AFL-CIO
AMERICA'S UNIONS

American Federation of Labor and Congress of Industrial Organizations
815 16th St. NW
Washington, DC 20006
202-637-5000
aflcio.org

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Submitted electronically to www.regulations.gov

Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights
Notice of Proposed Regulation (RIN 1210-AB91)

Dear Acting Assistant Secretary Wilson:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), we are writing to provide comments on the U.S. Department of Labor's notice of proposed rulemaking entitled "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (the "Proposed Rule"). If adopted, the Proposed Rule will create unnecessary and burdensome red-tape that will disenfranchise pension and employee benefit plans from voting proxies in the interests of plan participants and beneficiaries.

The AFL-CIO is a voluntary federation of 55 national and international labor unions that represent 12.5 million working people. Millions of AFL-CIO affiliated union members and retirees participate in private-sector pension and employee benefit plans that will be negatively affected by the Proposed Rule. For over three decades, fiduciaries for these pension and employee benefit plans have been voting proxies subject to the duties of prudence and loyalty as has been instructed by the Department's long-standing interpretive guidance.

The AFL-CIO respectfully requests that the Department withdraw the Proposed Rule and allow the current sub-regulatory guidance (Interpretive Bulletin 2016-01) to remain in place. In the alternative, the Department should withdraw the Proposed Rule until it has had an opportunity to correct the deficiencies described herein, after which it should re-propose a rule and provide sufficient time for comment thereon, including a public hearing and a post-hearing comment period.

The Department's Stated Rationale for Adopting the Proposed Rule Lacks Merit

Proxy voting is the practice of voting shares of corporate stock by authorizing a representative to vote on the shareholder's behalf. Proxy voting is therefore a cost-efficient means for shareholders to vote on corporate actions without having to actually attend shareholder meetings. Proxy voting by shareholders is an integral part of state corporate law,[1] and includes voting on a variety of corporate actions as required by federal law, state law, stock exchange listing standards, and company charters and bylaws. These include votes on boards of directors, executive compensation, auditor ratification, and shareholder resolutions. The U.S. Securities and Exchange Commission (the "SEC") has regulated the solicitation of proxy votes since enactment of the Securities Exchange Act of 1934.

Since the Reagan Administration, the Department has taken the view that under the Employee Retirement Income Security Act of 1974 ("ERISA"), the fiduciary duties of loyalty and prudence apply to proxy voting by pension and employee benefit plans ("ERISA plans"). In 1988, the Department stated that "[i]n general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock."[2] The Department subsequently memorialized and restated this long-standing view in 1994 (Interpretive Bulletin 94-2), 2008 (Interpretive Bulletin 2008-02), 2016 (Interpretive Bulletin 2016-01) and, most recently, in 2018 (Field Assistance Bulletin 2018-01).

The Department's notice of proposed rulemaking states that the Proposed Rule is intended to address "confusion" that ERISA plan fiduciaries are required to vote all proxies. But the Department's longstanding interpretive guidance has always been that ERISA plans can abstain from voting when the costs exceed the benefits of voting.[3] For three decades, ERISA plan fiduciaries have voted proxies to further the purpose of the plan after taking into consideration the costs of proxy voting. This does not mean that ERISA plan fiduciaries always vote each and every proxy. In fact, ERISA plan fiduciaries routinely abstain from casting proxy votes when the

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[1] *See* e.g., Delaware General Corporation Law § 212.

[2] Letter from U.S. Department of Labor to Mr. Helmuth Fandl, Chairman of the Retirement Board of Avon Products, Inc., (Feb. 23, 1988), 1988 WL 897696.

[3] "Although the same principles apply for proxies appurtenant to shares of foreign corporations, the Department recognizes that in voting such proxies, plans may, **in some cases**, incur additional costs. Thus, a fiduciary should consider whether the plan's vote, either by itself or together with the votes of other shareholders, is expected to have an effect on the value of the plan's investment that will outweigh the cost of voting" (emphasis added), Interpretive Bulletin 94-2, 29 CFR § 2509.94–2.
"Fiduciaries must take all of these factors into account in determining whether the exercise of such rights (**e.g., the voting of a proxy**), independently or in conjunction with other shareholders, is expected to have an effect on the economic value of the plan's investment that will outweigh the cost of exercising such rights" (emphasis added), Interpretive Bulletin 2008-02, 29 CFR § 2509.08-2.
"The fiduciary obligations of prudence and loyalty to plan participants and beneficiaries require the responsible fiduciary to vote proxies on issues that may affect the value of the plan's investment. This principle applies broadly. However, the Department recognizes that **in some special cases** voting proxies may involve out of the ordinary costs or unusual requirements, for example in the case of voting proxies on shares of certain foreign corporations" (emphasis added), Interpretive Bulletin 2016-01, 29 CFR § 2509.2016-01.

benefit of voting is outweighed by the cost of voting, if they do not have a policy position on a particular topic, or where there is insufficient disclosure to arrive at a voting decision.

Rather, it appears that the Department is confused about the proxy voting practices of ERISA plans. We note that the Department does not cite a single enforcement action where the Department has alleged that an ERISA plan fiduciary imprudently or disloyally voted proxies. Additionally, the Department does not acknowledge the myriad of instances where ERISA plan fiduciaries already abstain from voting proxies. For example, the Department cites a speech by a BlackRock executive to support its contention that ERISA plan fiduciaries are misinformed that they are required to vote every proxy, but the Department fails to consider that BlackRock itself does not vote 10 percent of its non-U.S. holdings due to share blocking requirements and other voting costs.[4] ERISA plan fiduciaries routinely forgo the voting of proxies in certain foreign jurisdictions which require that voted shares may not be traded before the shareholder meeting. In any event, if the Department feels it is necessary, it could make an even clearer statement through sub-regulatory guidance that ERISA plans have the discretion to eschew voting proxies where it is in the plan's best interest to do so. There is no need to impose the Proposed Rule's burdensome recordkeeping requirements in order to make this simple point.

The Department also expresses concern about the use of proxy advisory firms and cites the SEC's recently adopted proxy advisor regulations. However, the Department's own analysis of Form 5500 filings identified only 64 ERISA plans that had made any direct payments to a proxy service provider, and the average fees paid totaled just 0.2 basis points (0.002%) of plan assets.[5] ERISA plan service providers that use proxy advisory firms are likely to incur similarly immaterial costs compared with the overall administration expenses of ERISA plans. Even if one accepts the faulty arguments that new regulations are needed for proxy advisory firms,[6] the SEC adopted a rule to address these purported concerns on July 22, 2020.[7] We note that all proxy advisory firms and other proxy service providers are already subject to SEC regulation under the SEC's newly adopted proxy advisor rules and investment adviser registration requirements.

The Department's view that ERISA plans are incurring increased proxy voting costs due to "the recent increase in the number of environmental and social shareholder proposals" is factually incorrect. To the contrary, the total number of shareholder resolutions going to a vote has fallen dramatically in recent years.[8] Moreover, the Department itself acknowledges that shareholder

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[4] BlackRock, Proxy Voting and Shareholder Engagement FAQ, January 2020, *available at* https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-faq-global.pdf.

[5] As noted by the notice of proposed rulemaking, the Form 5500 reported payments to a third service provider observed by the Department are likely for other services than proxy voting and are not comparable.

[6] *See* Letter from the AFL-CIO to the U.S. Securities and Exchange Commission, February 3, 2020 (regarding proxy rules for proxy voting advice), *available at* https://www.sec.gov/comments/s7-22-19/s72219-6744333-207884.pdf.

[7] U.S. Securities and Exchange Commission, Exemptions from the Proxy Rules for Proxy Voting Advice, Final Rule Release No. 34-89372, July 22, 2020, *available at* https://www.sec.gov/rules/final/2020/34-89372.pdf.

[8] U.S. Securities and Exchange Commission, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Proposed Rule Release No. 34-87458, November 5, 2019, ("The average number of proposals submitted to S&P 500 companies has decreased from 1.85 in 2004 to 1.24 in 2018, representing a 33 percent decrease during our sample period, and the average number of proposals submitted to Russell 3000

resolutions makeup only 2 percent of all proxy votes. In addition, the SEC has recently adopted new rules that it estimates will further reduce the total number of shareholder resolutions by 35 percent.[9] Finally, the Department ignores the fact that shareholder resolutions are often value-enhancing.[10] For example, according to peer-reviewed academic studies, there is a positive relationship between shareholder resolutions submitted by labor unions and investment returns.[11]

The Proposed Cost-Benefit Analysis Requirement is an Unworkable Regulatory Burden

If adopted, the Proposed Rule will repeal the Department's longstanding sub-regulatory guidance and replace it with new and burdensome regulation of proxy voting by ERISA plans. While the Proposed Rule reaffirms that the right to vote proxies is subject to the fiduciary duty to manage plan assets, it creates new barriers for proxy voting by ERISA plans. Specifically, paragraph (3)(ii) of the Proposed Rule states that "[a] plan fiduciary must not vote any proxy unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan." Furthermore, this cost-benefit analysis for each proxy vote that is cast by an ERISA plan will be subject to an onerous recordkeeping requirement by paragraph (2)(ii)(E).

ERISA provides no statutory basis for the Proposed Rule's cost-benefit analysis and recordkeeping requirements for every single proxy vote. ERISA section 404(a)(1)(A) specifies that plan fiduciaries must discharge their duties solely in the interests of plan participants and beneficiaries. ERISA section 404(a)(1)(B) states that plan fiduciaries must act with the care, skill, prudence, and diligence of a prudent expert. Pursuant to these requirements, the Department's own existing regulations require only that ERISA plan fiduciaries give "appropriate consideration" to the relevant facts and circumstances when making investment decisions.[12] The Department's definition of "appropriate consideration" does not include a requirement to document a cost-benefit analysis for each individual investment decision. In fact, doing so would be a waste of plan resources.

Mandating that ERISA plan fiduciaries document their cost-benefit analysis before each proxy vote makes as much sense as mandating documentation of a cost-benefit analysis for each portfolio investment decision. When selecting individual stocks, investment advisers weigh the benefits of investing in a particular company's shares verses the opportunity cost of forgoing alternative investments. Evaluating these cost-benefit considerations is an inherent part of an

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companies has decreased from 0.38 in 2004 to 0.28 in 2018, representing a 26 percent decrease during our sample period."), *available at* https://www.sec.gov/rules/proposed/2019/34-87458.pdf.

[9] U.S. Securities and Exchange Commission, Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, Final Rule Release No. 34-89964, September 23, 2020, (PRA Table 1), *available at* https://www.sec.gov/rules/final/2020/34-89964.pdf.

[10] *See* Letter from the AFL-CIO to the U.S. Securities and Exchange Commission, February 3, 2020 (regarding Rule 14a-8 shareholder proposals), *available at* https://www.sec.gov/comments/s7-23-19/s72319-6744323-207881.pdf.

[11] Luc Renneboog and Peter Szilagyi, "The role of shareholder proposals in corporate governance," Journal of Corporate Finance, Volume 17, Issue 1, Pages 167-188 (February 2011); Andrew Prevost, Ramesh Rao, and Melissa Williams, "Labor Unions as Shareholder Activists: Champions or Detractors?, " Financial Review, Volume 47, Issue 2, Pages 327-349 (2012).

[12] 29 CFR 2550.404a-1, 44 FR 37225, June 26, 1979.

investment adviser's skill and expertise. The Department does not require that investment advisers who are acting as ERISA plan fiduciaries memorialize this analysis for each and every buy/sell decision that they make for ERISA plans. Nor should it, as such a requirement would be absurdly bureaucratic and extremely costly. Yet, this is exactly what the Department's Proposed Rule will arbitrarily require for proxy voting decisions.

The Proposed "Permitted Practices" Violate the Fiduciary Duties of Loyalty and Care

If implemented, the Proposed Rule would create three "permitted practices" for proxy voting that will relieve ERISA plans from the Proposed Rule's expanded cost-benefit analysis and recordkeeping requirements for casting individual proxy votes. As a practical matter, the Proposed Rule's cost-benefit analysis and recordkeeping requirement for casting individual proxy votes will act as a tax on proxy voting by ERISA plans that do not follow a "permitted practice." The Department's notice of proposed rulemaking explicitly acknowledges that the Department does not intend for ERISA plans to continue to generally vote proxies, and states that the Department expects that one of the following "permitted practices" will become the default proxy voting policy for ERISA plans:

> *(A) A policy of voting proxies in accordance with the voting recommendations of management of the issuer […]*
> *(B) A policy that voting resources will focus only on particular types of proposals […]*
> *(C) A policy of refraining from voting on proposals or particular types of proposals […]*

However, as discussed below, each of these proxy voting "permitted practices" violates ERISA's fiduciary duty requirements of loyalty and prudence under ERISA sections 404(a)(1)(A) and (B). Accordingly, any ERISA plan fiduciary that elects to adopt one of these unlawful "permitted practices" may be subject to private litigation by plan participants and beneficiaries under ERISA section 502(a).[13] Moreover, plan participants' and beneficiaries' statutory rights under ERISA to sue for breaches of fiduciary duty cannot be extinguished by the exculpatory language contained in paragraph (e)(3)(v) of the Proposed Rule that purports to relieve plans of liability by following the one of the Proposed Rule's "permitted practices." For these reasons, ERISA plan fiduciaries are unlikely to realize any cost savings from the "permitted practices."

[13] Although the Supreme Court's recent decision in *Thole v. U.S. Bank N.A., 140 S. Ct. 1615 (2020)* offers greater protection for fiduciaries by requiring that plan participants in a defined benefit pension plan show they have suffered a reduction in the value of their benefit to bring an ERISA claim for breach of fiduciary duty based on alleged mismanagement of plan assets, they may be able to do so in an underfunded pension plan that faces a likely reduction in accrued benefits. Moreover, the rationale of *Thole* applies primarily to defined benefit plans as defined contribution plan participants can more easily make a prima facie showing that alleged breaches of fiduciary duty have affected the value of their investment.

The "Permitted Practice" To Vote with Management Violates the Duty of Loyalty

The first "permitted practice" contained in paragraph (e)(3)(iii)(A) encourages ERISA plans to always vote in accordance with corporate management's proxy voting recommendations. This proposed practice openly invites ERISA plan fiduciaries to violate their ERISA section 404(a)(1)(A) fiduciary duty of loyalty to their plan participants and beneficiaries. There are many corporate actions where the recommendation of corporate management is conflicted. For example, corporate managers have a clear self-interest in votes to approve their executive compensation plans. For an ERISA plan fiduciary to always vote in favor of executive compensation plans that corporate management has recommended, even when such compensation is excessive or wasteful, would violate the duty of loyalty.

The Department's analogy to the fact that directors and officers owe fiduciary duties to the corporation under state law is unpersuasive. When making voting recommendations to shareholders, corporate managers are not acting as ERISA plan fiduciaries. Simply put, the fiduciary duties required by ERISA are more stringent than state corporate law. For example, ERISA plan fiduciaries automatically are disqualified from engaging in prohibited transactions involving self-dealing, whereas state law frequently permits such actions by corporate managers. Under state law, the business judgment rule generally protects corporate managers from judicial review of their business decisions if they are made in good faith. In contrast, ERISA plan fiduciaries do not enjoy the same wide latitude when making investment decisions.

Notably, the Proposed Rule's "permitted practice" to always vote according to corporate management's recommendations is strikingly pro-management compared to the SEC's recently updated proxy voting guidance for investment advisers. Specifically, SEC Rule 206(4)-6 requires that investment advisers adopt policies and procedures that are reasonably designed to ensure that the investment adviser votes proxies in the best interest of its clients. The SEC's recent guidance provides that a client and the investment adviser may agree that the investment adviser will vote in accordance with the voting recommendations of management of the issuer, or alternatively, in favor of all proposals made by particular shareholder proponents.[14] Unlike the SEC's guidance that is balanced between the interests of shareholders and management, the Department's "permitted practice" unilaterally favors management.

The "Permitted Practice" To Only Vote on Particular Issues Violates the Duty of Prudence

The second "permitted practice" contained in paragraph (e)(3)(iii)(B) would authorize ERISA plans to vote only on a pre-approved laundry list of proposals that the Department has deemed to be "substantially related to the corporation's business activities or likely to have a significant impact on the value of the plan's investment." These voting items include corporate transactions, repurchases of shares, new share issuances, and contested elections for directors. The inclusion of share buybacks in this list is curious given that U.S. companies do not seek shareholder

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[14] U.S. Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release Nos. IA-5325; IC-33605, September 10, 2019, *available at* https://www.sec.gov/rules/interp/2019/ia-5325.pdf.

approval to authorize stock buybacks. In any case, this "permitted practice" fails to consider that a myriad of other proxy votes are of equal importance to the value of ERISA plan investments. Moreover, the Department fails to provide any economic analysis as to why these particular proxy votes are more material to shareholders than other issues.

Voting on a variety of issues not covered by the list of corporate actions named in paragraph (e)(3)(iii)(B) is clearly in the pecuniary interests of ERISA plans. For example, corporations simply could not function if shareholders did not vote to approve the election of corporate directors or to approve the executive compensation plans of corporate managers. State corporate law relies on shareholder voting as a safeguard against self-dealing by corporate management, and voting against corporate directors or executive compensation plans has been shown to be a meaningful accountability mechanism. Similarly, a survey of academic studies found that, on balance, shareholder proposals are also associated with increases in shareholder value.[15] Of course, if a shareholder proposal is not in the interests of investors, the appropriate vote for an ERISA plan is a vote against the proposal. Abstaining from such votes is a penny wise, pound foolish choice that violates the duty of prudence as required by ERISA section 404(a)(1)(B).

One particularly concerning omission in the Department's arbitrary list of proxy votes that it has declared to be material are mutual fund votes. Although ERISA does not govern assets held internally by SEC-registered investment companies such as mutual funds, ERISA does apply to proxy voting of mutual fund shares that are held by ERISA plans. Mutual funds and other investment companies are required to hold special meetings of their investors to elect directors and approve other corporate actions such as investment policy changes. Obtaining a quorum for investment company meetings is often challenging given that the Investment Company Act of 1940 requires that 50 percent of the outstanding voting securities be present or represented by proxy. As noted by the Department, ERISA plans held 25 percent of all mutual fund shares in 2019. The Proposed Rule thus creates another significant problem: how are mutual funds going to achieve quorum if 25 percent of all their investors stop voting their mutual fund proxies?

The "Permitted Practice" To Refrain from Voting Violates the Prudent Expert Rule

The third and final "permitted practice" described by paragraph (e)(3)(iii)(C) encourages ERISA plan fiduciaries to refrain from proxy voting altogether if the plan holds a sufficiently small percentage of a company's stock. This "permitted practice" to refrain from proxy voting is a blatant violation of the "prudent expert" rule that is required by ERISA section 404(a)(1)(B). The prudent expert rule requires that ERISA plan fiduciaries act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters." The overwhelming majority of prudent experts – i.e., the expert professionals who make up the investment management community – have determined that

[15] Matthew Denes, Jonathan Karpoff and Victoria McWilliams, "Thirty Years of Shareholder Activism: A Survey of Empirical Research," Journal of Corporate Finance, Volume 44, Pages 405-424 (June 2017) (Figure 1 presents unweighted average findings from 35 academic studies that shareholder resolutions are associated with a 0.06 percent increase in share price valuation).

proxy voting is in their clients' interests.[16] To ignore this reality would invite ERISA plans to buck the standard of care that has been widely adopted by investment managers for their clients.

Investment managers widely view proxy voting to be a source of value creation because it helps to promote corporate accountability. As the Department notes in its discussion of changes in proxy voting behavior, proxy voting is no longer considered to be a compliance exercise "for the overwhelming majority of share capital represented in the U.S." But the Department then dismisses this development in asset management by asserting that "research regarding whether proxy voting has reliable positive effects on shareholder value and a plan's investment in the corporation has yielded mixed results." However, the handful of peer-reviewed academic studies the Department cites for this proposition do not support the contention that shareholders should refrain from proxy voting or always vote with corporate management. We also note that the cited self-published reports by "think-tanks" that have long criticized proxy voting by institutional investors on behalf of corporate managers are not a sound basis for rulemaking.

Most of the genuine academic studies the Department cites survey the literature and conclude that while some academic studies have mixed findings, shareholder activism generally is effective and creates value for investors.[17] The Department's cited publication that critiques proxy voting by passive index investors is a law review article, not an economics paper.[18] Moreover, the Department ignores many academic studies that have found a positive relationship between firm performance and proxy voting on environmental, social and governance issues.[19] We strongly encourage the Department to consider the large compilation of research papers

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[16]CFA Institute, Standards of Practice Handbook Eleventh Edition, 2014, page 85, *available at* https://www.cfainstitute.org/-/media/documents/code/code-ethics-standards/standards-practice-handbook-11th-ed-eff-July-2014-corr-sept-2014.ashx ("An investment manager who fails to vote, casts a vote without considering the impact of the question, or votes blindly with management on nonroutine governance issues (e.g., a change in company capitalization) may violate this standard. *Voting of proxies is an integral part of the management of investments.").*

[17] Matthew Denes, Jonathan Karpoff and Victoria McWilliams, "Thirty Years of Shareholder Activism: A Survey of Empirical Research," Journal of Corporate Finance, Volume 44, Pages 405-424 ("activism in more recent years is more frequently associated with increased share values and operating performance"); Maria Goranova & Lori Verstegen Ryan, "Shareholder Activism: A Multidisciplinary Review," Journal of Management, Volume 40, Issue 5, Pages 1230-1268 (July 2014) ("Shareholder activism has become a dynamic institutional force"); David Yermack, "Shareholder Voting and Corporate Governance," Annual Review of Financial Economics, Volume 2, Pages 103-125 (December 2010) ("Shareholders use voting as a channel of communication with boards of directors, and protest voting can lead to significant changes in corporate governance and strategy.").

[18] Dorothy Lund, "The Case Against Passive Shareholder Voting," Journal of Corporation Law, Volume 43, Issue 3, Pages 493-536 (2018)..

[19] While hardly an exhaustive list, such studies include: Vicente Cuñat, Mireia Gine, and Maria Guadalupe, "The Vote is Cast: The Effect of Corporate Governance on Shareholder Value," The Journal of Finance, Volume 67, Issue 5, Pages 1943-1977 (October 2012); Elroy Dimson, Oguzhan Karakas, and Xi Li, "Active Ownership," The Review of Financial Studies, Volume 28, Issue 12, Pages 3225–3268 (December 2015); Ian Appel, Todd Gormley, and Donald Keim, "Passive Investors, Not Passive Owners," Journal of Financial Economics, Volume 121, Issue 1, Pages 111-141 (July 2016); Yaron Nili and Kobi Kastiel, "Competing for Votes, " Harvard Business Law Review, Volume 10, Issue 2, Pages 287 - 335 (2020).

compiled by the Council of Institutional Investors,[20] CalPERS,[21] CFA Institute,[22] Principles for Responsible Investment,[23] and US SIF[24] before adopting the Proposed Rule.

As shareholders of Enron and WorldCom learned, monitoring a company's corporate governance is arguably just as important as monitoring a company's financial performance. Because corporate governance and corporate social and environmental responsibility are material to the long-term performance of companies,[25] it would be imprudent for an asset manager to simply ignore proxy voting. ERISA plan fiduciaries have no way of knowing when their votes are decisive to a voting outcome, or needed to help a company achieve its quorum requirements, and therefore a "permitted practice" to generally refrain from proxy voting is not prudent. Moreover, this "permitted practice" will have unintended consequences by concentrating proxy votes in the hands of the very largest investment managers and proxy advisory firms. Last, activist hedge funds whose interests may not align with the long-term interests of ERISA plans are also likely to benefit from ERISA plans abstaining from proxy voting in proxy contests.

Coercing ERISA Plans to Adopt the "Permitted Practices" Violates the US Constitution

Finally, it is our view that compelling ERISA plans to adopt one of the "permitted practices" by imposing the Proposed Rule's burdensome cost-benefit analysis requirements if they refuse to do so is unconstitutional under the First and Fifth Amendments of the U.S. Constitution. Proxy voting is a form of speech,[26] and a requirement that ERISA plan fiduciaries always vote with management or refrain from proxy voting will be subject to heightened judicial scrutiny. "The

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[20] Empirical Research on ESG Factors and Engaged Ownership, Council of Institutional Investors, August 2020, *available at* https://www.cii.org/esg_ownership.
[21] Sustainable Investment Research Initiative Library, CalPERS, *available at* https://www.calpers.ca.gov/page/investments/sustainable-investments-program/esg-integration/siri-library.
[22] The Corporate Governance of Listed Companies (Appendix C), CFA Institute, 2018, *available at* https://www.cfainstitute.org/-/media/documents/article/position-paper/ corporate-governance-of-listed-companies-3rd-edition.ashx; Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals, CFA Institute, October 2015, *available at* https://www.cfainstitute.org/-/media/documents/article/position-paper/esg-issues-in-investing-a-guide-for-investment-professionals.ashx.
[23] Top Academic Resources on Responsible Investment, Principles for Responsible Investment, *available at* https://www.unpri.org/academic-research/topacademic-resources-on-responsible-investment/4417.article.
[24] Research by Our Members, US SIF, 2020, *available at* https://www.ussif.org/content.asp?contentid=71.
[25] Luc Laeven and Vidhi Chhaochharia, "Corporate Governance, Norms and Practices," Journal of Financial Intermediation, Volume 18, Issue 3, Pages 405-431 (2008); Paul Gompers, Joy Ishii, and Andrew Metrick, "Corporate Governance and Equity Prices," Quarterly Journal of Economics, Volume 118, Issue 1, Pages 107-155 (2011); Robert Eccles, Ioannis Ioannou, and George Serafeim, "The Impact of Corporate Sustainability on Organizational Processes and Performance," Management Science, Volume 60, Issue 11, Pages 2835-2857 (February 2014); Gunnar Friede,Timo Busch and Alexander Bassen, " ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies," Journal of Sustainable Finance & Investment, Volume 5, Issue 4, Pages 210-233 (December 2015).
[26] "In deciding whether particular conduct possesses sufficient communicative elements to bring the First Amendment into play, we have asked whether an intent to convey a particularized message was present, and whether the likelihood was great that the message would be understood by those who viewed it." *Texas v. Johnson*, 491 U.S. 397, 404 (1989) (internal quotations omitted) (finding burning an American flag to be a form of expressive speech).

First Amendment requires heightened scrutiny whenever the government creates a regulation of speech because of disagreement with the message it conveys…Commercial speech is no exception." *Sorrell v. IMS Health Inc*., 564 U.S. 552, 566 (2011) (internal citations omitted). The First Amendment is particularly implicated when proxy voting on shareholder proposals that address political, social or environmental issues. "If there is any fixed star in our constitutional constellation, it is that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion, or other matters of opinion or force citizens to confess by word or act their faith therein." *W. Virginia State Bd. of Educ. v. Barnette*, 319 U.S. 624, 642 (1943).

The Proposed Rule makes it so burdensome for fiduciaries to meaningfully exercise their proxy voting rights that they are effectively forced to express their views on shareholder proposals in one of the three prescribed ways. "Just as the First Amendment may prevent the government from prohibiting speech, the Amendment may prevent the government from compelling individuals to express certain views." *United States v. United Foods, Inc.,* 533 U.S. 405, 410 (2001) citing *Wooley v. Maynard,* 430 U.S. 705, 714 (1977); *West Virginia Bd. of Ed. v. Barnette,* 319 U.S. 624 (1943). While generally requiring ERISA plan fiduciaries to comply with their fiduciary duties to participants and beneficiaries may be a legitimate government interest, the Proposed Rule is not tailored to advance that interest. "The State must assert a substantial interest to be achieved by restrictions on commercial speech. Moreover, the regulatory technique must be in proportion to that interest." *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557, 564 (1980). "The fact that the speech is in aid of a commercial purpose does not deprive . . . [it] of all First Amendment protection." *Id.* "[E]ven where mere 'commercial speech' is concerned, the First Amendment permits restraints on speech only when they are narrowly tailored to advance a legitimate governmental interest." *Lowe v. S.E.C.,* 472 U.S. 181, 234 (1985) (Justice White, concurring).

Here, not only does the Department's purported basis for so severely restricting ERISA plans' exercise of their proxy voting rights lack merit, but also the regulatory technique offered does not fulfill the regulation's stated purpose. "The limitation on expression must be designed carefully to achieve the State's goal. Compliance with this requirement may be measured by two criteria. First, the restriction must directly advance the state interest involved; the regulation may not be sustained if it provides only ineffective or remote support for the government's purpose. Second, if the governmental interest could be served as well by a more limited restriction on commercial speech, the excessive restrictions cannot survive." *Cent. Hudson Gas & Elec. Corp,* 447 U.S. at 564. The Proposed Rule fails to meet both criteria. As described above, it does not protect against fiduciary duty violations, and as demonstrated by the existing guidance, a more limited restriction serves the governmental interest not just as well, but better.

Given the Department's long-standing recognition that proxy votes are valuable assets, compelling ERISA plans to either use their proxy voting rights in a particular way or give them up entirely is both a regulatory and an actual taking without just compensation under the Fifth Amendment. "The general rule at least is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922). Moreover, even "a state statute that substantially furthers important public policies may so frustrate distinct investment-backed expectations as to amount to a 'taking.'" *Penn Cent. Transp. Co. v. City of New York*, 438 U.S. 104, 127(1978), citing *Pennsylvania Coal Co. v. Mahon*. Here, by making it so burdensome for plan fiduciaries to fully exercise their proxy voting rights, the Proposed Rule forces them to give up the asset of proxy voting rights in one of the three prescribed ways. As such, the Proposed Rule not only frustrates the investment-backed expectations of affected ERISA plans, it deprives them of the asset—their right to vote the proxy—thus amounting to a taking without just compensation.

The Proposed Rule's "Analytical Model" Is Flawed and Should Be Disregarded

The costs and benefits of the Proposed Rule, contained in the Department's Appendix A "analytical model," simply do not add up. Rather than use the baseline of not taking any regulatory action, the assumed baseline of the "analytical model" is that the Proposed Rule's cost-benefit analysis and documentation requirements will be adopted without ERISA plans following its "permitted practices." The "analytical model" estimates that the total costs in staff time for conducting and documenting a cost-benefit analysis for each proxy vote to be $535 million per year. To offset this compliance burden, the "analytical model" estimates that the "permitted practices" will save over $1 billion annually in voting expenses. However, these estimated costs and estimated savings are equally implausible for the following reasons.

In reality, the regulatory burden of the Proposed Rule's cost-benefit analysis and recordkeeping requirement will almost certainly exceed the actual costs of simply voting. As the Department's notice of proposed rulemaking estimates in its Appendix A "analytical model," ERISA plan service providers will be required to spend two hours to research each vote that falls outside of the proposed "permitted practices," compared with just 30 minutes that fall within the "permitted practices." Documenting votes outside the "permitted practices" is estimated to take 20 minutes compared with 10 minutes for "permitted practices" votes. The Department estimates the total costs of this new regulatory burden to be more than $535 million annually for all ERISA plan service providers. But even this $535 million "analytical model" cost estimate dramatically underestimates the actual likely regulatory burden of the Proposed Rule.

Specifically, the "analytical model" assumes that "research costs will increase by 5 percent and that documentation costs will increase by 1 percent." This assumption is intended to account for the potential burden for asset management firms whose current proxy voting practices are inconsistent with the vote-specific cost-benefit analysis requirements that the Proposed Rule will require. In other words, the "analytical model" assumes that ERISA plan service providers are already incurring 95 percent of the required staffing time to conduct a cost-benefit analysis on whether or not to vote and 99 percent of the required documentation time. This is a curious assumption given that the preamble to the Department's Interpretive Bulletin 2016-01 stated:

> *While there may be special circumstances that might warrant a discrete analysis of the cost of the shareholder activity versus the economic benefit associated with the outcome of the activity, the Department did not intend to imply that such an analysis should be conducted in most cases.*[27]

It is simply illogical for the Department to assume that 95 percent of ERISA plan service providers are already conducting a burdensome cost-benefit analysis that the Department itself has stated is unnecessary in most cases. Removing this faulty assumption from the "analytical model" paints a more realistic picture of the Proposed Rule's true costs. Using all the other assumptions contained in the Department's "analytical model," ERISA plan service providers can expect to incur $1.9 billion in additional research costs[28] and $306 million in documentation costs[29] for votes falling outside the "permitted practices" and $8.2 billion in research costs[30] and $2.6 billion in documentation costs[31] for votes falling inside the "permitted practices." This totals $13 billion in estimated annual costs that will be likely passed onto ERISA plans if they continue to vote most proxies, as many will do to comply with their fiduciary duties under ERISA.

To offset this compliance burden, the "analytical model" estimates that the "permitted practices" will save $1 billion annually in voting expenses. However, these estimated savings are equally implausible. The total annual revenue of all proxy advisory firms can be estimated using the total revenue of the largest proxy advisory firm, Institutional Shareholder Services ("ISS"). Using revenue data for ISS, we estimate that the total annual fees collected by all proxy advisory firms (including revenue received from non-ERISA plans and non-ERISA service providers) is $228 million. According to the most recent publicly available data, ISS's total annual revenue was $122 million in 2013.[32] ISS is estimated to represent 60 percent of the proxy advisor industry as measured by the number of clients.[33] Assuming that all other proxy advisor firm fees are competitive with ISS, we estimate that the total annual revenue for the proxy advisory industry was $204 million in 2013 dollars ($122 million / 0.6) – or $228 million today after inflation.

Alternatively, one can estimate the total costs of proxy advisory firms by extrapolating the Department's own analysis of what ERISA plans have directly paid to their service providers.

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[27] 81 FR 95879.
[28] 148,276,968 (the total number of proxy votes cast) x 0.056 (the percentage of votes falling outside the permitted practices) x 2 (the number of additional research hours) x $116.96 (the hourly cost)
[29] 148,276,968 (the total number of proxy votes cast) x 0.056 (the percentage of votes falling outside the permitted practices) x 0.333 (the number of additional documentation hours) x $110.39 (the hourly cost)
[30] 148,276,968 (the total number of proxy votes cast) x 0.944 (the percentage of votes falling inside the permitted practices) x 0.5 (the number of additional research hours) x $116.96 (the hourly cost)
[31] 148,276,968 (the total number of proxy votes cast) x 0.944 (the percentage of votes falling inside the permitted practices) x 0.166 (the number of additional documentation hours) x $110.39 (the hourly cost)
[32] Barry Burr, "Vestar Capital Partners to acquire Institutional Shareholder Services," Pensions & Investments, March 18, 2014 ("In 2013, ISS accounted for 11.8% of MSCI's $1.035 billion in revenue and 4% of its $371 million in operating income, according to its 10-K report"), *available at* https://www.pionline.com/article/20140318/ONLINE/140319845/vestar-capital-partners-to-acquire-institutional-shareholder-services.
[33] "Corporate Shareholder Meetings: Issues Relating to Firms That Advise Institutional Investors on Proxy Voting," U.S. Government Accountability Office, June 2007, *available at* https://www.gao.gov/new.items/d07765.pdf.

According to the notice of proposed rulemaking, the Department's own analysis of Form 5500 data found 18 direct payments to one of the two leading proxy advisory firms, and 46 payments to a second service provider known to provide proxy voting advice. On average, these ERISA plans reported paying 0.2 basis points of total assets to their proxy voting service providers. As the Department acknowledged, its observed payments to a third service provider are likely for other services in addition to proxy voting services, and, therefore, are not comparable.

This percentage of assets cost estimate for proxy voting can be compared to all ERISA plan assets of $10.1 trillion dollars. Given the Department's observation that certain ERISA plans are directly paying 0.2 basis points to proxy advisory firms and other service providers for proxy voting advice, we extrapolate that all ERISA plans are incurring annual proxy voting costs of 0.2 basis points. These proxy voting costs may either be paid directly by ERISA plans or indirectly through their asset manager service providers. Multiplying this proxy voting service provider fee assumption of 0.2 basis points (0.002% or 0.00002 in decimal form) times the total dollar value of all ERISA plans' assets ($10.2 trillion), we estimate that all ERISA plans are incurring $202 million in annual costs for proxy voting. This cost estimate is likely to be a high end given economies of scale for large ERISA plans and large service providers.

The Department "analytical model" estimates that the Proposed Rule's "permitted practices" will save ERISA plans $1,076 million annually in avoided proxy voting costs. But even if one assumes that all proxy advisory firms exclusively serve ERISA plans and their service providers, it is hard to imagine how ERISA plans will save over $1 billion annually if they simply cease to vote proxies under the "permitted practices." The entire proxy voting advisory industry only generates an estimated $202 million to $228 million in annual revenue. The estimated cost savings of the "permitted practices" that are projected by the "analytical model" exceed the combined estimated annual revenue of all the proxy advisory firms—several times over. In other words, the new costs created by the Proposed Rule will far exceed the cost savings even if the Department succeeds in driving all the proxy advisory firms entirely out of business.

The Department's Notice of Proposed Rulemaking Is Procedurally Deficient

The rushed timeline of the Department's notice of proposed rulemaking is procedurally deficient. We reiterate our request in our September 4, 2020 letter that the Department extend this rulemaking comment period from 30 days to 120 days and hold a public hearing on the Proposed Rule. Executive Orders 12866 and 13563 state that federal agencies should generally provide a comment period of at least 60 days.[34] Paragraph (g) of the Proposed Rule proposes an effective date of just 30 days after publication of the final rule. We also note that the Proposed Rule has been classified as "economically significant" and a "major rule" by the Office of Information and Regulatory Affairs of the Office Management and Budget. The Congressional Review Act requires that "major rules" have an effective date at least 60 days after publication of the rule in the Federal Register or submitted to the U.S. Congress.[35]

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[34] Executive Order 12866, 58 FR 51735, October 4, 1993, and Executive Order 13563, 76 FR 3821, January 21, 2011.
[35] 5 USC § 801(a)(1)(A).

Given the significant economic impact of the Proposed Rule, a 30-day effective date will be highly disruptive to both ERISA plans and their service providers right as they enter into the 2021 proxy season. Moreover, a brief comment period combined with a short effective date deprives the public of reasonable notice and a meaningful opportunity to comment on the Proposed Rule. We note that the Proposed Rule was misclassified as a deregulatory action on the 2019 and 2020 Unified Agenda of Regulatory and Deregulatory Actions that is maintained by the Office of Information and Regulatory Affairs.[36] We fail to see how issuing a burdensome new regulation, where no previous regulation existed, can be classified as a deregulatory action. This misclassification error has deprived ERISA plans and their service providers of due process notice that a regulatory action was under active consideration by the Department. Misclassifying the Proposed Rule also fails to comply with Executive Order 13771 which requires that "for every one new regulation issued, at least two prior regulations be identified for elimination."[37]

We question the Department's timing of the Proposed Rule's effective date to coincide with the Department's proposed rulemaking on "Financial Factors in Selecting Plan Investments."[38] Both of these proposals will amend regulation 29 CFR § 2550.404a-1 on investment duties and should have been proposed as a single rulemaking. Proposing these two rulemakings separately ignores the potential for unintended interactions between these two related rulemakings. For example, the Department has not sufficiently addressed the question of how ERISA plan fiduciaries should consider the proxy voting practices of mutual funds. Because ERISA Section 401(b)(1) excludes assets held by registered investment companies, the Proposed Rule will not apply to the proxy voting of corporate shares held by mutual funds. But the combined proposed regulatory actions raise the question of whether a mutual fund's proxy voting of corporate shares on shareholder proposals related to environmental, social and governance issues would be imprudent under the Department's proposed rulemaking on Financial Factors in Selecting Plan Investments. Similarly, defined contribution plans will be left wondering if such a mutual fund could be included as the qualified default investment alternative.

The Paperwork Reduction Act Analysis Underestimates the Proposed Rule's True Costs

The Department's Paperwork Reduction Act ("PRA") analysis does not provide a reasonable estimate of the additional recordkeeping requirements that will be required by the Proposed Rule. The Department's PRA analysis estimates that ERISA plans will require merely a half hour of a plan fiduciary's time and a half hour of clerical help to comply with the Proposed Rule. No rationale for this estimate is provided, and experience tells us that it is impossible to conduct a vote specific cost-benefit analysis for an entire equity portfolio in this amount of time. Indeed, the Department's own "analytical model" estimates that ERISA plan service providers who vote will spend 30 minutes conducting research and 10 minutes documenting each proxy vote that

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[36] Unified Agenda of Regulatory and Deregulatory Actions (RIN 1210-AB91), Office of Information and Regulatory Affairs, https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=&RIN=1210-AB91.
[37] 82 FR 9339.
[38] 85 FR 39113. *See also* Letter from AFL-CIO to the Employee Benefits Security Administration, July 30, 2020, *available at* https://www.regulations.gov/contentStreamer?documentId=EBSA-2020-0004-0633&attachmentNumber=1&contentType=pdf.

falls in the "permitted practices," and 2 hours conducting research and 20 minutes documenting each proxy vote that falls outside of the "permitted practices." Nor does the Department's notice of proposed rulemaking attempt to resolve the substantial difference between the PRA annual cost estimate of $6,291,078 and the "analytical model" annual cost estimate of $535,217,964.

Not only is the PRA analysis of the burden of the Proposed Rule's mandated collection of information unsubstantiated, but the notice of proposed rulemaking also fails to adequately assess if there is any need for the records that will be created. Requiring ERISA plan fiduciaries to document a cost-benefit analysis for casting each proxy vote is of little practical utility given the Department's inability to cite a single enforcement action related to proxy voting since 1994 when the Department first issued interpretive guidance on proxy voting. Moreover, the Proposed Rule provides zero guidance to ERISA plan fiduciaries about the type or quality of information they would be required to record when conducting a cost-benefit analysis. This failure maximizes the burden of collecting this information because plan fiduciaries would first spend time trying to figure out what documentation is required and then documenting more than might be expected were such guidance included in the Proposed Rule.

The Unfunded Mandates Reform Act Analysis Also Underestimates the True Costs

In addition, the Department's Unfunded Mandates Reform Act analysis erroneously states that the Proposed Rule will not result in the expenditure of $100 million or more in any one year by entities that include the private sector. To the contrary, the Department's own "analytical model" estimates that ERISA plan service providers who vote proxies will incur $535 million in additional annual costs as a result of the Proposed Rule's burdensome cost-benefit analysis research and documentation costs. As previously discussed, the "analytical model" assumption that 95 percent of ERISA plan service providers are already conducting this cost-benefit analysis is faulty. Correcting for this error, the true costs of the Proposed Rule are estimated to exceed $13 billion annually, a large unfunded mandate on the private sector that requires a proper § 202 Unfunded Mandates Reform Act analysis of the Proposed Rule's costs and benefits.

The Regulatory Flexibility Act Analysis Ignores Higher Costs for Small Entities

Finally, the Department's Regulatory Flexibility Act ("RFA") analysis should have given greater weight to the disproportionate costs that the Proposed Rule will impose on small entities, e.g. small ERISA plans that cover fewer than 100 participants. Specifically, the Department's assumption that small ERISA plans are significantly less likely to be covered by the Proposed Rule because they are less likely to directly invest in company stock is unfounded. Small ERISA plans that exclusively invest in mutual funds will still be subject to the Proposed Rule when voting mutual fund shares. For example, the plan documents of many participant-directed 401(k) plans provide that the trustee shall vote mutual fund proxies if they do not receive voting instructions from plan participants. In addition, collective investment trusts are the fastest growing investment option for 401(k) plans due to their lower administrative costs compared to

SEC-registered mutual funds.[39] The Proposed Rule will also apply to the proxy voting of corporate shares that are held by collective investment trusts and other commingled investments.

The Department's RFA analysis is equally flawed in its consideration of the likely regulatory impact of the Proposed Rule on small entity service providers to ERISA plans. Without factual support, the RFA analysis states that "the Department believes that small entities are less likely to oversee investments over the investment universe considered here." To the contrary, small asset management firms are more likely to manage public equities for ERISA plans compared to other less liquid investments such as private equity or alternatives. The Department's RFA analysis estimates that ERISA plan service providers will each incur a fixed annual cost of $50,390, which exceeds the average annual revenue of 22 percent of small entity service providers according to the notice of proposed rulemaking's data from the Small Business Administration. In other words, the Proposed Rule's regulatory costs will prevent at least 22 percent of small entity service providers from serving ERISA plans.

Contrary to the Department's view, the Proposed Rule creates significant duplication and conflicts with the SEC's existing proxy voting rules. Most ERISA plans use registered investment advisers to manage their investments in company stock that have proxy voting rights. SEC Rule 206(4)-6 requires that investment advisers adopt policies and procedures that are reasonably designed to ensure that the investment adviser votes proxies in the best interest of its clients. The SEC's Rule 206(4)-6 guidance provides that a client and the investment adviser may agree to vote in favor of all proposals made by particular shareholder proponents.[40] The notice of proposed rulemaking not only fails to analyze whether adopting this permitted practice under SEC Rule 206(4)-6 is consistent with ERISA fiduciary duties, but it also proposes a conflicting "permitted practice" that only permits ERISA plan fiduciaries to vote in favor of corporate management. Moreover, the Proposed Rule's requirements for ERISA plan fiduciaries that use proxy advisory firms overlaps with the SEC's new regulations on proxy advisory firms.[41]

The Proposed Rule's "Permitted Practices" Intrude into State Corporate Law

The Department's notice of proposed rulemaking does not adequately consider the federalism implications of the Proposed Rule. State general corporation laws provide for proxy voting by shareholders to address the principal-agent problem that arises from the separation of ownership and control.[42] Proxy voting by shareholders on director elections and other corporate actions is

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[39]Erach Desai and Jason Dauwen, "Collective Investment Trusts – A Perfect Storm," DST Systems, March 2017, *available at* https://www.ctfcoalition.com/portalresource/AM-WP-CollectiveInvestmentTrustsAPerfectStorm-030317.pdf.
[40] U.S. Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release Nos. IA-5325; IC-33605, September 10, 2019, *available at* https://www.sec.gov/rules/interp/2019/ia-5325.pdf.
[41] U.S. Securities and Exchange Commission, Exemptions from the Proxy Rules for Proxy Voting Advice, Final Rule Release No. 34-89372, July 22, 2020, *available at* https://www.sec.gov/rules/final/2020/34-89372.pdf.
[42] *See e.g., MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003) ("while these "fundamental tenets of Delaware corporate law provide for a separation of control and ownership," the stockholder franchise has been characterized as the "ideological underpinning" upon which the legitimacy of the directors managerial power rests").

an inherent part of the checks and balances that effectuates good corporate governance.[43] Contrary to this state corporate law presumption that shareholders vote in their self-interest, the Proposed Rule's "permitted practices" encourage ERISA plan fiduciaries to always vote with corporate management or to refrain from proxy voting. Pursuant to Executive Order 13132, the Department should first consult with state officials regarding these federalism implications for proxy voting by shareholders before adopting the Proposed Rule.

Conclusion

For these reasons, the AFL-CIO respectfully requests that the Department withdraw the Proposed Rule in its entirety and allow its existing sub-regulatory guidance to remain in place. In the alternative, the Department should revise the Proposed Rule to remove the unlawful "permitted practices" for proxy voting and the burdensome cost-benefit analysis and documentation requirements. The Department should invite additional comments on its revisions to the Proposed Rule if the Department decides to move forward with a rulemaking. The AFL-CIO also requests that the Department schedule a public hearing on the Proposed Rule, to be conducted virtually in accordance with COVID-19 public health guidelines. As is customary for Department rulemakings, the hearing should be accompanied by the opportunity for the submission of post-hearing comments by participants and observers. Accordingly, the comment period on the Proposed Rule should be held open after the public hearing.

Sincerely,

Brandon J. Rees
Deputy Director, Corporations and Capital Markets

[43] Robert Monks and Nell Minow, Corporate Governance (5th Edition), John Wiley & Sons, August 2011.