives, and board composition.

⁵ "Proposed Rule: Amendments to Rules on Shareholder Proposals," U.S. Securities and Exchange Commission. Release No. 34-39093; IC-22828; File No. S7-25-97, Section V.

- Corporate social responsibility resolutions address issues such as company policies and practices on the environment, health and safety, race and gender, tobacco, sweatshops and other human rights issues.

The analysis in this study has used this traditional classification of shareholder resolutions. However, many issues of concern to shareholders can be described as both corporate governance and corporate social responsibility.

Taken as a whole, the shareholder resolution process helps to maintain a healthy, reasonable and responsible dialog between shareholders and management. When companies fail to address their governance, environmental and social impact problems, shareholders often suffer. For example, Texaco management's failure to deal with workplace discrimination cost shareholders over \$150 million to settle a legal suit. In addition, companies like Home Depot, Shoney's and Denny's have recently been forced to pay hundreds of millions of dollars in response to lawsuits over discrimination and employment.

A healthy shareholder process is integral to the democratic free-market system. It is a market-based approach preferable to the alternatives of legislation or litigation. The shareholder resolution process is an investor right and responsibility. Protecting these rights is the mandated mission of the SEC.

III. Methodology

This section describes the SEC proposal analyzed in this report and the methodology used in the analysis.

SEC Proposal on Resubmission Thresholds

Under existing SEC rules, a shareholder resolution may be resubmitted for consideration at a company's annual meeting and for inclusion on the proxy ballot if:

- after the first year of submission, it garners at least 3% of the shareholder vote;
- after the second year of submission, it garners at least 6% of the shareholder vote; and
- after the third year of submission, it garners at least 10% of the shareholder vote.

The SEC proposes to double the resubmission thresholds for years one and two, and triple it in year three. The proposed SEC rules would raise the resubmission thresholds to:

- 6% in the first year of submission;
- 15% in the second year of submission; and
- 30% in the third year of submission.

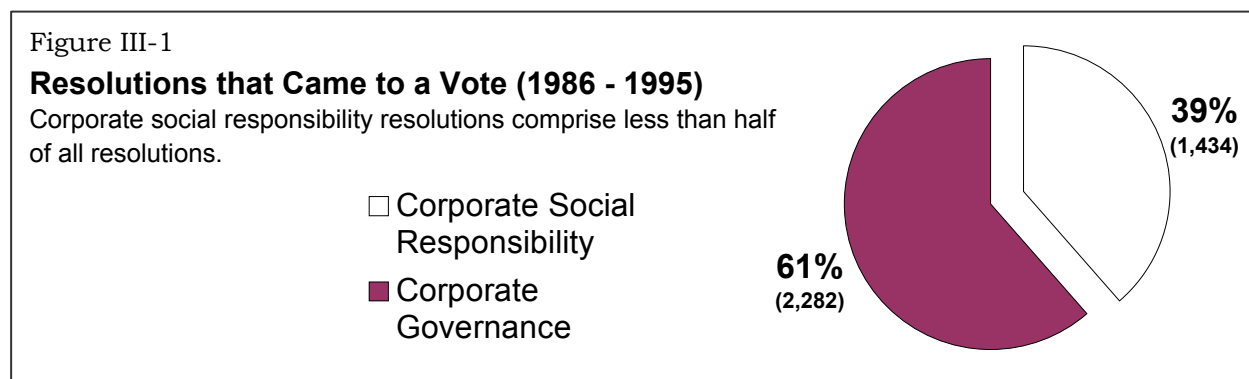
Methodology

This study analyzes the impact of the proposed increase in the SEC's resubmission thresholds. Using data for the ten-year period 1986 – 1995, it back tests what would have happened had these proposed rules been in place. It examines the increase in the **failure rate** due to the proposed rules, how many more shareholder resolutions would have failed to pass the new resubmission thresholds. It also determines the **cumulative survival rate** if the proposed rules had been in place, how many proposals would have survived after three rounds of submission.

A straightforward, robust methodology was used for the study:

- (1) Data Source: The analysis in this study utilized data from the Investor Responsibility Research Center (IRRC).⁶ It covers 1986 – 1995, the most recent ten-year period for which complete data on both corporate governance and corporate social responsibility voting were available. Corporate governance data covers the nation’s largest 1,500 publicly traded companies; corporate social responsibility data include virtually all corporate social responsibility resolutions in this ten-year time period. The entire data set is comprised of 3,716 resolutions that came to a vote in this ten-year period. (See Figure III-1, below.)
- (2) Database Construction: A database was created that included the following information for each resolution that came to a vote: Date of vote, type of resolution (corporate governance or corporate social responsibility), subject of resolution and percentage of shareholders that voted for the resolution. (See Figures III-2 and III-3, pg. 11, for a breakout of the resolutions by type, subject and percentage of vote.)
- (3) Analysis: Using the database, the results in this study were compiled by a simple count of which resolutions passed and which failed under both existing and proposed resubmission threshold rules.

The ten-year time period and the significant size of the database allow a robust analysis. The methodology allows a direct comparison between the existing and proposed rules on resubmission thresholds. It also allows the analysis of alternative resubmission thresholds.



⁶ The Investor Responsibility Research Center is a nonpartisan, research firm that has compiled a comprehensive database of shareholder resolutions and tracked ongoing and emerging shareholder issues for 25 years.

Figure III-2

Corporate Governance Resolutions by Subject (1986 – 1995)

Subject	Number	Percentage
Annual Meeting	70	3.1%
Board Diversity	31	1.4%
Board Structure / Composition	41	1.8%
Confidential Voting	209	9.2%
Cumulative Voting	314	13.8%
Director Compensation	65	2.8%
Director Elections	54	2.4%
Discretionary Voting	12	0.5%
Director Tenure	55	2.4%
Executive Compensation	256	11.2%
Golden Parachute	82	3.6%
Independent Directors	27	1.2%
Independent Nominating Committee	29	1.3%
Minimum Stock Ownership	95	4.2%
Other	287	12.6%
Poison Pill	218	9.6%
Repeal Classified Board	402	17.6%
Sell Company / Spin Off / Hire Investment Banker	26	1.1%
Separate CEO and Chairman	9	0.4%
TOTAL	2,282	100%

Figure III-3

Corporate Social Responsibility Resolutions by Subject (1986 – 1995)

Subject	Number	Percentage
Animal Rights	40	2.8%
Banking	47	3.3%
Energy / Environment	264	18.4%
Health	23	1.6%
Human / Political Rights	10	0.7%
Military / Weapons	119	8.3%
Northern Ireland	131	9.1%
Other	14	1.0%
Political / Charitable Contributions	44	3.1%
Race / Gender	50	3.5%
Sweatshops	27	1.9%
South Africa	572	39.9%
Tobacco	67	4.7%
Workforce Issues	26	1.8%
TOTAL	1,434	100%

IV. Major Findings

This section presents the major findings of the study. First, it provides data on the impact of the SEC's proposed resubmission thresholds on all the shareholder proposals that came to a vote in the ten-year period covered in this study. Then it examines the impact of the proposed thresholds on new and emerging issues.

Direct Impact of the SEC's Proposed Resubmission Thresholds

The SEC's proposed resubmission thresholds would dramatically alter the shareholder resolution process. By raising the thresholds from 3%, 6% and 10% for the first, second and third votes, respectively, to 6%, 15% and 30%, the proposed rules would have disqualified a majority of the resolutions that passed under the existing thresholds over the past ten years. Significant findings include:

- Under the proposed rules, the failure rate for all shareholder resolutions would have nearly tripled in the first year, more than tripled in the second year and quadrupled in the third year. After year three, over 80% of all shareholder resolutions would have been ineligible for resubmission, compared to only 21% of third-year resolutions under the current rules. (See Figure IV-1, pg. 13.)
- The dramatically increased failure rates would have seriously impaired corporate governance resolutions. Under the proposed rules, 70% of all corporate governance resolutions would have failed in their third year, as opposed to only 12% under today's rules. (See Figure IV-2, pg. 13.)
- Corporate social responsibility resolutions would essentially be destroyed under the proposed rules. Failure rates under the proposed rules would have quadrupled after year one, tripled after year two and doubled after year three. Under the proposed rules, 99% of corporate social responsibility resolutions would have failed after year three, compared with only 41% under the existing rules. (See Figure IV-3, pg. 13.)

Figure IV-1: **Overall Failure Rates (1986 - 1995)**

The proposed rules would quadruple the overall shareholder proposal failure rate to 80% after year 3

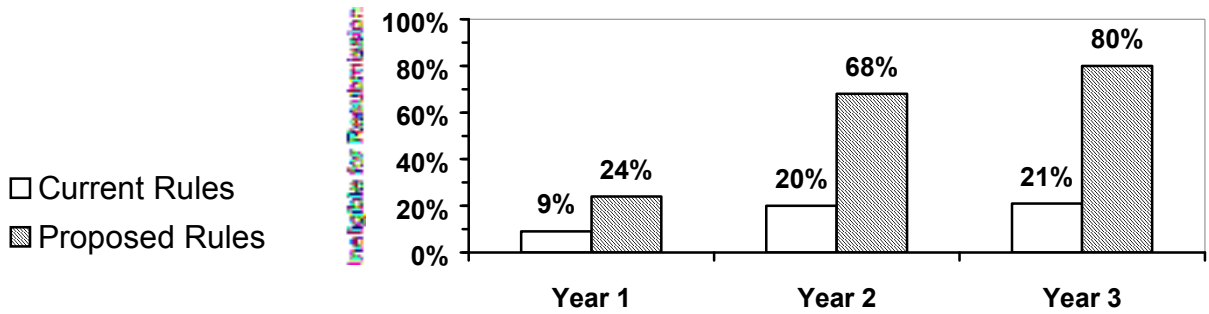


Figure IV-2: **Corporate Governance Failure Rates (1986 - 1995)**

The proposed rules would increase corporate governance resolution failure rates six-fold after year 3.

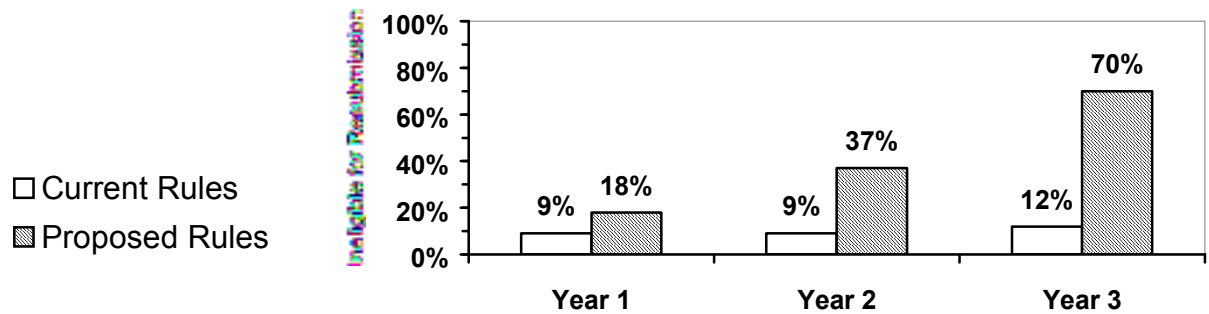
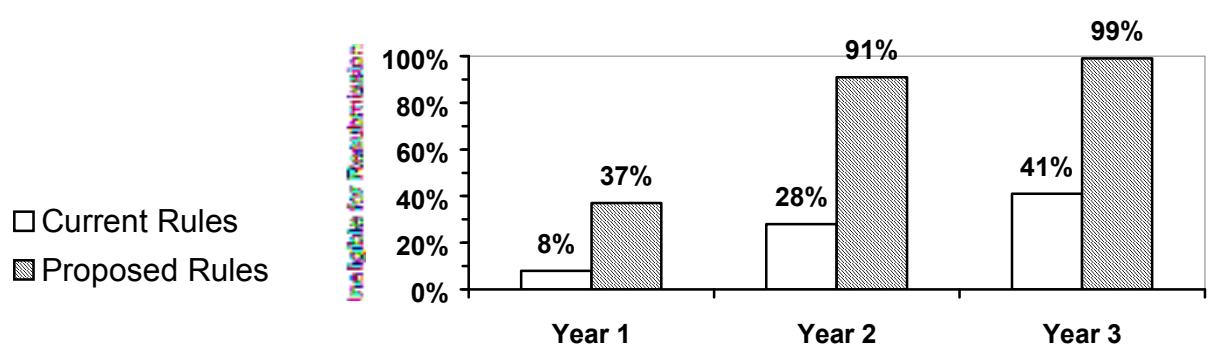


Figure IV-3: **Corporate Social Responsibility Failure Rates (1986 - 1995)**

The proposed rules would effectively end social responsibility resolutions after year 2.



Cumulative Impact of the SEC's Proposed Resubmission Thresholds

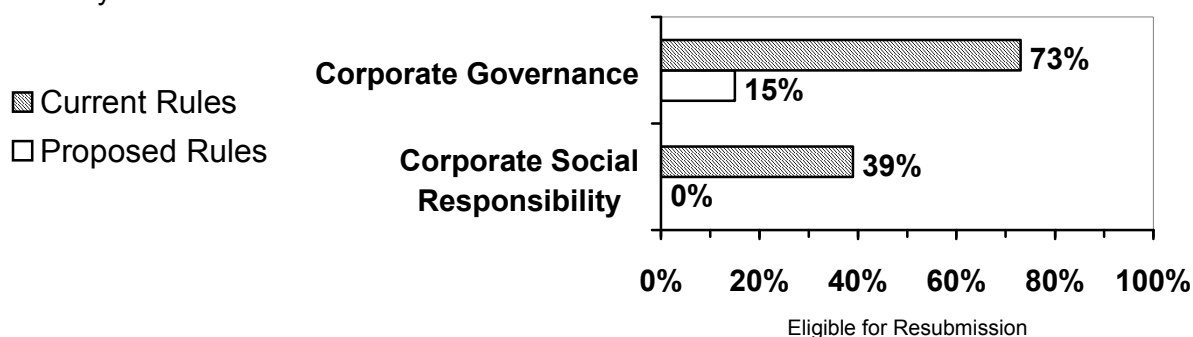
Due to the fact that resubmission in years two and three depends on the percentage of votes cast in favor of a resolution in years one and two, higher failure rates will have a more significant cumulative impact than the year-by-year analysis indicates. The year-by-year back tested failure rates *do not* reflect the fact that the proposed thresholds would have reduced the number of resolutions resubmitted in years two and three; examining the cumulative survival rates provides insights into this effect. The cumulative data clearly shows that had the proposed rules been in place between 1986 and 1995:

- For every 100 resolutions coming to a vote for the first time, only 5 would have survived after year three.
- For every 100 new corporate governance resolutions, 15 would have survived after year three.
- For every 100 new corporate responsibility resolutions, none would have survived after year three.

Survival rates under the proposed rules would be dramatically lower than the actual survival rates under the current rules. Between 1986 and 1995, for every 100 new resolutions that came to a vote, 57 survived. Under the existing rules, corporate governance resolutions had a cumulative survival rate of 73%, while 39% of all corporate social responsibility resolutions survived after year three. (See Figure IV-4, below.)

Figure IV-4: **Cumulative Effect of Proposed and Current Resubmission Thresholds, Survival Rate After Year 3**

Under the proposed rules none of the corporate social responsibility resolutions would survive year 3.



Hidden Effects: Dialog and Shareholder Education

Not only would the SEC's proposed resubmission thresholds increase the failure rates in each year and lower the cumulative survival rate of resolutions, but they would be likely to create several other effects that are impossible to quantify with the back test methodology used in this study.

By dramatically reducing the staying power of resolutions, the SEC's proposed rules will reduce the corporate incentive to dialog. Resubmission thresholds are most likely inversely proportionate to the willingness of management to problem-solve with owners. Shareholder proponents expect that dramatic increases in failure rates will coincide with an increasing unwillingness of management to enter into productive conversation on difficult, but crucial issues.

The impact of the SEC's proposed new resubmission thresholds is so severe that corporations may simply refuse to dialog with shareholders, knowing that they no longer have access to the resolution process. Management need only refuse to negotiate and then wait one or two years until the issue dies through the shareholder process.

Another unquantifiable result of higher failure rates will likely be a decrease in the ability to educate fellow shareholders on emerging issues and concerns affecting the business environment. Certain shareholders, because of their unique institutional knowledge or cutting-edge research in their own fields, may have access to information and insights on emerging issues that could have a significant positive impact on company reputation and profitability. If the general public, management and shareholder knowledge about such issues is low, these resolutions may garner low proxy votes at first. Under the current rules, these issues can stay in play while the public, management and other shareholders learn about them – possibly preventing major problems for a company. However, under the new rules, these issues would be cut out of the shareholder process. Examples of issues over the past ten years that enjoyed increasing public education and shareholder votes include classified board voting, independent directors, separating the chairperson and CEO, refusing to do business in Apartheid South Africa and environmental performance measures. For example:

- The average first year vote on classified board voting grew from 13.4% in 1986 to 43% in 1995.
- The average first year vote on South Africa divestment grew from 4% in 1982 to 13% in 1991.

Shareholders exercising their right to submit resolutions urge corporate managers to choose policies and practices that will enhance the well being of all stakeholders. Therefore, shareholders advancing traditional corporate governance and corporate social responsibility resolutions are indistinguishable in terms of their desire to improve the bottom-line and reputation of a company over time. Shareholder resolutions are utilized by a diverse and broad base of concerned shareholders. Over the ten-year period of this study, a number of diverse and important resolutions came to a vote. (See Figures III-2 and III-3, pg. 11.)

Shareholder resolutions have played a key role in advancing important business issues over the past 20 years. Resolutions have helped to prevent boycotts, avoid environmental liabilities, improve management incentives, curtail public relations quagmires and much more. The shareholder resolution process that led the South African divestment movement has been credited in helping to destroy Apartheid, and shareholder resolutions have helped advance fair labor practices in Northern Ireland. Under the proposed rules shareholder work on a variety of key business issues would have been entirely curtailed. After year three:

- 87.3% of cumulative voting resolutions would have failed.
- 91% of all resolutions addressing fair labor practices in Northern Ireland would have failed.
- 100% of executive compensation resolutions would have failed.
- 100% of all environmental resolutions would have failed.
- 100% of all resolutions addressing race and gender would have failed.
- 100% of all resolutions addressing sweatshop issues would have failed.
- 100% of South African anti-apartheid resolutions would have failed.

V. Additional Analysis

The analysis presented in the last section shows that, if implemented, the SEC's proposed rules on resubmission thresholds – 6%, 15% and 30% for the first, second and third year votes – would essentially destroy the shareholder resolution process.

Figure V-1, pg. 19, summarizes the data presented so far. It shows that 70% of all corporate governance resolutions and 99% of all corporate social responsibility resolutions would have failed by year three under the proposed rules. On a cumulative basis, this means that only 15 of every 100 corporate governance resolutions would have survived, and *no* corporate social responsibility resolutions would have survived.

This section analyzes the impact of other thresholds on the shareholder resolution process and presents a sensitivity analysis on thresholds in both the earlier and later years.

Threshold Analysis

What would the impact of other thresholds be on the shareholder resolution process? An analysis of several different threshold sets shows that:

- 5% - 10% - 20%: Resubmission thresholds of 5%, 10% and 20% for the first, second and third year's votes, are nearly as destructive to the shareholder process as those proposed by the SEC. Overall, failure rates double and triple from current levels. The three-year cumulative survival rate is only 17 out of 100 resolutions. Just as in the case of the proposed SEC thresholds, the 5%, 10% and 20% set destroys the resolution process for corporate social responsibility issues. The across-the-board failure rate is 64% after year two and nearly total failure, 97% after year three. For each 100 new corporate responsibility resolutions, barely one survives after three years (0.8 rounded to 1).
- 5% - 10% - 15%: Thresholds of 5%, 10% and 15% for the first, second and third votes, would also debilitate the shareholder process. This set of thresholds would double and triple the failure rates for both corporate governance and corporate social responsibility resolutions – and in some cases, quadruple the failure rates. This set of thresholds would deal a particularly hard blow to the corporate social responsibility issues, causing across-the-board failure rates of 64% after year two and 84% after year three. With this threshold set, the cumulative three-year

survival rate would only be 4 out of every 100 corporate social responsibility resolutions.

- 4% - 8% - 12%: Thresholds of 4%, 8% and 12% for the first, second and third votes, respectively, continue to be problematic for the shareholder resolution process. Failure rates for the corporate social responsibility resolutions are 48% after the second vote and 57% after the third vote. The three-year cumulative survival rate is only 19%. Even for this relatively modest increase over the current thresholds, 4%, 8%, and 12% thresholds on corporate social responsibility resolutions are destructive.

Sensitivity Analysis

A sensitivity analysis examining the impact of small changes in first, second and third year votes finds that:

- Changes in first and second year thresholds: Small increases in first and second year resubmission rates would double and triple the failure rates for both corporate governance and corporate social responsibility resolutions. For example, increasing the first year resubmission threshold from 3% to 5% would double the failure rate for corporate governance resolutions and triple the failure rate for corporate social responsibility resolutions. Increasing the second year threshold from 6% to 8% would nearly double the failure rate for both corporate governance and corporate social responsibility resolutions.
- Changes in third year thresholds: Corporate social responsibility resolutions suffer the most from changes to the third year threshold. Failure rates increase rapidly if the third year threshold rises above 10%. For example, if the third year failure rate were increased from 10% to 12%, corporate social responsibility failure rates would increase from 41% to 57%. At a 15% third-year threshold, the failure rates would skyrocket to 84%. In order to prevent the majority of corporate social responsibility resolutions from failing, the third-year threshold cannot be set higher than 10%.

Figure V-1:

Comparison of Existing and Proposed SEC Resubmission Thresholds (1986-1995)

Failure Rates for ALL Resolutions Under Existing & Proposed Rules (1986-95)			
	% failing current rules	% failing proposed rules	comments
1st Year Vote	9%	24%	Failure rates almost triple under new rules
2nd Year Vote	20%	68%	Failure rates more than triple under new rules
3rd YearVote	21%	80%	Failure rates quadruple under new rules

Failure Rates for Corporate Governance Resolutions Under Existing & Proposed Rules (1986-95)			
	% failing current rules	% failing proposed rules	comments
1st Year Vote	9%	18%	Failure rates double under new rules
2nd Year Vote	9%	37%	Failure rates quadruple under new rules
3rd Year Vote	12%	70%	Failure rates are six times greater under new rules

Failure Rates for Corporate Social Responsibility Resolutions Under Existing & Proposed Rules (1986-95)			
	% failing current rules	% failing proposed rules	comments
1st Year Vote	8%	37%	Failure rates more than quadruple under new rules
2nd Year Vote	28%	91%	Failure rates more than triple and only 9% survive
3rd Year Vote	41%	99%	Failure rates are more than double - almost NONE survive

Cumulative SURVIVAL Rates: For every 100 new resolutions proposed, the % SURVIVING after 3 years		
<u>Type of Resolution</u>	<u>Current Rules</u>	<u>Proposed Rules</u>
All	57%	5%
Corporate Governance	73%	15%
Corporate Social Responsibility	39%	0%

Figure V-2

Comparison of Resubmission Threshold Alternatives (1986 - 1995)

	Resubmission Vote	Threshold	All Resolutions	Corporate Social Responsibility	Corporate Governance
Total # of Resolutions Voted	1st Year Vote	----	1,962	677	1,285
	2nd Year Vote	----	714	412	302
	3rd Year Vote	----	1,040	345	695
Current Rules	1st Vote Failure Rate	3%	9%	8%	9%
	2nd Vote Failure Rate	6%	20%	28%	9%
	3rd Vote Failure Rate	10%	21%	41%	12%
	<i>Cumulative 3-year Survival Rate</i>	----	57%	39%	73%
Proposed Rules	1st Vote Failure Rate	6%	24%	37%	18%
	2nd Vote Failure Rate	15%	68%	91%	37%
	3rd Vote Failure Rate	30%	80%	99%	70%
	<i>Cumulative 3-year Survival Rate</i>	----	5%	0%	15%
5%-10%-20% Threshold Set	1st Vote Failure Rate	5%	18%	24%	15%
	2nd Vote Failure Rate	10%	46%	64%	22%
	3rd Vote Failure Rate	20%	61%	97%	40%
	<i>Cumulative 3-year Survival Rate</i>	----	17%	1%	40%
5%-10%-15% Threshold Set	1st Vote Failure Rate	5%	18%	24%	15%
	2nd Vote Failure Rate	10%	46%	64%	22%
	3rd Vote Failure Rate	15%	45%	84%	25%
	<i>Cumulative 3-year Survival Rate</i>	----	24%	4%	50%
4%-8%-12% Threshold Set	1st Vote Failure Rate	4%	13%	15%	11%
	2nd Vote Failure Rate	8%	34%	48%	15%
	3rd Vote Failure Rate	12%	30%	57%	17%
	<i>Cumulative 3-year Survival Rate</i>	----	40%	19%	63%

VI. Recommendations

The analysis in this study leads to the following recommendations:

- (1) The proposed SEC rules on resubmission thresholds should not be implemented. These proposed rules would virtually destroy the shareholder resolution process. Had the proposed rules been in effect during the past decade, the vast majority of shareholder resolutions would have failed. On a cumulative three-year basis, only 15 out of 100 corporate governance resolutions would have survived the proposed rules, and no corporate social responsibility resolutions would have survived. Resubmission thresholds that would produce such dramatic, anti-shareholder results must not go forward.
- (2) The entire package of proposed rules must meet the mandate of the SEC's mission to protect shareholder rights and the mandate of Congress to increase access to the shareholder process.

Appendix:

Additional Concerns with the SEC's Proposed Rules

Although this report provides a detailed quantitative analysis of the impact of the SEC's proposed new resubmission thresholds, there are a number of proposed changes that will adversely affect shareholder access to the resolution process. Major concerns with the proposed rules include:

- (1) **Resubmission Thresholds (c)(12):** Would more than double the votes needed to resubmit shareholder proposals, from the current 3% after the first year, 6% after the second year, and 9% after the third year, to 6%, 15% and 30%.
- (2) **Personal Grievance (c)(4):** The SEC would withdraw from enforcing its shareholder proposal rule if companies claim a shareholder proponent has a personal grievance. This would allow management to force shareholders to bear the cost and delay of litigation as the price of proxy access. The SEC should continue to enforce shareholders' rights to access the proxy.
- (3) **The Relevance Test (c)(5):** Would eliminate the significant policy issue portion of the relevance test that allows issues like child labor and business practices in Northern Ireland to be raised through shareholder resolutions. The Commission should continue its current two-pronged relevance test.
- (4) **Reversal of Cracker Barrel (c)(7):** Though the SEC claims it is reversing its controversial 1992 Cracker Barrel ruling barring all proposals on employment and discrimination, the footnotes and explanatory language appears to radically narrow the reversal. Cracker Barrel needs to be fully reversed, with no countervailing footnotes or language.
- (5) **Override (c)(5) and (c)(7):** Would require proposals submitted with the support of 3% of a company's shareholders to appear on the proxy even if they would have been omitted by management. While the 3% level is too high in large cap companies, the principle of an override is vital to maintaining shareholder access to the proxy process.

- (6) **Shareholder-Funded Proposals (Rule 14(a)(4)):** Would allow management to seek proxies without giving shareholders the opportunity to vote for proposals that management knows are being brought to the meeting in a solicitation paid for by other shareholders. The SEC should continue requiring persons soliciting proxies to give all shareholders the opportunity to vote for or against all items that will be raised at the annual meeting.
- (7) **Review of Company Statements (Rule 14(a)(8)(e)):** The SEC would no longer review management statements in opposition to shareholder proposals for false and misleading content. This procedure is important and virtually costless and should be maintained.

About the Publishers

Social Investment Forum

The Social Investment Forum is a national nonprofit membership organization of institutional investors and professionals actively involved in the socially responsible investment industry. The Forum is dedicated to promoting the concept, practice and growth of socially and environmentally responsible investing.

Social Investment Forum Foundation

The Social Investment Forum Foundation is a national nonprofit organization providing research and educational programs on socially responsible investing. It provides cutting-edge research on the trends, practice, performance and impact of social investing.

Co-op America

Co-op America is a national nonprofit consumer education organization providing consumers and investors information on how they can use their purchases and investments to create a better world. Co-op America publishes the nationally acclaimed *Financial Planning Handbook for Responsible Investors*.

Extra copies of this report may be ordered from:

Social Investment Forum
1612 K Street NW, Suite 650
Washington, DC 20006
202-872-5319

This report may also be found on the World Wide Web at:

www.socialinvest.org

Additional information on social investing can be found at:

www.socialinvest.org
www.coopamerica.org