FORDHAM UNIVERSITY
THE SCHOOL OF LAW

FACULTY

SEAN J. GRIFFITH
T.J. MALONEY PROFESSOR OF BUSINESS LAW

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Jeffrey J. Turner
Deputy Director, Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW, FP Building, Room N-5655
Washington, DC 20210

Re: Comments in Response to DOL Proposed Rulemaking on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 29 CFR Part 2550 (RIN 1210–AB91)

Submitted by: Sean J. Griffith

Dear Deputy Director Turner:

I respectfully submit comments concerning the Department of Labor's (DOL) Proposed Rule, dated September 4, 2020, regarding fiduciary duties in connection with proxy voting for plans under the Employee Retirement Income Security Act of 1974 (ERISA). The Proposed Rule articulates a set of default rules for whether and how fiduciaries should exercise shareholder voting rights for assets held by ERISA-covered plans. Simplifying somewhat, the Proposed Rule holds that plan fiduciaries ***must*** vote proxies when the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan (paragraph (e)(3)(i)). Conversely, fiduciaries ***must not*** vote shareholder proxies when the fiduciary cannot determine that the matter being voted upon would have an economic impact on the plan (paragraph (e)(3)(ii)).

The Proposed Rule is consistent with the theory of "intermediary voting" I describe in my article, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 TEXAS LAW REVIEW 983 (2020). In outline, an intermediary's authority to exercise shareholder voting rights, whether undertaken by an ERISA fiduciary or a mutual fund manager, must satisfy two necessary conditions. First, can the intermediary assume a common investor purpose? And second, does the intermediary possess an information advantage over the matter to be voted upon relative to the ultimate economic beneficiary? Unless the intermediary can answer both of these questions in the affirmative, the intermediary should not exercise voting discretion.

The DOL's Proposed Rule is fully consistent with these theoretical foundations. I am therefore writing to express my support for the Proposed Rule and to suggest how it might be strengthened or extended.

What is intermediary voting?

Intermediary voting occurs any time an institutional intermediary receives authority to vote shares, the economic benefit of which redounds to someone other than the institutional intermediary. Intermediary voting is extremely common in modern financial markets. For example, mutual fund advisors receive contractual authority to vote shares, the economic benefit of which redounds not to the advisor but to the mutual fund investor. Likewise, fiduciaries under ERISA-covered plans receive voting authority for plan assets, the economic return of which redounds to plan beneficiaries.

In spite of being pervasive, intermediary voting is problematic because it separates economic returns from voting rights. The separation of voting rights from economic interest has long been a basic concern of corporate law. It is a form of the separation of ownership from control and therefore a source of "agency costs"—that is, conflicts of interest between the holder of economic rights and the voting intermediary. In work with Professor Lund, I catalogued the recurring forms of this conflict, including "Cross-Ownership Conflict," "Corporate Client Conflict," and "Uniform Policy Conflict." [1] For present purposes, however, it is enough to observe that voting presents many opportunities for the intermediary to advance its own interests at the expense of the ultimate economic beneficiary.

Intermediary voting is nevertheless common because it offers potential benefits as well as costs. Institutional intermediaries may possess an informational advantage in voting upon certain corporate matters. In comparison with ordinary investors, institutional intermediaries may have greater training and skill in assessing complex financial matters. Intermediary voting thus presents a tradeoff. It creates value when the benefits, in the form of informational advantages, exceed the costs, in the form of conflicts of interest.

Why do shareholders vote?

Corporate voting must be understood in the context of the investment relationship as a whole, in which voting is linked with residual risk.[2] Among corporate constituencies, shareholders ultimately bear the marginal cost and receive the marginal gains of corporate actions. Although other stakeholders, most notably creditors and employees, also bear risk, their risk is fixed by contract and thus limited by terms to which they have agreed. As residual risk bearers, shareholders are exposed to the consequences of all corporate actions—past, present and future.

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[1] Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 BOSTON UNIVERSITY LAW REVIEW 1151 (2019).

[2] Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 JOURNAL OF LAW & ECONOMICS 395, 398–99 (1983) ("'Why do shareholders vote?' is three questions in one. First, why do any investors have voting rights? Second, why do shareholders *alone* have voting rights? Third, why do shareholders exercise their voting rights?").

This gives shareholders the best incentive of all corporate constituents to monitor corporate decision-making. Hence, shareholders alone vote.

When the voting shareholders are the ultimate economic beneficiaries, we can trust them to act in their own interests, trading off the costs and benefits in the way most appropriate to themselves. However, when the voter is an intermediary, it is confronted by a potentially dizzying array of shareholder preferences—as diverse as the interests of any group of human beings. How are institutional intermediaries to bring these often conflicting preferences into effect?

The baseline purpose of wealth maximization

Disparate though their general preferences may be, shareholders are typically assumed to have a common interest in maximizing their own wealth.[3] This assumption facilitates both management and monitoring—management because shareholder wealth maximization gives corporate agents an unambiguous mandate, and monitoring because it gives shareholders a simple metric by which to judge the performance of management. Shareholder wealth maximization is reducible, essentially, to return on equity, which in efficient markets can be simplified even further to share price. Because such metrics are easily observable, they greatly facilitate shareholders' task of gathering and analyzing the information necessary to vote intelligently. Such easy metrics also make it harder for managers to conceal poor performance relative to peer firms, thus facilitating shareholder decisions on such matters as takeovers and proxy contests.

Commentators occasionally object to the norm of shareholder wealth maximization.[4] However, these objections misconstrue the role of wealth maximization in two ways. First, wealth maximization is posited as shareholders' common purpose not because it is the highest and best thing for real-life shareholders but because it is the most that can be assumed about shareholders as a class.[5] It does not rest upon the results of a poll of shareholder passions, but rather operates as a kind of lowest common denominator solution to their inability to coalesce around other objectives. In this way, wealth maximization operates as a form of agenda control. It is not shareholders' most cherished goal but rather, to paraphrase Churchill's famous dictum about democracy, the least bad of the alternatives.[6]

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[3] HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 62 (1996) ("Investor-owned firms . . . generally share a single well-defined objective: to maximize the net present value of the firm's earnings.")..

[4] *See, e.g.,* E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARVARD LAW REVIEW 1145, 1162 (1932) ("Business—which is the economic organization of society—is private property only in a qualified sense, and society may properly demand that it be carried on in such way as to safeguard the interests of those who deal with it either as employees or consumers even if the property rights of its owners are thereby curtailed."). For a more recent recitation of these claims, *see* COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD (2019).

[5] Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STANFORD LAW REVIEW 923, 961 (1984) (observing that "profit maximization is the only goal for which we can at least theoretically posit shareholder unanimity" and suggesting that "the presumption of profit maximization could be changed by express shareholder approval").

[6] *See* Winston S. Churchill, Speech on Parliament Bill (Nov. 11, 1947), *in* 7 WINSTON S. CHURCHILL: HIS COMPLETE SPEECHES 1897–1963, at 7563 (Robert Rhodes James ed., 1974) ("[I]t has been said that democracy is the worst form of Government except all those other forms that have been tried . . . .").

Second, positing shareholder wealth as the basic corporate maximand does not restrict shareholders, who remain free to invest or vote in any way they like. Rather, it restricts their *agents*, who are rendered accountable to a clear constituency according to a clear set of metrics. Corporate managers cannot depart too far from this maximand without facing fiduciary-duty litigation, a takeover contest, or a proxy fight. Shareholders, by contrast, remain free to invest and vote according to other interests and objectives.

Applying these considerations to intermediary voting implies that the institutional intermediary must confine itself to the purpose of shareholder wealth maximization because it is the most that they can assume of their investor base. It is therefore inappropriate for an institutional intermediary to act to advance a social agenda, as for example, BlackRock has announced it would do, insisting that "every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."[7] Unless such considerations legitimately advance shareholder welfare, they are inappropriate agenda items for a voting intermediary.

The DOL's Proposed Rule is fully consistent with these baseline principles of intermediary voting. When agents act for shareholders, they must assume a common purpose of shareholder wealth maximization unless investors have expressly opted into some other principle or purpose. Shareholders principals are free to act according to any preference they may hold. But intermediaries are agents, not principals, and as such, they must be constrained by wealth maximization as the sole purpose that is plausibly shared by all investors. They should vote to maximize wealth and not to advance any other agenda. The Proposed Rule reflects this foundational corporate law principle and ought therefore to be adopted.

The limits of intermediary knowledge

Some will claim that wealth maximization can best be achieved by advancing a particular social or environmental agenda. For example, BlackRock asserts that "climate risk is investment risk and that sustainability-integrated portfolios, and climate-integrated portfolios in particular, can produce better long-term, risk-adjusted returns."[8] However, such claims exceed the limits of knowledge and expertise that can plausibly be attributed to financial intermediaries. These claims should therefore be greeted with skepticism.

To see this, consider the assertion that preventing global warming will increase investor wealth by heading off environmental calamity and general destruction. What would a financial intermediary need to know in order to operationalize this view in the context of shareholder voting? Imagine, in particular, a climate proposal that has the potential to harm oil companies but also the potential to benefit the investment portfolio more generally. To determine the portfolio-wide effect of the proposal, the intermediary would need the information to calculate:

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[7] Larry Fink, *A Sense of Purpose*, (2018), at https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

[8] Sandra Boss, *et al.*, *Our Approach to Sustainability*, (July 20, 2020), at https://corpgov.law.harvard.edu/2020/07/20/our-approach-to-sustainability/.

(a) the financial benefit of the proposal if enacted (that is, *the proposal's actual effect on climate change* and the *pecuniary* benefit of this effect on the portfolio as a whole); (b) the financial cost to the oil company of enacting the proposal; (c) the counterfactual (that is, the effect on the portfolio of any climate change that would occur in the absence of enacting the portfolio, *accounting for the possibility that other approaches that might address climate change in a less costly way* that the given proposal); and (d) the weighted marginal impact (whether benefit or harm) of the action on every other firm in the portfolio. Only an intermediary capable of producing and processing all of this information would be in a position to determine whether such a proposal created more benefit than harm. But, of course, this information is entirely unavailable and the necessary calculation is therefore completely impossible.[9]

In light of the absence of real knowledge concerning their ultimate effects, such decisions appear at last for what they actually are: tradeoffs between competing values. It is not that pro-growth investors hate the environment or that climate-conscious investors are indifferent to growth. It is simply that different investors make this tradeoff in different ways, as they do with respect to diversity, guns, and all other issues on which reasonable people may differ. As a result, the relevant information to decide these issues is ***not** centrally held* by the institutional intermediary. Rather, it is *diffusely held* by the investors, each of whom knows how he or she would tradeoff the various competing values.[10] Because the institutional intermediary has *less* of the requisite information and expertise to decide these matters than investors, the intermediary should not be given the authority to decide.

Cashing out the theory: when should we expect intermediaries to vote?

The animating principle of the theory I have outlined here is that a rational investor will delegate voting authority to an intermediary if and only if the intermediary advances the investor's interests and possesses sufficient information to do so. I have argued that the DOL's Proposed Rule is perfectly consistent with this principle and ought therefore to be adopted. In the space remaining, I will outline certain extensions or implications of these ideas. In particular, when should an intermediary typically exercise voting rights and when should it typically not?

The principal situation in which intermediaries ought to exercise voting discretion is in "contests"—that is, proxy fights, takeovers, and mergers. In contests, meaningful information is produced, and the intermediary has a comparative advantage over most ordinary investors in analyzing this information. Moreover, in contests, the intermediary can assume that its investors are motivated by the common purpose of wealth maximization.

The opposite situation is presented by environmental and social proposals. There, intermediaries are neither presented with meaningful information nor are they able to assume a common purpose on the part of their investors. It is worth noting, however, that corporate managers do

[9] This is not to deny climate change. It is merely to deny that anyone knows how firm-specific climate-change proposals will affect climate change, the value of the firms that enact them, or indeed, any other firm.
[10] The classic statement of this argument appears in F. A. Hayek, *The Use of Knowledge in Society*, 35 AMERICAN ECONOMIC REVIEW 519 (1945) (arguing that when information is dispersed, decisions are best made by those with localized knowledge rather than a central authority).

not face a conflict of interest vis-à-vis their shareholders with regard to environmental and social proposals. If a proposal is wealth-maximizing, corporate managers have as much reason to go along with it as they do with any other means of increasing shareholder wealth. Given these incentives and the better information of corporate managers, relative at least to institutional investors, concerning the relative effect of any given proposal at the company she manages, institutional intermediaries should generally defer to the company's recommendation with regard to environmental and social proposals.

Governance issues are distinguishable from both contests and from environmental and social proposals. Like contests (and unlike environmental and social issues), institutional intermediaries can assume a common investor purpose with respect to governance proposals. Investors will favor governance reforms that increase corporate value and oppose governance changes that decrease it. Also like contests (and unlike environmental and social issues), a corporate manager's recommendation with respect to governance reforms may be tainted by her own interests. Managers can be expected to disfavor governance reforms that restrict their authority or reduce their tenure. Unfortunately, the link between corporate performance and particular governance terms is weak and largely unproven. In the absence of meaningful information concerning the effect of a particular governance reform on the performance of a specific firm, mutual funds should abstain from voting on governance proposals.

These thoughts are fleshed out more completely in my "Opt-In Stewardship" article.[11] They are offered here merely to suggest how the principles grounding the DOL's Proposed Rule might unfold in actual voting scenarios. They are, in this sense, ancillary to my central comment which is that the DOL's Proposed Rule is thoroughly grounded in foundational corporate law theory. As such, it will well serve the interests of ERISA beneficiaries and ought therefore to be passed.

Thank you for the opportunity to submit comments on the Notice of Proposed Rulemaking. Please do not hesitate to contact me for further information.

Sincerely,

Sean J. Griffith
T.J. Maloney Chair in Business Law
Fordham University School of Law
150 West 62nd Street
New York, New York 10023

Telephone: 212-636-7687
Email: sgriffith@law.fordham.edu

[11] 98 TEXAS LAW REVIEW 983, 1020-44 (2020), at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3404298.