SIDLEY

SIDLEY AUSTIN LLP
787 SEVENTH AVENUE
NEW YORK, NY 10019
+1 212 839 5300
+1 212 839 5599 FAX

AMERICA • ASIA PACIFIC • EUROPE

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January 15, 2019

Office of the Secretary
Federal Trade Commission
600 Pennsylvania Avenue NW
Suite CC-5610 (Annex C)
Washington, DC 20580

Re: FTC Hearing #8: Competition and Consumer Protection: Corporate Governance, Institutional Investors, and Common Ownership

Dear Mr. Secretary:

Thank you for the opportunity to comment on the potential anticompetitive impact of common ownership by large institutional investors of non-controlling interests in companies that compete in concentrated industries. I participated in the panel on Institutional Investors, Diversification, and Corporate Governance at the December 6, 2018 hearing. I am submitting my prepared remarks to augment the comments I made on the panel which were shortened due to time constraints.

Prepared Remarks

Thank you for inviting me to share a corporate governance lawyer's[1] perspective on the governance implications of common ownership.[2]

As co-chair of Sidley Austin's global corporate governance practice, I advise corporate boards on the full range of governance issues including engagement with institutional investors and

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[1] Holly J. Gregory is a partner at Sidley Austin LLP, where she is co-chair of the Global Corporate Governance & Executive Compensation Practice. She is the immediate past chair of the American Bar Association Business Law Section's Corporate Governance Committee. Rebecca Grapsas, Counsel at Sidley Austin LLP in the Global Corporate Governance & Executive Compensation Practice, assisted in the preparation of these remarks.

[2] "Common ownership" refers to "the simultaneous ownership of stock in competing companies by a single investor, where none of the stock holdings is large enough to give the owner control of any of those companies." Note submitted by the United States to the OECD for December 6, 2017 OECD Hearing on Common Ownership by Institutional Investors and Its Impact on Competition, (Nov. 28, 2017) at 2.

other shareholders. I have not advised anyone on the subject matter of this hearing nor have I been retained by anyone to participate on this panel. The views I express are my own and not for attribution to Sidley Austin LLP or any of our clients.

I understand that interest in the potential anticompetitive effects of common ownership has emerged from several studies that suggest a correlation between common ownership and higher prices in certain concentrated industries.[3] I also understand that the empirical evidence is under development and debate,[4] yet proposals have been made to restrict the ownership stakes of institutional investors within an industry.[5]

I will make four observations from a corporate governance perspective:

First: While institutional investor influence on publicly traded corporations has increased considerably in the past twenty years, the subjects of this influence -- as evidenced by the topics on which they vote and engage -- do not typically include ordinary course business decisions such as the prices to charge, or the products to offer.

Second: Both institutional investors and the proxy advisors who make recommendations on how these investors should exercise their advisory vote on executive compensation heavily emphasize -- as reflected in their proxy voting policies -- that executive compensation should be aligned with company performance relative to their peers (including competitors) and not with industry-wide performance. In other words, institutional investors expressly pressure boards of directors to link management's incentive compensation to success in outperforming competitors.

Third: The topics on which corporations and their institutional investors engage is heavily influenced by legal concerns, including the need to strictly comply with federal securities and antitrust laws and regulations. In preparation for engagement with investors, corporate directors and managers are advised by legal counsel. Focused attention by counsel in line with written

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[3] Jose Azar, Martin C. Schmalz & Isabel Tecu, Anticompetitive Effects of Common Ownership, 73 J. of Fin. 1513 (August 2018) (airlines); Jose Azar, Sahil Raina & Martin C. Schmalz, Ultimate Ownership and Bank Competition (Jul. 23, 2016) (commercial banking), *available at* http://ssrn.com/abstract+2710252. For a review of this literature see Martin C. Schmalz, Common Ownership, Concentration and Corporate Conduct, SSRN Scholarly Paper ID 3165340 (Soc. Sci. Res. Network), Feb. 26, 2018.

[4] Edward B. Rock & Daniel L. Rubinfeld, Antitrust for Institutional Investors, 82 Antitrust L. J. 221 (2018); C. Scott Hemphill & Marcel Kahan, The Strategies of Anticompetitive Common Ownership at 6 (August 1, 2018; last revised December 17, 2018), NYU Law and Economics Research Paper No. 18-29; European Corporate Governance Institute (ECGI) - Law Working Paper No. 423/2018, *available at* https://ssrn.com/abstract=3210373.

[5] Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, A Proposal to Limit the Anticompetitive Power of Institutional Investors, 81 Antitrust L. J. 669, at 724 (2017) (proposing that "no institutional investor invested in more than a single (effective) firm in an oligopoly may own more than 1 percent of the industry or [if they do] communicate with its managers"); Edward B. Rock & Daniel L. Rubinfeld, Antitrust for Institutional Investors, 82 Antitrust L. J. 221 (2018) (proposing "a quasi 'safe harbor' of 15 percent, so long as investors engage only in "normal" corporate governance activities.").

SEC and other guidance on engagement activity undermines the notion that engagement is a means through which investors encourage companies to soften their competition or through which companies communicate confidential information about their competitive plans.

Fourth: Institutional investor engagement with portfolio companies has contributed to decisions by corporate boards to improve corporate governance practices, and to provide greater transparency into board decision-making.

My first three observations lead me to conclude that it is unlikely that large institutional investors having common ownership in concentrated industries are using shareholder proposals, shareholder voting and shareholder engagement to press portfolio companies into anti-competitive conduct. (I also note that regulators already have tools to address intentional anticompetitive conduct should evidence of specific instances of such conduct arise.[6])

To the extent that even absent intentional conduct, anticompetitive effects arise where there is common ownership,[7] policy makers will face difficult tradeoffs given the benefits that institutional investors provide by satisfying consumer interests in diversified investment vehicles for retirement and college savings, and by engaging on corporate governance matters with portfolio companies.

[6] "If an institutional investor were to orchestrate an anticompetitive agreement between two direct competitors, both competitors and the investor could be liable for a per se violation of the antitrust law. Similarly, passing competitively sensitive information between competitors through an institutional investor could expose the companies and the investor to liability." Note submitted by the United States to the OECD for December 6, 2017 OECD Hearing on Common Ownership by Institutional Investors and Its Impact on Competition, (Nov. 28, 2017) at 3.

[7] Einer Elhauge, Horizontal Shareholding, 129 Harv. L. Rev. 1267, at 1270 (2016) ("The anticompetitive incentive created by this horizontal shareholding is purely structural ...."). *But see, e.g.*, C. Scott Hemphill & Marcel Kahan, The Strategies of Anticompetitive Common Ownership at 6 (August 1, 2018; last revised December 17, 2018), NYU Law and Economics Research Paper No. 18-29; European Corporate Governance Institute (ECGI) - Law Working Paper No. 423/2018, *available at* https://ssrn.com/abstract=3210373 ("Missing from the debate thus far is an explication and assessment of the causal mechanisms that might link common ownership to higher prices. ... Identifying the mechanism is important because its absence would raise doubts about proponents' preferred interpretation of the statistical relationship between price and ownership structure."). Hemphill and Kahan conclude that the studies to date do not establish a specific causal mechanism, institutional investors generally have much weaker incentives than reform proponents presume to maximize the aggregate value of their portfolio securities and many of the posited mechanisms entail significant legal and reputational risk reducing the likelihood they would be employed. "Given the absence of a clear mechanism as well as the unsettled state of the empirical literature, we consider the case for broad reform to be not proved. Moreover, we disagree with the view that mechanism identification can or ought to be simply dispensed with, or that reform efforts or enforcement actions against institutional investors should simply charge ahead in the meantime." Id. at 68.

1. Shareholders' Decision Rights & Influence Do Not Extend to Ordinary Business Matters

While institutional investor influence on publicly traded corporations has increased considerably in the past twenty years, the subjects of this influence -- as evidenced by the topics on which they vote and engage -- do not typically extend to ordinary course business decisions by portfolio companies such as the prices to charge or the products to offer.

Under state law,[8] shareholder decision rights are generally limited to a short list of fundamental matters that transcend the direction and management of the business (which is the responsibility of the board of directors[9]), such as electing directors, amending the certificate of incorporation and the bylaws, and approving significant corporate transactions such as mergers, consolidations, or the sale of substantially all of the assets.[10] In addition, shareholders of New York Stock

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[8] Shareholder decision rights and board responsibilities are governed by the corporate law of the state of incorporation under the internal affairs doctrine. This conflict of laws principle "recognizes that only one State should have the authority to regulate a corporation's internal affairs -- matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders -- because otherwise a corporation could be faced with conflicting demands." Edgar v. MITE Corp., 457 US 624 (1982). While the corporate laws of the 50 states vary to some degree, due to the large proportion of publicly traded companies incorporated in Delaware -- more than 66% of the Fortune 500, according to the Delaware Division of Corporations -- Delaware General Corporation Law ("DGCL") and related court decisions serve as the primary reference for this discussion together with the Model Business Corporation Act (2016 Revision) (the "MBCA"). The MBCA is a model statute drafted and annotated by the Committee on Corporate Laws of the Business Law Section of the American Bar Association ("ABA"). The MBCA has been "substantially adopted by a majority of states." ABA Press Release: Model Business Corporation Act (2016 Revision) Launches (September 19, 2018), available at https://www.americanbar.org/groups/business_law/publications/blt/2017/01/08_mbca/.

[9] "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation." DGCL Section 141(a); accord, MBCA Section 8.01(b).

[10] Subject to the terms of a corporation's articles and bylaws as to certain rights, shareholder rights generally include electing directors (DGCL Sections 141(d), 211(b) & 216; MBCA Sections 8.03(c) & 10.22), filling board vacancies (DGCL Section 223(a); MBCA Section 8.10), removing directors (DGCL Section 141(k); MBCA Section 8.08), amending the certificate of incorporation (DGCL Section 242; MBCA Section 10.03), amending the bylaws (DGCL Section 109(a); MBCA Section 10.20), and approving significant corporate transactions such as mergers, consolidations (subject to exceptions) (DGCL Section 251; MBCA Section 11.04) or the sale, lease or exchange of all or substantially all of the assets (DGCL Section 271; MBCA Section 12.02). Other issues that may be brought to shareholder vote include ratifying defective corporate acts that would have required shareholder approval (DGCL Section 204(c); MBCA Sections 1.47(c) & 1.48), approving certain business combinations with interested shareholders that would otherwise be prohibited (DGCL Section 203(a)(3)), approving conversion to a different type of entity (DGCL Section 266; MBCA Section 9.32), transfer, domestication or continuance in a foreign jurisdiction (DGCL Section 390; MBCA Section 9.21), and dissolution and revocation of dissolution (DGCL Sections 275 and 311; MBCA Sections 14.02 and 14.03). Shareholders may also be asked by the board to approve interested director or officer transactions, (DGCL Section 144(a)(2); MBCA Section 8.63 and 8.70), indemnification of a director or officer (DGCL Section 145(d)(4); MBCA Section 8.55(b)(c)), and the consideration for which shares of stock with or without par value may be issued and treasury stock disposed of if so provided in the charter (DGCL Section 153; MBCA Section 6.21). Also by operation of state law, shareholders may bring actions on behalf of the company

Exchange and Nasdaq listed companies must approve equity compensation plans and certain share issuances.[11]

Outside of their limited decision rights, shareholders cannot dictate the actions of the corporation's board or officers who, as fiduciaries, are required to make their own judgments in "managing the business and affairs of the corporation."[12]

Shareholder influence comes in large measure from their ability under federal law and regulation to bring non-binding shareholder proposals in company proxy materials[13] and also to have an advisory vote on executive compensation and on "golden parachute" compensation.[14] Publicly traded companies face significant pressure to address compensation issues when the shareholder vote does not significantly support the board's approach to executive compensation issues and

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(derivative actions) for breaches of director fiduciary duties (DGCL Section 327; MBCA Section 7.41), seek access to corporate books and records (DGCL Section 220; MBCA Section 16.02) and request the Court of Chancery to appoint a custodian if the directors are deadlocked or acting fraudulently or a receiver if the company is insolvent (DGCL Sections 226 and 291; MBCA Section 7.48).

[11] NYSE Listed Company Manual Sections 303A.08, 312.03; Nasdaq Rule 5635. Many listed companies provide shareholders with the opportunity to ratify the independent auditor but this is not required.

[12] The board, not the shareholders, is charged under state law with managing or directing the business and affairs of the corporation. DGCL Section 141(a); MBCA Section 8.01(b). As fiduciaries, directors must apply their own business judgment to board decisions and may not simply take direction from shareholders. See e.g. In re PLX Tech., Inc. S'holders Litig., 2018 WL 5018535 (Oct. 16, 2018) (VC Laster) (criticizing a board for allowing a hedge fund activist and its principal, who had been added to the board, to drive and take control of a sale process, finding that the activist "succeeded in influencing the directors to favor a sale when they otherwise would have decided to remain independent" and that the directors improperly deferred to the activist and allowed him "to take control of the sale process when it mattered most").

[13] Under the federal Securities Exchange Act of 1934, as amended ("Exchange Act") and Rule 14a-8 promulgated thereunder, shareholders who beneficially own at least $2,000 in market value or 1% of the company's outstanding stock for at least 1 year, and commit to hold qualifying shares through the meeting date, may bring binding or non-binding shareholder proposals for inclusion in the company's own proxy materials for vote at the annual meeting. Other procedural and substantive restrictions apply. *See* Rule 14a-8 and SEC Division of Corporation Finance Staff Legal Bulletins 14 & 14A - 14J. Binding shareholder proposals seeking bylaw amendments are more likely to be excluded as impermissible under state law under Rule 14a-8(i)(1) and can be more difficult to formulate within the 500 word limit set forth in Rule 14a-8(d). Therefore most shareholder proposals are brought as non-binding requests that the board take specified action. Shareholders may also include proposals and nominate directors in their own proxy solicitation materials, but given the expense, this generally occurs in the contest of a proxy contest for control of the board.

[14] Dodd-Frank Wall Street Reform and Consumer Protection Act Section 951 (15 U.S.C. § 78n-1) amended the Exchange Act by adding Section 14A to require a periodic shareholder advisory vote on executive compensation ("say-or-pay" vote) and also a shareholder advisory vote an compensation that is based on or otherwise relating to an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the company's assets ("golden parachute compensation"). Shareholders also have a related vote at least once every six years on how often "say on pay" votes should be exercised (i.e., every one, two or three years). See Exchange Act Rule 14a-21.

also to implement majority-supported shareholder proposals even though the shareholder vote is non-binding. Failure to be responsive to shareholder votes can lead the proxy advisory firms who advise institutional investors to recommend voting against the re-election of directors.[15]

Under SEC regulations, ordinary business operations are not a proper subject of shareholder proposals.[16] Absent a sufficiently significant policy issue, what products to offer, what prices to charge and what areas to compete in are ordinary business operation topics that are excluded from shareholder proposals.[17]

The delineation of shareholder rights and board responsibilities under state law and the additional federal overlay of areas that are appropriate for shareholder proposals to be included in the company's proxy materials provides the framework for shareholder efforts to seek to influence corporate behavior. In my experience, and as is reflected in the stated engagement priorities of large institutional investors, institutional investors focus their efforts to influence portfolio companies primarily on shareholder rights, board accountability and attention to

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[15] Institutional Shareholder Services(ISS), an influential proxy advisory firm that recommends to institutional shareholders how to vote their shares, may issue negative vote recommendations against compensation committee members and potentially the entire board if in its view the board failed to respond adequately to a previous shareholder advisory vote on executive compensation that received the support of less than 70% of votes cast. ISS may also issue negative vote recommendations against directors if ISS determines that the company failed to act on a shareholder proposal that received the majority of votes cast in the previous year. ISS, United States Proxy Voting Guidelines (Dec. 2018) at 13, 40 and 42-43. Proxy advisory firm Glass Lewis has a similar policy and may issue negative vote recommendations against compensation committee members when in its view shareholder concerns were expressed on the advisory executive compensation as indicated by receiving less than 80% approval. Glass Lewis may also issue negative vote recommendations against directors if Glass Lewis determines that the company did not sufficiently implement a shareholder proposal that received the majority of votes cast in the previous year. Glass Lewis, 2019 Proxy Paper Guidelines, United States (Oct. 2018) at 10, 14, 16 and 34.

[16] Exchange Act Rule 14a-8(i)(7). As discussed in SEC Division of Corporation Finance Staff Legal Bulletin No. 14I (CF) (Nov. 1, 2017) ("SLB 14I") (footnotes omitted), "Rule 14a-8(i)(7), the 'ordinary business' exception, is one of the substantive bases for exclusion of a shareholder proposal in Rule 14a-8. It permits a company to exclude a proposal that 'deals with a matter relating to the company's ordinary business operations.' The purpose of the exception is '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.'"

[17] "Proposals that raise matters that 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, be subject to direct shareholder oversight' may be excluded, unless such a proposal focuses on policy issues that are sufficiently significant because they transcend ordinary business and would be appropriate for a shareholder vote. Whether the significant policy exception applies depends, in part, on the connection between the significant policy issue and the company's business operations." SLB 14I (footnotes omitted). For example, in 2017, proponents filed 17 resolutions seeking reports on drug pricing increases. While one proposal was withdrawn, the SEC permitted exclusion of the remaining proposals on the basis that the proposals related to the conduct of the company's ordinary business. ISS, United States 2017: Proxy Season Review – Environmental and Social Issues (Sept. 2017) at 14 and 39.

strategy, governance processes, the structure of executive incentive compensation, and company disclosure of policies regarding corporate social and environmental responsibility.[18]

According to stewardship reports from large institutional investors and surveys of corporate directors and members of management,[19] the most common topics for engagement in 2018 and 2017 were:

- Board composition, quality and accountability, including the alignment of board composition and strategy, director tenure and diversity, independent board leadership and board oversight of risk and strategy; [20]
- Climate related risk reporting and board oversight re sustainability;[21]
- Executive compensation including alignment of compensation with company performance;[22]
- Shareholder rights including annual election of directors, supermajority vote requirements, special meeting and written consent thresholds, and proxy access;[23]

[18] For example, BlackRock's published Investment Stewardship Engagement Priorities for 2018 (Mar. 2018) included: (1) Governance including board composition, effectiveness, diversity, and accountability; (2) Board review of corporate strategy including a company's purpose and culture; (3) Executive pay policies that link closely to long-term strategy and goals; (4) Disclosure of material climate risks under consistent standards to enhance understanding of the impact of material climate change risk on individual companies, sectors and investment strategies; and (5) Human capital management: how companies are attracting and retaining employees in a tightening labor market.

[19] The data disclosed by key institutional investors is generally consistent with survey data from Spencer Stuart and the National Association of Corporate Directors ("NACD") on engagement topics. See Spencer Stuart U.S. Board Index 2017 (Dec. 2017) (reporting on responses from 65 companies in the second quarter of 2017); NACD Public Company Governance Survey 2017-2018 (Nov. 2017) (reporting on responses from 587 public company corporate directors and executives).

[20] BlackRock, Investment Stewardship 2018 Annual Report (Aug. 2018); State Street, Stewardship 2017 (July 2018); State Street, Stewardship Activity Reports Q1 & Q2 2018; Vanguard, Investment Stewardship Annual Report 2018 (Aug. 2018); Vanguard, Engaging with Vanguard (2018).

[21] BlackRock, Investment Stewardship 2018 Annual Report (Aug. 2018); State Street, Stewardship 2017 (July 2018); State Street, Stewardship Activity Report Q1 2018; State Street, Stewardship Activity Report Q2 2018.

[22] BlackRock, BlackRock Investment Stewardship's Approach to Executive Compensation (Mar. 2018); State Street, Stewardship 2017 (July 2018) (citing Investor Stewardship Group (ISG) Principles). See also State Street, Stewardship Activity Report Q1 2018; State Street, Stewardship Activity Report Q2 2018. Vanguard, Investment Stewardship Annual Report 2018 (Aug. 2018); Vanguard, Engaging with Vanguard (2018).

[23] State Street, Stewardship 2017 (July 2018) (citing ISG Principles). See also State Street, Stewardship Activity Report Q1 2018; State Street, Stewardship Activity Report Q2 2018; Vanguard, Investment Stewardship Annual Report 2018 (Aug. 2018); Vanguard, Engaging with Vanguard (2018).

- Gender pay parity;[24] and,
- Risks associated with opioids and weapons.[25]

2. Institutional Investors Seek Company-Specific Alignment of Pay and Performance

The express voting policies of both institutional investors and their proxy advisors heavily emphasize that executive compensation should be aligned with company performance relative to their peers (including competitors) and not with industry-wide performance. These express policies are directly at odds with the hypothesis that corporations in concentrated industries with common ownership by large institutional investors understand that these investors want them not to compete, and prefer that compensation is aligned with industry rather than company performance.

The proxy voting policies of the largest institutional investors provide in clear and direct terms that misalignment between pay and company performance is grounds for a negative "say-on-pay" vote and in certain circumstances grounds for a negative vote on the re-election of compensation committee members.[26] Similarly, proxy advisors ISS and Glass Lewis both

[24] State Street, Stewardship 2017 (July 2018); State Street, Stewardship Activity Report Q1 2018; State Street, Stewardship Activity Report Q2 2018.

[25] State Street, Stewardship 2017 (July 2018); State Street, Stewardship Activity Report Q1 2018; State Street, Stewardship Activity Report Q2 2018; Vanguard, Investment Stewardship Annual Report 2018 (Aug. 2018); Vanguard, Engaging with Vanguard (2018). State Street's 2017 report includes an appendix of companies engaged with and the topics of focus (governance, proxy contest/M&A, pay, environmental/social).

[26] BlackRock states that it may vote against say on pay and/or compensation committee members if it, among other things, identifies a misalignment over time between target pay and/ or realizable compensation and company performance as reflected in financial and operational performance and/ or shareholder returns, or determines that a company has not persuasively demonstrated the connection between strategy, long-term shareholder value creation and incentive plan design. BlackRock, Proxy Voting Guidelines for U.S. Securities (Feb. 2018) at Appendix; BlackRock, BlackRock Investment Stewardship's Approach to Executive Compensation (Mar. 2018).

State Street's Global Proxy Voting and Engagement Principles state that "[d]espite the differences among the types of plans and the awards possible, there is a simple underlying philosophy that guides SSGA's analysis of executive compensation; SSGA believes that there should be a direct relationship between executive compensation and company performance over the long-term." State Street's U.S. policy provides that it supports management proposals on executive compensation where there is a strong relationship between executive pay and performance over a 5-year period, and may vote against compensation committee members where there is a weak relationship between executive pay and performance over a 5-year period. State Street, Global Proxy Voting and Engagement Principles (Mar. 2018); State Street, Proxy Voting and Engagement Guidelines – North America (Mar. 2018).

Vanguard advocates that "a substantial portion of executive compensation should be tied to relevant financial and/or operational outcomes that (a) reflect the decisions and effort of those being compensated, and (b) contribute to the creation of value over the long term. Accordingly, incentives should be structured to reward relative outperformance, as opposed to a general rise in stock prices or other market-wide trends, over the course of a business or product cycle that is relevant to the company. ... While compensation should ultimately reward long-term performance, incentives for shorter term (i.e., annual) performance objectives may be appropriate to the extent incorporate relative performance evaluation (RPE) into their analysis and will issue negative recommendations for the shareholder advisory vote on executive compensation if executive pay and company performance are not aligned.[27] Misalignment of pay and company performance relative to peers is the most common reason for proxy advisors to recommend a negative vote on compensation and for a company to fail to achieve high levels of shareholder support on the advisory vote on executive compensation.[28]

Boards and their compensation committees pay close attention to investor and proxy advisor policies on compensation, the vote recommendations of the proxy advisors and the outcome of the votes. If the shareholder advisory vote on executive compensation fails, or passes but without a high level of majority support (70% or more), among S&P 500 companies it is common practice to engage with investors to find out what drove the vote results and to adjust compensation structure and metrics in response.[29]

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that the incentives support sustainable value creation." Vanguard asserts that its funds generally support pay programs that demonstrate effective linkage between pay and performance over time and that provide compensation opportunities that are competitive relative to industry peers, and are less likely to support pay programs in which significant compensation is guaranteed or insufficiently linked to performance. Vanguard, Policies and Guidelines (last accessed Dec. 4, 2018).

[27] ISS recommends against say on pay if it finds a significant misalignment between CEO pay (measured by the CEO's annualized total pay rank within a peer group) and company performance (measured by the company's annualized Total Shareholder Return), each over a three-year period. ISS uses TSR as the primary metric to evaluate pay and performance alignment because it is objective and transparent, and if "the business strategy is sound and well-executed, the expectation is that it will create value for shareowners over time, as reflected in long-term total shareholder returns." ISS, United States Proxy Voting Guidelines (Dec. 2018) at 40. ISS, Pay-for-Performance Mechanics (Dec. 2017).

Glass Lewis "strongly believes executive compensation should be linked directly with the performance of the business the executive is charged with managing." Glass Lewis will generally recommend voting against say on pay if the company's policies and practices fail to demonstrably link compensation with performance, as indicated by the company's current and past pay-for-performance grades (generated by Glass Lewis' model that benchmarks executive pay and company performance against peers across performance metrics). Performance measures should be carefully selected and should relate to the specific business/industry in which the company operates and, especially, the key value drivers of the company's business. Glass Lewis, 2019 Proxy Paper Guidelines, United States (Oct. 2018) at 32, 34 and 36.

[28] ISS, U.S. Compensation 2018 Proxy Season Review (Aug. 27, 2018) at 5. See also Semler Brossy, 2018 Say on Pay Results (Oct. 4, 2018) at 8.

[29] Radford Aon, Lessons from the 2018 Proxy Season for Say-on-Pay and Equity Plan Votes (July 2018) ("Companies that failed to obtain majority approval in 2018 or fell below one or both proxy advisory firms' Board Responsiveness Policy thresholds in 2018 will be expected to disclose in 2019 that they engaged with shareholders to understand their concerns and took some action to address those concerns."). See also Exequity, Bouncing Back from a Low Say-on-Pay Vote (Aug. 28, 2018); Semler Brossy, Handling Say-on-Pay Aftershocks: How Directors Can Prepare for Elections After a Poor Vote Outcome (Aug. 17, 2015).

3. Engagement Topics are Subject to Strict Legal Limits

Since the advent of the mandated shareholder vote on executive compensation ("say-on-pay") in 2011, engagement efforts between shareholders and corporations have increased exponentially. Engagement has proven to be an effective tool for releasing tensions between shareholders and corporations, improving boards' understanding of shareholder concerns and improving shareholders' understanding of how boards of portfolio companies approach their oversight of long-term strategy and other corporate governance responsibilities. Corporate engagement efforts may be motivated by an interest in convincing shareholders to provide support for management on say-on-pay or on a shareholder activism issue, but increasingly corporations undertake engagement efforts on a regular basis to help strengthen relations with key shareholders and to foster a better understanding of how shareholders view the company. Similarly, large institutional shareholders may seek engagement with portfolio companies to explain their point of view on a corporate governance matter, or to learn more about the drivers of corporate decisions.[30]

The topics on which corporations and their institutional investors engage are heavily influenced by legal concerns, including the need to strictly comply with federal securities and antitrust laws and regulations. It is common practice for legal counsel to provide corporate directors and members of the management team with strict instructions about the rules of engagement, including parameters of topics for engagement.[31] In line with SEC Staff Guidance and other guidance on engagement practices, discussion topics are typically pre-cleared with the shareholder, and company counsel either participates in the meeting or briefs the company's participants in advance.[32] Focused attention by counsel in line with written guidance on engagement activity undermines the notion that engagement is a means through which investors

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[30] For example, Vanguard states that its aim in engagement is to build a strong understanding of how companies govern their long-term strategy, not to seek to influence company strategy. Vanguard, Investment Stewardship Annual Report 2018 (Aug. 2018); Vanguard, Engaging with Vanguard (2018).

[31] See Sidley Austin LLP, Outline of Key Legal Considerations in Shareholder-Company Engagement (Feb. 2016), Investment Company Institute 2016 Mutual Funds and Investment Management Conference (Orlando, FL, Mar. 13-16, 2016), Supplemental Materials for Session 2-D, available at https://www.ici.org/pdf/16_mfimc_ebinder.pdf (last accessed Jan. 14, 2019) (hereinafter "Sidley Outline of Key Legal Considerations in Shareholder-Company Engagement"); NACD, Governance Challenges 2018: Board-Shareholder Engagement in the New Investor Environment (2018) (hereinafter, "NACD Governance Challenges 2018"); The Conference Board, Guidelines for Investor Engagement (Mar. 2014); The Shareholder-Director Exchange, Introduction and Protocol (Feb. 2014).

[32] SEC Staff Compliance & Disclosure Interpretations, Regulation FD, Question 101.11 (June 4, 2010); NACD Governance Challenges 2018; The Conference Board, Guidelines for Investor Engagement (Mar. 2014); The Shareholder-Director Exchange, Introduction and Protocol (Feb. 2014). If counsel does not attend engagement discussions, it is considered a recommended practice for someone else on the engagement team to be tasked with attending to the legal risks that such discussions may implicate.

encourage companies to soften their competition or through which companies communicate confidential information about their competitive plans.

Specifically, through engagement policies and direct instruction from counsel, participants are reminded that they must not selectively disclose material non-public information in violation of Regulation FD.[33] They are reminded about tipping and insider trading liability that could result from someone misusing material non-public information.[34] If engagement is occurring during proxy season, special care is given to abide by the proxy solicitation rules which only permit attempts to influence shareholder votes based on what has been disclosed in filed proxy soliciting material.[35] Directors and officers are also reminded not to discuss competitive information,

[33] Engagement efforts between companies and shareholders must comply with Regulation FD which prohibits selective disclosure of material non-public information to securities market professionals and shareholders who may trade on the basis of the information. SEC Regulation Fair Disclosure, Rule 100; SEC Staff Compliance & Disclosure Interpretations, Regulation FD, Question 101.11 (June 4, 2010). If, in an engagement, selective disclosure is made intentionally, the company must make a public disclosure *simultaneously*. If made unintentionally, the company must make public disclosure *promptly*, which means as soon as practicable but in no event later than 24 hours thereafter or the commencement of the next day's trading on its stock exchange, whichever is later. Under Regulation FD, the required public disclosure may be made by filing or furnishing a Form 8-K, or by another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public such as a press release. The SEC staff has also indicated that, in certain situations, the required level of disclosure can be achieved through the use of a website posting. Companies generally rely on Form 8-Ks and press releases to disclose material information, and may supplement these methods with corporate blogs and postings on social media channels. See SEC Release 33-7881, Selective Disclosure and Insider Trading (Aug. 15, 2000) (listing the following as examples of information or events that may prove material: (1) earnings information; (2) mergers, acquisitions, tender offers, joint ventures, or changes in assets; (3) new products or discoveries, or developments regarding customers or suppliers (e.g., the acquisition or loss of a contract); (4) changes in control or in management; (5) change in auditors or auditor notification that the issuer may no longer rely on an auditor's audit report; (6) events regarding the issuer's securities -- e.g., defaults on senior securities, calls of securities for redemption, repurchase plans, stock splits or changes in dividends, changes to the rights of security holders, public or private sales of additional securities; and (7) bankruptcies or receiverships).

[34] Strict attention to avoiding selective disclosure of material non-public information is also necessary to ensure compliance with federal and state securities laws which prohibit insider trading or tipping. (Similar considerations apply when portfolio company officers and directors who engage with a shareholder that is itself publicly traded gain access to material non-public information about that shareholder.) Investment Advisers Act Section 204A and Rule 204A-1; Exchange Act Section 10(b) and Rule 10b-5. Improper disclosure of confidential information can also raise issues of misuse of company property and breach of fiduciary obligations by officers and/or directors, regardless of whether the disclosing person obtains a personal pecuniary interest or other benefit.

[35] Exchange Act Rules 14a-6 and 14a-12 require that all written solicitation materials be filed with the SEC on the date of first use. Depending on the circumstances, scripts, Q&A sheets or similar written materials used during shareholder engagement may need to be filed by the company if they are distributed publicly or designed for repeated use. Sidley Outline of Key Legal Considerations in Shareholder-Company Engagement. Additional areas of legal concern that counsel provide guidance on include the antifraud rules. The antifraud rules prohibit insider trading (Exchange Act Section 10(b) and Rule 10b-5) and making false and misleading statements of material fact in connection with the solicitation of proxies by means of any proxy statement, form of proxy, notice of meeting or other written or oral communication (Exchange Act Rule 14a-9(a)). A private right of action exists to remedy

customer-specific information or details about the company's pricing, production capacity or market share.[36]

Participation by independent directors is becoming more common in meetings with institutional investors.[37] For example, if executive compensation is to be a topic of discussion, the compensation committee chair often participates. And engagement efforts are often reported to the board or an appropriate board committee.

While engagement between institutional investors and directors and management members reflect a range of styles, common guardrails have emerged as a result of SEC guidance, the counsel of legal advisors and the emergence of "best practice" guidance such as the SDX Protocol[38] which identifies common engagement topics and procedures.

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violations of Rule 14a-9 and scienter is not a required element. This is all in addition to the care that investors are required to take to comply with the Investment Advisers Act by safeguarding sensitive information and Section 13(d) filing requirements regarding group formation. The Investment Advisers Act Section 204A requires each SEC registered investment adviser to establish, maintain and enforce written policies and procedures, reasonably designed to prevent the misuse of material non-public information by such investment adviser or any person associated with such investment adviser. The SEC has clarified that this would encompass the misuse of material non-public information about client recommendations, trading and holdings. An adviser's duty of care also requires it to safeguard such sensitive information. Rule 204A-1 under the Investment Advisers Act requires each SEC-registered investment adviser to establish, maintain and enforce a written code of ethics. Though not required to do so, many advisers integrate their required procedures under Section 204A into their codes of ethics, often including a summary of insider trading law and procedures for determining whether information is material and when it has become public. Exchange Act Rule 13d-1 requires investors (or a group of investors) to file a Schedule 13D or 13G within 10 days of acquiring beneficial ownership of more than 5% of a class of voting securities registered under the Exchange Act. If investors are operating as a "group" with respect to their investment in the company's stock, they will each be required to file the applicable report when their collective ownership exceeds the 5% threshold. Institutional investors may be deemed to have formed a "group" under Section 13(d) of the Exchange Act if they engage in coordinated activity with respect to investment in a company. In addition to an express agreement between investors to act as a group, the following conduct may suggest group activity: (i) direct communications among the institutional investors relating to their investment in the company or a shared goal or plan involving the company, (ii) the provision of funds or advice among investors or (iii) or any pattern of parallel actions by investors within the same time period.

[36] See NACD Governance Challenges 2018 at 28; Sidley Outline of Key Legal Considerations in Shareholder-Company Engagement.

[37] Half of all respondents to the NACD Public Company Governance Survey 2017-2018 (Nov. 2017) had a board representative meet with institutional investors in the prior year. The micro/nano-cap segment had the largest percentage (65%) of respondents indicating that they had met with investors. The board chair (69%) and lead director (24%) were the most common meeting participants overall for those boards meeting with institutional investors, in addition to the investor relations officer (21%) and the compensation committee chair (19%). NACD Public Company Governance Survey 2017-2018 (Nov. 2017).

[38] Introduction and Protocol, Shareholder-Director Exchange (2016), www.sdxprotocol.com.

Given the legal concerns that need to be navigated in engagements between corporations and their shareholders, and the involvement of counsel in preparing for these efforts -- and at times participation by independent directors -- engagement efforts are under considerable scrutiny and are unlikely to provide opportunity for investors to influence boards and managers to ease up on competition.

4. Institutional Stewardship Benefits Corporate Governance

Institutional investor engagement with portfolio companies has contributed to decisions by corporate boards to improve corporate governance practices, and to provide greater transparency into board decision-making. For example, in response to a combination of engagement and non-binding shareholder proposals, a majority of S&P 500[39] boards now require:

- Annual election of all directors ("declassified" boards);[40]
- Majority voting in the election of directors (replacing plurality voting standards in uncontested elections);[41] and
- Shareholder access to the company's proxy to nominate directors.[42]

This investor influence has a multiplier effect: Other corporate boards take heed of these developments as evidence of evolving best practices and broad shareholder expectations, making

[39] Larger, more prominent public companies are generally more likely to receive shareholder proposals than smaller companies. For example, in 2018, 366 proposals were brought at S&P 500 companies, compared to only 89 proposals for Russell 2000 companies (SharkRepellent.net, last accessed January 8, 2019).

[40] The vast majority of S&P 500 companies (92%) now hold annual elections for all directors, up from 66% in 2008, and 40% in 2000. Spencer Stuart U.S. Board Index 2018 (Nov. 2018); Spencer Stuart Board Index 2010 (Nov. 2010).

[41] The majority of S&P 500 companies (89%) have adopted majority voting in director elections, up from 56% in 2008 and in 2005, approximately 1% of S&P 500 companies had adopted a majority voting director resignation policy. Spencer Stuart U.S. Board Index 2018 (Nov. 2018); Spencer Stuart Board Index 2005 (2005). For example, the Council of Institutional Investors launched a letter writing campaign in 2005 requesting 1500 companies to implement majority voting in uncontested director elections.

[42] The majority of S&P 500 companies (71%) have adopted proxy access (SharkRepellent.net, last accessed December 4, 2018), giving shareholders the right to nominate one or more candidates for director in the company's own proxy materials under certain conditions. Prior to the campaign launched by institutional investors in 2015, only 15 companies across all indices (not just S&P 500 companies) had adopted proxy access. Sidley Austin LLP, The Latest in Proxy Access (Jan. 11, 2019), available at https://www.sidley.com/en/insights/newsupdates/2019/01/the-latest-on-proxy-access; Sidley Austin LLP, Proxy Access – Now a Mainstream Governance Practice (Feb. 1, 2018).

it more likely that corporate boards will implement these kinds of changes without the same level of direct shareholder engagement, and in many instances voluntarily.

While the stewardship impact of large institutional investors on the accountability of corporate boards and managers may not yet be sufficient in the views of some observers,[43] institutional investors have become far more engaged in efforts to influence corporate governance over the past decade. Their focus is now shifting to issues of board composition and diversity, corporate sustainability and social responsibility,[44] with a particular emphasis on greater transparency by companies about how they approach these issues.[45]

Conclusion

If a decline in competition in concentrated industries occurs where there is also common ownership -- and I understand that the evidence is not at this time fully developed or agreed upon -- the type of engagement between institutional investors and portfolio companies that has arisen largely in the last decade (in the wake of the Dodd-Frank Wall Street Reform and Consumer Protection Act) is an unlikely mechanism through which investors and portfolio companies might plan anti-competitive actions. To the extent that even absent intentional conduct,

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[43] See Lucian Bebchuk & Scott Hirst, Index Funds and the Future of Corporate Governance: Theory, Evidence , and Policy (Working Draft June 2018; last revised, November 2018) and papers cited therein at note 13 and accompanying text.

[44] Environmental and social (E&S) shareholder proposals have increased in recent years and major investors such as BlackRock, State Street and Vanguard often support them, particularly those that call for sustainability reporting and climate change risk disclosure. E&S proposals accounted for 54.4% of all proposals submitted in 2018. Climate change was the most prevalent sub-category of environmental proposals, with 91 submitted in 2018 (compared to 89 in 2017), with 29 going to a vote in 2018 (compared to 49 in 2017). Overall support for E&S proposals continues to rise; median support in 2018 was 29% compared to 16% in 2012. A record number of E&S proposals (10 proposals) have received majority support from shareholders in 2018 and 35% of E&S proposals (60 proposals) received support above 30% (up by 28% compared to 2017). ISS U.S. Environmental and Social Issues, 2018 Proxy Season Review (August 30, 2018; data as at August 10, 2018). In line with this, sustainability reporting by companies has increased exponentially in recent years. (85% of S&P 500 companies published sustainability reports in 2017, up from 20% in 2011 and 72% in 2013. Governance & Accountability Institute, Flash Report: 85% of S&P 500 Index Companies Publish Sustainability Reports in 2017.) Some major investors including BlackRock, State Street and Vanguard are involved as members and/or supporters of organizations such as the Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-Related Financial Disclosures (TCFD), that seek to standardize measurement and reporting on specific E&S issues and related assurance with the goal of encouraging more widespread adoption by companies and enhancing comparability.

[45] U.S.-domiciled assets under management using ESG strategies has grown to $12.0 trillion as at the start of 2018 (up 38% since 2016, an 18-fold increase since 1995). Examples of ESG investment strategies include positive screening/best-in-class, negative/exclusionary screening, integrate ESG risks and opportunities in financial analysis of potential investments, impact investing (regardless of returns), asset selection related to sustainability, index based, and direct corporate engagement and activism (e.g., shareholder proposals). U.S. Forum for Sustainable and Responsible Investment, 2018 Report on U.S. Sustainable, Responsible and Impact Investing Trends (Oct. 2018).

anticompetitive effects arise where there is common ownership (and I reiterate my understanding that the evidence is neither fully developed or agreed upon), policy makers will face difficult tradeoffs given the benefits that institutional investors provide by satisfying consumer interests in diversified investment vehicles for retirement and college savings, and by engaging on corporate governance matters with portfolio companies.

Thank you for the opportunity to comment and to participate in the December 6 hearing. I would be more than happy to discuss these issues further. Please contact me at or .

Sincerely,

Holly J. Gregory