Social Responsibility Resolutions

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Shareholders exert significant influence on the social and environmental behavior of U.S. corporations through their votes on social responsibility resolutions. However, the outcomes of many social responsibility resolutions are distorted, because the largest shareholders—institutional investors, such as mutual funds and pension funds—often do not follow the interests or the preferences of their own investors. This Article presents evidence that institutions with similar investors and identical fiduciary duties vote very differently on social responsibility resolutions, suggesting that some institutional votes distort the interests of their investors. Other evidence presented suggests that institutional votes on social responsibility resolutions vary significantly from the preferences of their own investors. Whether such distortion of preferences is a problem is an open question. If such distortion is considered to be a problem, it could be addressed by institutions changing their voting policies on social responsibility resolutions to better approximate the preferences of their investors. The stakes are high: eliminating distortion could significantly influence the behavior of corporations on social and environmental matters in a way that investors, and society, would prefer.

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I. INTRODUCTION

Shareholders exert significant influence on the social and environmental behavior of U.S. corporations. Shareholders vote on social and environmental resolutions, which I refer to as 'social responsibility resolutions,' that are put forward at corporations. The success or failure of social responsibility resolutions influences the social and environmental behavior of those corporations. The largest shareholders are institutional investors—mutual funds, investment advisers, and pension funds. When they vote on social responsibility resolutions, they do so as fiduciaries for their own investors. This article considers two questions: Do the votes of institutions on social responsibility resolutions follow the interests of their own investors? And do the votes of institutions on social responsibility resolutions follow the preferences of their own investors? The article puts forward evidence that they do not, and considers whether this is a problem, and how it could be addressed. The stakes are high: if institutional investors voted on social responsibility proposals as their own investors preferred, corporate behavior on social and environmental matters might be much closer to what investors, and society, would prefer.

Voting has long been recognized as one of the primary rights of shareholders.[1] Shareholders vote to elect the board of directors of the corporation, as well as on fundamental corporate transactions and changes to the corporate charter.[2] Shareholders can also vote on precatory resolutions put forward by other shareholders, including those included in the corporation's proxy statement by shareholder proposals, as required by the Securities and Exchange Commission (SEC).[3] This article focuses on social responsibility resolutions, those requesting that corporations take certain actions on social and environmental matters.

If a sole investor or a small group of investors held shares in a corporation directly, they could coordinate and vote to cause the board of directors to act in their preferred manner. However, the number of investors in U.S. public corporations is very large, making coordinated action difficult. Some of these investors own shares in corporations

1. *See, e.g.*, Blasius Indus. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."); Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996) ("[T]he stockholders control their own destiny through informed voting. This is the highest and best form of corporate democracy.").

2. For a discussion of shareholder voting on charter amendments, *see* Scott Hirst, *Frozen Charters*, 34 YALE J. REG. 91 (2017).

3. 17 C.F.R. § 240.14a-8 (2017). Shareholder proposals submitted pursuant to Rule 14a-8 contain "recommendation or requirement that the company and/or its board of directors take action." These recommendations or requirements are presented as resolutions that shareholders vote upon at the corporation's meeting. The terms "proposal" and "resolution" are often used interchangeably; I will generally use the term "resolution."

directly, but the overwhelming majority invest through institutional investors—mutual funds, investment advisers, and pension funds. Each of these institutions invests in corporations as a fiduciary on behalf of these investors. Because these investors invest through intermediaries that make voting decisions on their behalves, there is a possibility that the voting decisions may not reflect their interests, or their preferences. In examining this issue, this article focuses on voting by mutual funds, not only because mutual funds hold the largest proportion of equity of U.S. corporations, but also because they are the only type of institution for which voting data is widely available. The fiduciary duties of mutual fund directors and investment advisers are generally interpreted as requiring them to vote on resolutions at portfolio corporations, in the best interests of their investors.[4]

A consideration of the voting records of mutual funds suggests that the way some mutual funds vote on social responsibility resolutions may represent a distortion of either the interests or the preferences of their investors. First, votes of different mutual funds on social responsibility resolutions diverge widely, even among mutual funds that are likely to have very similar investors with very similar interests. If there is a way to vote on these resolutions that reflects the best interests of these investors, some mutual funds appear to be voting wrongly on many resolutions. Second, this article provides evidence that the way that many mutual funds vote on resolutions may differ from the views of a majority of their own investors. Because funds vote 'all-or-nothing' for, against, or abstain, even where funds vote the way a majority of their investors are likely to prefer, there will be a divergence from the preferences of a minority of their investors.

Even if this is the case, does it matter that mutual fund votes may not follow the preferences of their investors? This is open to debate. If mutual funds can determine better than their own investors what is in the interests of those investors, then this distortion may be optimal. Alternatively, if corporations can determine for themselves the actions that will maximize value on the matters being considered, then the preferences of investors may be irrelevant. However, if it is considered valuable for corporations to follow the wishes of their investors, then these distortions may represent a significant problem, as they result in corporations being less likely to act as their ultimate investors would prefer. Many resolutions requesting action on environmental and social matters may fail where investors would prefer that they pass. Corporations are less likely to take requested actions where resolutions fail. And proponents are less likely to bring resolutions at other corporations, or bring other kinds of resolutions, given that such resolutions attract less support than they otherwise would. Public officials that consider the results of resolutions as a proxy for investor preferences on these matters will receive distorted information, and may be less likely to take action themselves.

This Article does not attempt to offer a conclusion regarding whether distortion constitutes a problem, or even whether it is taking place. However, in the event that distortion is taking place and is considered a problem, the article considers the alternatives for resolving the problem. One possible solution is for investors to choose mutual funds that vote in the ways that they prefer. This already takes place to limited extent when

4. *See, e.g.*, Interpretive bulletin relating to written statements of investment policy, including proxy voting policy or guidelines. 29 C.F.R. § 2509.94-2 (2006) (codifying policies previously issued in advisory letters) ("The fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock."). While this interpretation only applies to investment advisers to ERISA pension plans, since these are the same advisers that advise mutual funds its effect has been that investment advisers to mutual funds routinely vote the shares of those mutual funds.

investors invest in "socially responsible investment" funds. However, socially-responsible investment funds represent a small percentage of aggregate funds invested, and there are significant impediments to widespread sorting among mutual funds, including very limited investor access to the information necessary to make such decisions. The alternative is for mutual funds to consider the preferences of their investors when determining voting policies and decisions. In order to represent investors with preferences representing a minority of investment in the fund as well as those representing a majority, mutual funds could adopt policies whereby they would split their vote in proportions consistent with the preferences of their investors. Vote splitting is currently rare, but as a practical matter it is likely to be relatively straightforward for these well-resourced institutions.

The next step in this debate should be for further consideration of the preferences of investors. The data used in this Article to draw conclusions about investor preferences is limited and imperfect; the investment industry—with the encouragement of the SEC—should undertake their own analysis to determine whether their voting differs from how their investors would prefer, and whether this represents a problem.

The remainder of this Article is structured as follows. Part II describes the background to shareholder voting on social responsibility resolutions. Part II.A. considers the composition of "shareholders," and describes how they are predominantly institutional investors—mutual funds, investment managers and pension funds—that invest on behalf of U.S. households, the ultimate investors in U.S. corporations. Part II.B. considers shareholder voting, including the rules that apply to mutual fund voting, and the resolutions that are voted on by shareholders. Part III provides empirical evidence of mutual fund voting on social responsibility resolutions. Part III.B. highlights the divergence of voting among mutual funds, and the potential issues this raises. Part III.C. considers evidence of likely investor preferences to draw conclusions about how mutual fund votes may not represent the preferences of their investors, and Part III.D. considers arguments whether or not this distortion constitutes a problem. If distortion is considered to be a problem, Part IV examines two alternatives approaches for undistorting shareholder voting, and explains how this may have a significant impact on the social and environmental behavior of U.S. corporations.

II. Shareholder Voting & Social Responsibility Resolutions

A. Shareholders

Although some proportion of the equity of public corporations is owned by individuals and households directly or through brokers, the significant majority of equity of most corporations is beneficially owned by institutional investors—mutual funds, investment advisers and pension funds. Each of these institutions are fiduciaries for their own beneficiaries. According to the U.S. Federal Reserve's quarterly accounts as of the end of 2014, of approximately $29.8 trillion in equity of U.S. corporations, 35% was owned directly by households and non-profit organizations, 14% was owned by pension funds (split approximately equally between public and private pension funds), 24% was held by mutual funds, 6% by insurance companies, and 20% was held by foreign investors.[5]

5. *See* BOARD OF GOVERNORS OF THE FED. RES., FEDERAL RESERVE STATISTICAL RELEASE Z.1, FINANCIAL ACCOUNT OF THE UNITED STATES 119 (Mar. 12, 2015),

The beneficiaries of institutional investors are U.S. households. In the case of defined benefit pension plans, they are past and future retirees. In the case of mutual funds and investment advisers, although a significant proportion—25% of mutual funds and investment advisers[6]—is held by public pension funds, the majority is held by individuals who purchase directly ("retail" investors) or through individual retirement accounts (IRAs), and many more that purchase through their defined contribution plans, often referred to as "401(k) plans."[7]

This Article focuses on voting by mutual funds, because mutual funds own the largest proportion of U.S. equity, and because—as discussed below—mutual funds are the only type of institution generally required to disclose their votes. The structure of mutual fund holdings, through shares or units, also makes it easy to identify the proportion of the fund that is held for particular beneficiaries. It is not possible to do the same for beneficiaries of defined benefit plans, which contain a mix of vested interests for employees that have retired, and unvested interests for employees that have not yet retired, the value of which cannot be ascertained. However, similar issues of distortion of beneficiary preferences as discussed below are likely to arise for defined contribution plans as well, and similar arguments could be applied.

B. Shareholder Voting

As the beneficial owners of shares in corporations, mutual funds generally have the right to direct the votes[8] associated with those shares on the matters that are put to a vote at those corporations. Each mutual fund is organized as a corporation (predominantly in Maryland), or a trust (predominantly Massachusetts business trusts or Delaware statutory trusts).[9] Directors or trustees have the responsibility to vote but delegate this

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https://www.federalreserve.gov/releases/z1/20150312/z1.pdf. [hereinafter FEDERAL RESERVE STATISTICAL RELEASE Z.1]. The remainder was held by other financial institutions, and government (excluding public pension funds). Because the value for households is calculated as the residual left after other owners of corporate equity are determined, and because the Federal Reserve's accounting is insufficiently granular to pick up certain kinds of institutional investors—for example, hedge funds—these numbers likely understate the ownership of corporate equity by institutions. *See Description of Table L.101 - Households and Nonprofit Organizations*, FED. RES. SYS. (2015), https://www.federalreserve.gov/apps/fof/TableDesc.aspx?t=L.101 (describing the data in table L.101).

6. *See* FEDERAL RESERVE STATISTICAL RELEASE Z.1, , *supra* note 5, at 119 (laying out the collected data).

7. "401(k) plans" are defined contribution plans sponsored by corporations. *See* Internal Revenue Code, Qualified pension, profit-sharing and stock bonus plans, 26 U.S.C. § 401(k)(2) (2012). Similar defined contribution plans sponsored by tax-exempt organizations are governed by Section 403(b) of the Internal Revenue Code. *See* Internal Revenue Code, Taxation of employee annuities, 26 U.S.C. § 403(b) (2012). Defined contribution plans sponsored by federal or state government are generally governed by separate legislation—e.g., the Thrift Saving Plan for employees of the U.S. Federal Government, or the New York State Voluntary Defined Contribution Plan.

8. Technically, the right to vote associated with shares is held by the registered owner of shares. The shares beneficially owned by institutional investors such as mutual funds are held by custodians, which in turn hold the shares through a clearing organization, the Depository Trust Corporation (DTC), which is the legal owner of shares in the corporation, and, therefore, exercises the legal right to vote. The DTC does this by submitting an omnibus proxy, which aggregates voting directions that it has received from custodians, which in turn received instructions from the mutual funds and other institutions that beneficially own the shares held by the custodian. For a comprehensive discussion of this process, *see* Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 GEO. L.J. 1227, 1243–249 (2008).

9. Although the fiduciary duties of trustees under common law generally vary significantly from those of

responsibility—along with the management of the mutual fund—to investment advisers, each of which advises many different mutual funds. Although directors formally appoint the investment adviser, mutual funds are generally established and organized by investment advisers, which not only operate the funds, but also use the investment adviser's name in the naming and marketing of the fund. Each investment adviser generally advises dozens or hundreds of funds. The group of funds advised by an investment adviser is often referred to as a 'fund complex' or 'fund family.'

Mutual funds are required to publicly disclose the policies and procedures by which they determine how to vote the shares owned by the mutual fund,[10] and to publicly disclose how the fund voted on each resolution that was put to a vote at companies in which it owned shares, in an SEC filing on Form N-PX.[11] Investment advisers are also required to disclose their proxy voting policies, and maintain records of their proxy voting.[12] Larger investment advisers have dedicated corporate governance staff, who are responsible for the preparation and implementation of voting policies. Smaller investment advisers may delegate the task of voting according to each fund's voting policies to an outside proxy advisor. In each case, voting policies are approved by the board of directors of the fund.

C. Social Responsibility Resolutions

The matters that mutual funds vote on—and therefore, the matters covered by these policies—encompass all of the matters put to a vote at public corporations: the election of directors, fundamental corporate changes such as mergers, changes to the corporation's charter, and resolutions put forward by the directors or shareholders of the corporation. Resolutions put forward by shareholders include social responsibility resolutions—those related to environmental and social matters—as well as governance matters. This article focuses on social responsibility resolutions, as mutual fund voting on these matters is more likely to diverge from the preferences of individual investors than voting on elections, mergers or governance matters. Voting for directors and voting on mergers requires considerable information about the company, its prospects and management, which ultimate investors—households—are unlikely to have knowledge of. Similarly, households are unlikely to have in-depth knowledge about governance matters voted on at corporations, such as whether corporations' compensation arrangements are value enhancing, or whether corporations should have classified boards or annual elections. In contrast, the most common social responsibility resolutions relate to political contributions and lobbying disclosure, greenhouse gas emissions, climate change and sustainability. These are topics that are part of the popular discourse, on which individual investors are

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directors, the Massachusetts and Delaware statutes under which these trusts are established recognize that trustees of those trustees owe duties akin to directors, rather than akin to trustees in general law. Saminksy v. Abbott 185 A.2d 765 (Del. Ch. 1961) sets out the position in Delaware. Halebian v. Berv, 931 N.E.2d 986 (Mass. 2010) illustrates the Massachusetts position. For parsimony, this article will refer to 'directors' of mutual funds, but the arguments made apply equally to mutual funds organized as trusts that therefore have trustees rather than directors.

10. Item 17(f), Form N-1A, 17 C.F.R. § 239.15A (2017) (requiring the disclosure of "the policies and procedures that the [f]und uses to determine how to vote proxies relating to portfolio securities").

11. Form N-PX, 17 C.F.R. § 274.129 (2017) (requiring the disclosure of proxy voting records).

12. 17 C.F.R. § 275.204-2 (2017) (requiring investment advisers to maintain proxy voting policies and records); *see also* 17 C.F.R. § 275.206(4)-6 (2017) (providing that exercises of voting authority are fraudulent, deceptive or manipulative unless voting policies are formulated and disclosed to clients).

likely to have their own preferences, and their own views regarding whether or not actions on these matters are likely to increase value. Table 1, below, lists the most common types of social responsibility resolutions voted on at annual meetings in 2014 (excluding categories with less than five resolutions voted on), the number of resolutions voted on for each category, and the average votes cast in favor of those resolutions as a percentage of votes cast.[13]

Table 1: Results for Most Common Social Responsibility Resolutions, 2014

13. Data is derived from ISS's Voting Analytics database. Note that there are significantly more shareholder resolutions submitted than voted upon. If Rule 14a-8 permits, certain resolutions may be omitted from proxy statements. *See* 17 C.F.R. § 240.14a-8(i) (2017) (setting out bases on which a company may rely to exclude resolutions). A corporation receiving a resolution may also reach agreement with the proponent to withdraw the resolution. However, it can be difficult to find accurate figures for the number of resolutions submitted. Requests for permission to exclude resolutions are public. However, neither companies nor proponents are required to disclose the number of resolutions that are withdrawn by agreement with corporations. As a matter of practice, many of the organizations submitting such resolutions disclose their resolutions, and these are collected by the organization As You Sow, but these are likely to underestimate the true number of resolutions submitted. *See, e.g.,* As You Sow et al., *Proxy Preview 2015*, PROXY PREVIEW, http://www.proxypreview.org/Proxy-Preview-2015.pdf (last visited Nov. 29, 2017).

	Type of Resolution	*Resolutions*		*Percentage of votes cast*		
		Voted	*Passed*	*For*	*Against*	*Abstain*
Social Resolutions	Political Contributions Disclosure	45	1	26%	61%	12%
	Political Lobbying Disclosure	38	0	23%	66%	11%
	Political Activities and Action	12	0	7%	88%	5%
	Human Rights Risk Assessment	9	0	22%	66%	12%
	Sexual Orientation Anti-bias Policy	6	0	35%	59%	6%
	Anti-Social Resolution	7	0	3%	90%	7%
Environmental Resolutions	Green House Gas Emissions	20	0	21%	66%	13%
	Report on Sustainability	13	0	25%	63%	13%
	Climate Change	9	0	19%	68%	12%
	Recycling	6	0	18%	74%	9%
	Genetically Modified Organisms	6	0	5%	84%	11%

Source: ISS Voting Analytics Database.[14]

Table 1 shows that, of the most common social responsibility resolutions in 2014, only one resolution passed,[15] and that social responsibility resolutions receive relatively low levels of shareholder support,[16] with the most successful category receiving average support of 35% of votes cast.

The social responsibility resolution most frequently voted on in 2014 requested the disclosure of political contributions by the corporation. The most common version of this type of resolution was based on a template promulgated by the Center for Political Accountability, which takes the following form:

> Resolved, that the shareholders of [Company] hereby request that the Company provide a report, updated semi-annually, disclosing the Company's:
>
> 1. Policies and procedures for making, with corporate funds or assets, contributions and expenditures (direct or indirect) to (a) participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office, or (b) influence the general public, or any segment thereof, with

14. The social responsibility proposal data extracted from the proprietary ISS Voting Analytics Database and summarized in this table is on file with the Journal of Corporation Law.

15. That resolution was a resolution requesting that Smith & Wesson Holding Corporation disclose its political contribution and lobbying expenditure. It received 49.7% of votes cast, but 55.8% of the for/against votes, the standard on which the company determines shareholder resolution success. Smith & Wesson Holding Corp., Current Report (Form 8-K) (Sept. 22, 2014).

16. The low rates of success in the resolutions that are voted on are likely to reflect some level of selection bias. If a company believes a resolution is likely to pass, or even to receive significant support, the company may reach an agreement with the proponent to undertake all or some of the measures that the resolution requests, in return for the proponent withdrawing the resolution.

respect to an election or referendum.

2. Monetary and non-monetary contributions and expenditures (direct and indirect) used in the manner described in section 1 above, including:

a. The identity of the recipient as well as the amount paid to each; and

b. The title(s) of the person(s) in the Company responsible for decision-making.

The report shall be presented to the board of directors or relevant board committee and posted on the Company's website.[17]

Part III uses resolutions requesting disclosure of political contributions like this one to consider how mutual fund votes may distort investor interests and preferences.

III. Distortions in Social Responsibility Resolutions

A. Voting on Social Responsibility Resolutions

How do mutual funds actually vote on resolutions requesting disclosure of political spending? To consider this question, this section presents voting data drawn from ISS's Voting Analytics database, which is based on the data released by mutual funds on Form N-PX, and includes data on 746 shareholder resolutions voted on at 326 companies at annual meetings between July 1, 2013 and June 30, 2014. For those resolutions, the database contains votes by 4,003 mutual funds in 236 fund families, with 295,441 total fund-votes.

I assemble voting data on resolutions requesting disclosure of political spending, and for comparison, those relating to greenhouse gas emissions, the most frequently submitted environmental resolution in *Table 1***.** For each fund family with more than 10 votes on a particular resolution, I determine the proportion of the fund-votes in that family that were for, against, and abstain.

For each mutual fund family, I present the percentage of fund-votes in favor, against and abstain on each type of resolution. Almost all funds in the sample voted 'all-or-nothing' on each resolution[18]—that is, the fund voted all of its shares the same way on the resolution, either for, against, or abstain. To illustrate, a 30% "for" result for a fund family with 50 mutual funds that voted on 20 resolutions of a particular type could mean that, of the fund family's 1,000 total fund-votes, 30 of the funds in the family voted all of their shares in 10 companies in favor of the resolution, or all 50 of the funds in the family voted all their shares in 6 companies in favor of the resolution.

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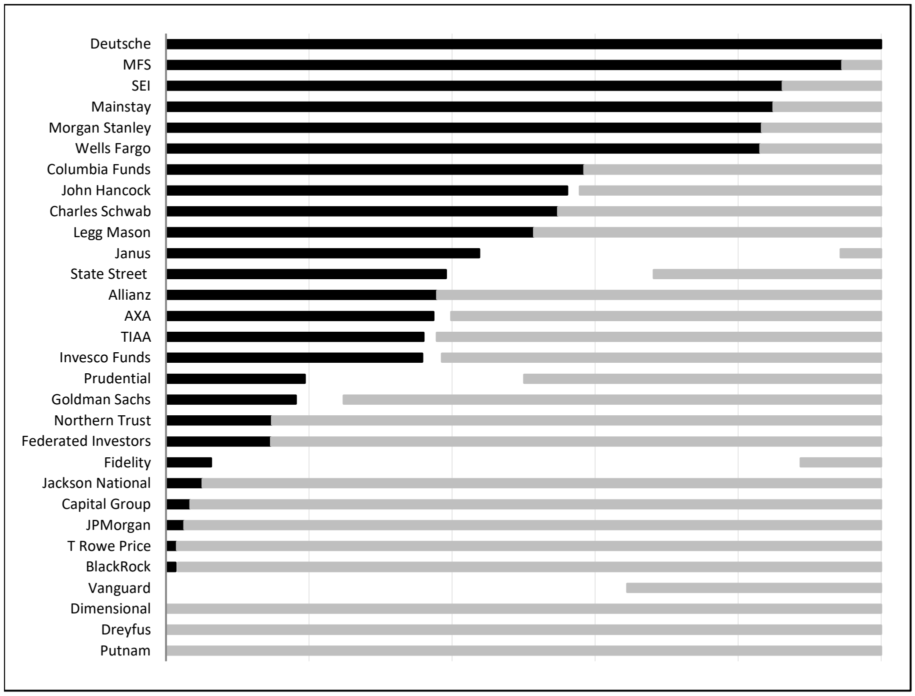
17. *The CPA Model Resolution Information Packet: Disclosure of Corporate Election-Related Spending*, Ctr. for Political Accountability 5, http://files.politicalaccountability.net/reports/transparency-and-accountability-3/CPA_Model_Resolution_Info_Packet.pdf (last visited Dec. 12, 2017).

18. Of the 295,411 fund-votes in the data set, there were only 106 split votes (0.04%), from 12 fund families, notably from J.P. Morgan Asset Management, which split 33 fund-votes, Leader Capital-19 votes, John Hancock-16 votes, and Wilshire Associates-14 votes. The voting policy of J.P. Morgan Asset Management suggests that it likely split votes because one or more of the funds' portfolio managers had a different opinion on the resolution's value than the fund's overall voting decision. *See* J.P. Morgan Asset Management, *Global Proxy Voting Procedures and Guidelines* 3 (Apr. 1, 2017) https://am.jpmorgan.com/blob-gim/1383433248923/83456/2017_Global%20Procedures%20and%20Guidelines_FINAL.pdf ("JPMAM may cast different votes on behalf of different clients or on behalf of the same client with different accounts.").

Figure 1 presents data for votes by the largest 30 fund families[19] on political spending disclosure resolutions, in decreasing order of the percentage of fund-votes in favor. Funds with less than 100 fund-votes are excluded. Black bars denote the proportion of fund-votes in favor, gray bars the proportion against, and white (the gap between the black and grey bars) denotes the proportion of fund-votes that abstained. The data are also presented in tabular form in the Appendix, together with the corresponding data ranked by fund family size.

19. The largest funds are determined by the total net assets of the fund, derived from the CRSP Mutual Funds database.

Figure 1: Largest Mutual Fund Family Voting on Resolutions regarding Political Spending Disclosure



Source: ISS Voting Analytics Database.[20]

The funds in *Figure 1* voted, on average 27.6% "for" and 55.4% "against" (weighted by the number of fund votes in the family). For comparison purposes, *Figure 2*, present corresponding results for resolutions regarding greenhouse gas emissions disclosure (the corresponding averages are 27.2% "for" and 58.6% "against").

Figure 2: Largest Mutual Fund Family Voting on Resolutions regarding

20. The fund voting data extracted from the proprietary ISS Voting Analytics Database and summarized in this chart is on file with the Journal of Corporation Law.

Greenhouse Gas Source: ISS Voting Analytics Database.[21]
Emission Disclosure

B. Heterogeneity in Voting on Social Responsibility Resolutions

Figure 1 and Figure 2 show that different fund families vote very differently from one another on particular types of resolutions.[22] For example, on resolutions to disclose political spending, Deutsche Asset Management voted 100% of its fund-votes in favor of such resolutions. Yet Dreyfus, Putnam and Dimensional voted 100% of their fund-votes against such resolutions. If there was likely to be significant variation in the investors served by these different fund families, the variation might be explained by the fund following the preferences of their investors. For instance, if one of the institutions were a socially responsible investment fund, it might attract particularly socially-minded investors, whose preferences may differ from those mainstream mutual fund investors, which might explain the different voting results. However, all of the funds included in *Figure 1 and Figure 2* are all very large, mainstream mutual funds. Given the size and number of investors in these mutual funds, the comparability of their mutual fund offerings, and the robust competition in the mutual fund market,[23] it is likely that there is a significant overlap between the types of investors these funds cover. It is therefore likely that the views of ultimate investors in the funds in *Figure 1 and Figure 2* do not vary significantly from one fund to another. As a result, the preferences of the ultimate investors in these funds are unlikely to vary as much as the variation in the votes among the funds. Funds that vote in radically different ways cannot all be right about which vote would maximize shareholder

21. The fund voting data extracted from the proprietary ISS Voting Analytics Database and summarized in this chart is on file with the Journal of Corporation Law.

22. This is consistent with empirical evidence on mutual fund voting in director elections. *See, e.g.*, Gregor Matvos & Michael Ostrovsky, *Heterogeneity and Peer Effects in Mutual Fund Proxy Voting*, 98 J. FIN. ECON 90, 90 (2010) ("[M]utual funds systematically differ in their voting behavior.").

23. *See* John C. Coates IV & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151, 153 (2007) ("[P]rice competition is in fact a strong force constraining fund advisers . . . .").

value. And if those funds have shareholders with similar preferences, at least some of the funds must be voting in ways that do not match the preferences of their investors.

How can mutual funds vote so differently? Mutual funds directors, who are ultimately responsible for fund voting, have a fiduciary duty to act in the best interest of the mutual fund. Investment advisers, which advise on and carry out fund votes, have a fiduciary duty to act in the best interests of their client, the mutual fund. The content of these duties is the same for all mutual funds: to maximize the value of the fund, which means maximizing the value of the portfolio companies that are subject to these resolutions. If these fiduciaries have the same imperative, how can they vote for opposite outcomes?

The only way to reconcile these conflicting actions is that different mutual funds have different beliefs about the actions that are most likely to increase the value of the company. This is possible because of the limited evidence about the effects of different environmental and social actions by corporations on value. For instance, consider the evidence regarding disclosure of political contributions. Although there has been a substantial amount of research spread across a number of disciplines about corporate political activity by corporations,[24] only a small part of this deals with the value effects of political contributions. Key parts of this question are under-explored, and the empirical evidence that has been produced provides conflicting evidence of whether political spending increases or decreases corporate value, and for which corporations and under what circumstances it does so. This empirical evidence relating to the value effects of political spending relates to spending that has been disclosed; the evidence on *whether* disclosure of political spending increases or decreases corporate value is very limited.

Despite this paucity of evidence, mutual fund directors and investment advisers are nonetheless forced to make decisions about which outcome on each issue is most likely to maximize the value of the corporation. So it should be no surprise that they make decisions based on factors other than the evidence, and that those factors, and the consequent decisions, vary widely. In some cases, there may be interests other than those of their clients that could affect investment adviser decision making. Others have suggested that mutual funds may have incentives to not vote against the preferences of managers of corporations, in order to improve their chances of receiving plan administration business from those corporations.[25] Investment advisers that are public companies may themselves be subject

24. A number of review articles describe the extensive empirical literature on corporate political activity, which includes political contributions, political spending, lobbying, and political networks, and which also consider the effects of corporate political activity on value. *See generally* Brian Shaffer, *Firm-level Responses to Government Regulation: Theoretical and Research Approaches*, 21 J. MGMT. 495 (1995); Amy Hillman, Gerald Keim & Douglas Schuler, *Corporate Political Activity: A Review and Research Agenda*, 30 J. MGMT. 837 (2004); Ike Mathur & Manohar Singh, *Corporate Political Strategies*, 51 ACCT. & FIN. 252 (2011); Sean Lux, T. Russell Crook & David J. Woehr, *Mixing Business with Politics: A Meta-Analysis of the Antecedents and Outcomes of Corporate Political Activity*, 37 J. MGMT. 223 (2011) (concluding that corporate political activity does increase corporate value).

25. *See, e.g.*, Lucian Bebchuk et al., *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 102 (2017); Jennifer S. Taub, *Able but Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights*, 34 J. CORP. L. 843, 846 (2009) ("[t]he greater the dependency of the [a]dviser upon the [defined contribution] channel for asset management business, the less likely the fund family will be to support shareholder-sponsored governance resolutions."); Rasha Ashraf, Narayanan Jayaraman & Harley Ryan, *Do Pension-Related Business Ties Influence Mutual Fund Proxy Voting? Evidence from Shareholder Proposals on Executive Compensation*, 47 J. FIN. & QUANTITATIVE ANALYSIS 567, 567 (2012) ("Overall, our results suggest that pension-related business ties influence fund families to vote with management at all firms.").

to potential shareholder pressure on the same matters that they are voting on at their portfolio companies;[26] voting in favor of change at a portfolio company might invite suggestions that the investment adviser itself make such a change.

C. Distortions in Social Responsibility Resolutions

How do mutual fund votes compare to the views of their own investors on the issues they vote on? No public data exists showing the preferences of the investors in particular mutual funds. However, since the ultimate investors in mutual funds are U.S. households, and the largest mutual funds represent millions of investors, the preferences of the investors in these funds are likely to approach the preferences of American households more generally. Mutual fund ownership is skewed towards wealthier and higher income members of society.[27] However, a rough sense of the preferences of investors in mutual funds can be gained by considering opinion polls of the general population.

In an opinion poll conducted by Bannon Communications on behalf of the Corporate Reform Coalition in October 2012, 71.4% of respondents favored or strongly favored a resolution that "shareholders in a company approve all corporate political spending before the money is spent," an even stronger position than requiring disclosure of political spending. 76.5% of respondents favored or strongly favored a resolution that required corporations to "publicly disclose political expenditures to other groups that spend money on politics like the Chamber of Commerce."[28] The results showed small and inconsistent variations among the groups of respondents younger than 35, between 35 and 55, and older than 55.

Additional light is shed on the robustness of the results across different groups by a poll conducted by Survey USA on behalf of People for the American Way, in February 2010.[29] One of the questions in the poll asked "Should a publicly traded corporation get shareholder approval before the corporation spends money to support or oppose a candidate for elected office? Or, is shareholder approval not necessary?".[30] 75% of respondents responded that corporations should get shareholder approval, compared to 13% responding that approval was not necessary.[31] Respondents aged 50 and over were more likely to respond that approval was necessary than those aged 18 to 49.[32] Similarly, respondents

26. For instance, in 2016 shareholders of T. Rowe Price Group, Inc. and Franklin Resources, Inc. put forward shareholder resolutions requesting reports on climate change. T. Rowe Price Group, Definitive Proxy Statement (Def. 14a) (Mar. 18, 2016), at 50; Franklin Resources, Definitive Proxy Statement (Def. 14a) Jan. 8, 2016, at 53.

27. *See* Edward N. Wolff, *Who Owns Stock in American Corporations*, 158 PROC. AM. PHIL. SOC'Y 372, 387 (2014) (describing ownership of mutual funds).

28. *Corporate Reform National Survey*, PHONETICALL (Mar. 28, 2015), http://perma.cc/BAJ8-4ZA2. The poll interviewed a random sample of 804 Americans aged 18 and over, and had an estimated margin of error of 3.8%. *See also* Brad Bannon, *Executive Summary for National Survey on Corporate Reform*, BANNON COMM. RES. (Oct. 18, 2012), http://www.citizen.org/documents/bannon-communications-research-executive-summary.pdf (explaining the survey).

29. *People for the American Way, Results of Survey, USA News Poll #16270*, SURVEYUSA (Feb. 10, 2010), http://www.surveyusa.com/client/PollPrint.aspx?g=05cabb5f-599f-47a8-98fb-e3e254e425e4 [hereinafter *People for the American Way*]. 1,200 American adults were interviewed for the poll. The poll had a margin of error of 2.5%. *Id.* at 1.

30. *Id.* at 6.

31. *Id.*

32. *Id.*

with annual income over $50,000 were more likely to respond that approval was necessary than those with annual income less than $50,000.[33]

Obviously, these are imperfect estimates of the views of mutual fund investors, for a multitude of reasons: the polls were not restricted to mutual fund investors; there was no weighting by the number of mutual fund units or shares owned; results were likely to be influenced by the framing and wording of the questions posed (for instance, the questions did not mention the potential cost of implementing the resolutions); and the polls were commissioned by progressive organizations seeking to limit corporate political activity. To further this debate, methodologically superior polling of mutual fund investors should be conducted. The results of such polling are likely to differ from those presented here. However, in the absence of any other evidence, I will use these numbers to illustrate the ways in which investor preferences can be distorted.

While some of the opinion poll questions asked about approval rather than disclosure of political spending,[34] I will assume—based on those poll results described above—that about 70% of mutual fund investors, weighted by the value of their holdings, would be in favor of disclosure of political spending by corporations. Comparing this assumption to the actual mutual fund votes on political spending resolutions described in *Figure 1* suggests that most large mutual funds are likely voting against the preferences of a majority of their investors on most resolutions of this nature. As discussed above, Dreyfus, Putnam and, Dimensional voted all of their shares against every resolution requesting disclosure of political spending in 2014. In each case, if 70% of the fund's investors were in favor of the resolution, there was a negative distortion of 70% from the vote in favor of the resolution that the fund investors would have preferred.

Because mutual funds vote all of their shares in favor, against or abstain on resolutions, even when funds vote in the way that a majority of their investors would prefer, some distortion is inevitable. For instance, Deutsche Asset Management voted 100% of their shares in favor of almost all political spending disclosure resolutions. If only 70% of the fund's investors would have preferred that the fund vote in favor, and 30% would have preferred that the fund vote against, then there was a positive distortion of 30% in the vote in favor of each resolution, and a negative distortion of 30% in the vote against each resolution. This effect is even more pronounced for those mutual fund families that vote the shares of each of their individual funds in the same way. As Chief Justice Leo Strine has pointed out, these fund families often include several socially-responsible investment funds, but the shares held by those funds are voted in the same way as other funds in the fund family, despite the investors in the socially responsible investment funds likely having different preferences.[35]

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33. *People for the American Way*, *supra* note 29, at 6.

34. One of the questions in the Bannon Communications poll asked about policies requiring disclosure of political contributions to groups that spend money on politics. *Corporate Reform National Survey*, *supra* note 28, at 7–8. The other question referred to in the Bannon Communications poll, and the question referred to in the SurveyUSA poll, referred to policies requiring prior approval for political spending, which are even more stringent (and therefore likely to be less popular) than disclosure rules. *Id.* at 15; *People for the American Way*, *supra* note 29, at 6. The Bannon Communications numbers were relatively consistent between the two questions, with greater support for the disclosure resolution. *Corporate Reform National Survey*, *supra* note 28, 7–8, 15.

35. *See* Leo E. Strine, Jr., *Making It Easier for Directors to "Do the Right Thing"?*, 4 HARV. BUS. L. REV. 235, 250 (2014) ("Even now, there are socially responsible investment funds that appear to vote their shares in line with all the other funds of their mutual fund family, and to take no special efforts to vote in a way that is

This distortion against the preferences of the minority of investors is inevitable if funds vote all-or-nothing: there will always be some proportion of fund investors that disagree with the fund's vote, and whose preferences are distorted through the mutual fund's voting.[36]

D. Should Fiduciaries Consider Investor Preferences?

Whether fiduciaries, such as those directing and advising mutual funds, should consider the preferences of their investors is open to debate. This can be seen as an application of one of the most central and longest-running arguments in corporate law, regarding whether directors should act in what they think are the best interests of shareholders, or what shareholders think are in the best interests of shareholders.[37] The aim of this article is not to reach a conclusion on this question, but rather to put forward some considerations about the question as it applies to shareholder resolutions, and mutual fund voting on those resolutions.

Although fiduciary duties require mutual fund directors and investment advisers to maximize the value of the fund, these duties are unlikely to prevent mutual fund managers from considering investor preferences except in the most extreme cases. To the extent investors prefer certain actions because they believe that those actions will maximize the value of the fund assets, or reduce the risk of an investment or the portfolio as a whole, those actions could obviously be considered.[38] Questions of whether a fund manager can implement preferences that are likely to have no material effect on fund value, or to reduce fund value, are much more difficult.

Whether mutual funds should consider their investors' preferences may depend on the view taken of mutual fund managers, and of the managers of their portfolio companies. If fund managers understand the likely effect of certain actions on fund value much better than their investors, then disregarding investors' preferences will be in investors' best interests. Similarly, if managers of portfolio companies understand the likely effect of corporate actions on the value of the corporation better than their shareholders (including mutual funds), then for them to disregard precatory resolutions will maximize firm value, and whether or not fund managers consider their investors' preferences in voting on those

consistent with the fund's supposed commitment to social responsibility."); Leo E. Strine Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporate Law*, 50 WAKE FOREST L. REV. 761, 790 n.111 (2015) ("Vanguard's FTSE Social Index Fund voted in exactly the same manner as all other Vanguard funds, including on socially-oriented shareholder proposals.") Chief Justice Strine's description of the votes of the Vanguard FTSE Social Index Fund being cast identically to other Vanguard funds are consistent with the data in *Table 2* and *Table 3*, that show that Vanguard voted against or abstained on *all* 2014 proposals relating to political spending disclosure and greenhouse gas emission disclosure, including for its socially-responsible investment funds.

36. This assumes away the vanishingly unlikely possibility that all of a fund family's very large number of investors are unanimously in favor or against a resolution.

37. I am grateful to Ryan Bubb for discussions on this subject, and on some of the ideas underlying this section more generally.

38. *See, e.g.*, Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65,135, 65, 136 (Oct. 26, 2015) (codified at 29 C.F.R. § 2509.2015-01, ("Fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social, or other such factors."). This applies only to fiduciaries and advisers for pension plans, but demonstrates that such factors can clearly be considered by fiduciaries.

resolutions will be irrelevant.

The existence of shareholder resolutions, and the fact that successful shareholder resolutions influence the actions of directors, have implications for this debate. If investor preferences were irrelevant, then the shareholder resolution process—the sole aim of which is to express the preferences of shareholders for certain corporate actions—would also be irrelevant. However, successful shareholder resolutions clearly have an impact on corporate actions,[39] suggesting that directors—who are fiduciaries for shareholders—do believe that the preferences of those shareholders are important.

That shareholder resolutions are implemented by directors also highlights a flaw in the idea that directors always fulfil their fiduciary duty to act in the best interests of the company. Consider a company where directors always and only act in the best interests of the corporation, and where a shareholder resolution to disclose political spending is being voted on by shareholders. If directors believed that the measure was in the best interests of the company they would have implemented it when they first became aware of the possibility of such action. Even if they had not been previously aware of the possibility of such action, when the shareholder resolution first brought it to their attention they would have taken the action, obviating the need for a vote of shareholders. Under this view, that the resolution goes to a vote means that directors do not believe it is in the best interests of the corporation. Therefore, even if the resolution receives majority support, directors should not implement it, as doing so would not be in the best interests of the corporation.

A more direct version of this argument is the fact that mutual funds vote on shareholder resolutions at portfolio companies, and express their disapproval when directors do not respond to shareholder resolutions by withholding votes from those directors' own elections. These facts suggest that mutual funds believe that directors should consider the preferences of their shareholders. If that weren't the case, voting on resolutions, and voting to withhold from unresponsive directors, would be a waste of the mutual fund's resources. That mutual fund directors believe that portfolio company directors, as fiduciaries for their investors, should consider the preference of those investors, would seem to be consistent with the view that those mutual fund directors should consider the views of their own investors.

Courts have also expressed views on the general question of directors taking into account the preferences of shareholders, and the specific question of mutual funds voting on shareholder resolutions. Delaware courts have generally suggested that corporate directors are not required to consider the preferences of their shareholders.[40] However,

39. *See, e.g.*, Randall S. Thomas & James F. Cotter, *Shareholder Proposals in the New Millennium: Shareholder Support, Board Response, and Market Reaction*, 13 J. CORP. FIN. 368, 388 (2007) ("Increased shareholder voting support is positively correlated with board action on the resolution."); Mira Ganor, *Why Do Managers Dismantle Staggered Boards*, 33 DEL. J. CORP. L. 149, 152 (2008) (finding "a statistically significant connection between precatory resolutions and the management's decision to destagger"); Yonca Ertimur et al., *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 62 (2010) ("[T]here is a strong, significantly positive association between the likelihood of implementation and the percentage of [Votes For]."); Luc Renneboog & Peter G. Szilagyi, *The Role of Shareholder Proposals in Corporate Governance*, 17 J. CORP. FIN. 167, 181 (2011) ("[t]he higher the percentage votes cast in favor, the higher the probability that a proposal is adopted."). I am also grateful to Ryan Bubb for discussions of his work on this topic.

40. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 967 A.2d 640, 655 (Del. Ch. 2008) ("Directors are not thermometers, existing to register the ever-changing sentiments of stockholders. . . . [D]irectors may take good

such suggestions have generally come in the context of whether directors could take actions that they had reason to believe shareholders might disagree with.[41] Federal courts have affirmed the importance of shareholder preferences on social and environmental matters as expressed in shareholder resolutions under Rule 14a-8, and indicated that corporate managers should not replace the preferences of their shareholders on such matters with managers' own preferences,[42] and that taking into account shareholder preferences on such matters does not conflict with managers' need to apply its day-to-day business judgment.[43] In considering whether there is any conflict between these positions, it should be noted that hundreds of Delaware corporations have taken actions initially opposed by directors in response to successful shareholder resolutions, without any challenge claiming such actions were in breach of those directors' fiduciary duties.

IV. UNDISTORTING SOCIAL RESPONSIBILITY RESOLUTIONS

Distortions in mutual fund voting may occur if the way mutual funds vote does not match the preferences of mutual fund investors. If such distortion is taking place, and is considered to be a problem, this definition suggests two kinds of solutions: mutual fund investors could choose mutual funds that vote the way they prefer or mutual funds can change the way they vote to match their investors' preferences.

A. Investor Sorting by Mutual Fund Voting Policy

One solution is for investors to choose funds whose voting policies match their preferences, and for current investors in funds whose voting policies do not match their preferences to switch to another mutual fund.[44]

To a limited extent, such sorting already occurs. Some mutual funds families, such as

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faith actions that they believe will benefit stockholders, even if they realize that the stockholders do not agree with them."). The decision also cited language that "a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation, subject however to a fiduciary obligation." TW Servs., Inc. v. SWT Acquisition Corp., 1989 WL 20290, at 8 n. 14 (Del. Ch. 1989).

41. For instance, Vice Chancellor Strine's decision in *Lear Corp. S'holder Litig.* related to whether directors could put forward a merger agreement for stockholder approval if they believe that stockholders would benefit from its adoption, even if they had some reason to believe that stockholders may prefer not to approve it. *In re* Lear Corp. S'holder Litig., 967 A.2d at 655.

42. *See, e.g.*, Med. Comm. for Human Rights v. SEC, 432 F.2d 659, 681 (D.C. Cir. 1970) (regarding whether the Dow Chemical Corporation could exclude a shareholder resolution requesting that directors consider ceasing production of napalm) ("It could scarcely be argued that management is more qualified or more entitled to make these kinds of decisions than the shareholders who are the true beneficial owners of the corporation; and it seems equally implausible that an application of the proxy rules which permitted such a result could be harmonized with the philosophy of corporate democracy which Congress embodied in section 14(a) of the Securities Exchange Act of 1934."). *Id*.

43. *Id.* ("[T]here is a clear and compelling distinction between management's legitimate need for freedom to apply its expertise in matters of day-to-day business judgment, and management's patently illegitimate claim of power to treat modern corporations with their vast resources as personal satrapies implementing personal political or moral predilections.").

44. I do not consider the possibility that mutual fund investors whose preferences do not match the voting policy of their mutual fund should change their preferences to match that voting policy. This suggests that investors would accept that the mutual fund understands what is best for them better than they do themselves. This would be plausible if they do not have preferences on a matter but not if they have preferences that they developed independently of the mutual fund's position on the matter.

Calvert, are socially responsible investment funds—they choose investments and vote their proxies in a way that they believe serves social purposes, as well as maximizing returns or minimizing risk. Other fund families that are not socially responsible investment funds may have one or more fund families that are SRI funds—for instance, TIAA's Social Choice Equity Fund. Socially responsible investment funds make up a growing proportion of the overall mutual fund market. However, the value of investments in these funds is still dwarfed by that in traditional funds. If, as Part II suggests, a significant number of mutual fund investors have preferences that are closer to the voting policies of socially responsible investment funds than those of traditional investment advisers, why do more of those investors not choose to switch their investments from funds that do not vote as they would prefer to funds that do?[45] And why do new investors choose funds that vote differently than investors would prefer?[46] That is, why is this problem not solved by the mutual fund equivalent of the "Wall Street Walk," what we could call a "Main Street Walk"? There are several potential reasons.

1. Informational Problems

Investors in mainstream mutual funds are likely to be unaware of the way their funds vote, and that those votes may not be consistent with their own preferences. Mutual funds disclose their voting policies, usually on their own websites; however, these policies are difficult to compare and interpret. Comparing voting policies among multiple funds requires considerable effort. There is no central repository for voting policies from different fund families. Policies are structured and worded very differently, making side-by-side comparisons difficult. Policies are often vague; on many matters they indicate simply that the fund will vote on a case-by-case basis.

Similarly, it is difficult for investors to get useful information about fund voting records. Although each fund discloses its votes for the past year on Form N-PX, the forms include every single resolution voted on at every single company in which the fund invests, so they can be incredibly lengthy.[47] Form N-PX provides no aggregation of voting by fund family or resolution type of the kind presented in Part II, and it is unrealistic to expect individual investors to perform such analysis. A number of non-profit organizations that advocate on various issues consider mutual fund votes on the particular issue of interest to them.[48] However, there is currently no way for mutual fund investors to gain a comprehensive view of the voting of the mutual funds in which they invest or may wish to invest.

Reducing this information problem is possible, and may allow additional sorting. For instance, the website proxydemocracy.org contains voting data for a number of mutual funds on many social and environmental resolutions, scraped from their Forms N-PX.[49]

45. *See supra* Part II.

46. This Part focuses on the existing investor aspect of the question. *Infra* Part IV.A.4, applies the reasoning to new investors.

47. The Form N-PX filed by the Vanguard Total Stock Market Index Fund for the year ended June 30, 2014 is over 400 pages long.

48. For instance, the Center for Political Accountability produced annual reports on mutual fund voting on political spending resolutions. *See, e.g.*, *Corporate Political Spending and the Mutual Fund Vote*, CTR. FOR POL. ACCOUNTABILITY (Nov. 2014), http://perma.cc/2EVZ-R4XT.

49. *See* Andy Eggers, *Alpha Version of our mutual fund vote database*, PROXY DEMOCRACY BLOG (July

However, while the site contains comprehensive data from 2003 to 2010, data since that time is limited to that provided by a small number of mutual funds that voluntarily provided it to the site,[50] because of resource constraints in gathering Forms N-PX on an annual basis and administering the site. This demonstrates the collective action problem of voting information gathering—even though such information would be of value, the benefits are divided among very widely dispersed mutual fund investors, each of whom may value the information only very slightly, and insufficiently to pay for the costs of supplying that benefit and the transaction costs of gathering the payment. This could be overcome by the intervention of a non-profit organization, for instance one that that aims to assist investors, or that aims to improve the choices of companies on some of the social responsibility resolutions that would be more successful if corporations voted as their investors preferred.[51] It is possible that mutual funds that believe that their voting policies compare favorably to their peers may also be prepared to fund the collection and dissemination of such data, as it would provide them with a marketing advantage.[52]

2. Insufficient Options

Mutual fund voting policies represent a "bundle" of voting preferences on different topics. Most funds in a fund family share the same voting policies, so the number of bundles is limited by the number of mutual fund families. It is therefore unlikely that every investor will be able to find a bundle that perfectly matches their own preferences. This is even more likely to be the case for investors that invest in mutual funds through defined contribution plans, which are limited to a number of plan choices chosen by the plan sponsor. Their options are even less likely to include a fund whose voting matches their preferences.

Even if a fund with a sufficiently well-matched bundle exists, there are likely to be costs associated for an investor to switch to it. Most obviously, there may be commissions on trades in mutual fund shares. Many mutual funds also charge penalties to discourage excess trading, which take effect if the fund is sold before a certain period has elapsed.[53] Switching costs will include the information costs of finding the fund that sufficiently matches the preferences of the investor, and the burden of comparing the fund on a diverse set of attributes. There may also be behavioral obstacles to switching funds—Madrian and Shea observe a strong 'inertia' effect in employee 401(k) behavior.[54] This may be exacerbated by the significant amounts of information that it is necessary to process in order to make an optimal decision.

24, 2007), https://proxydemocracy.wordpress.com/2007/07/24/alpha-version-of-our-mutual-fund-vote-database (detailing how firms voted their shares from 2003 to 2006).

50. *See About Data*, PROXY DEMOCRACY, http://proxydemocracy.org/about/data (last visited Nov. 29, 2017) (detailing investor votes for 72,731 shareholder meetings between 2003–2016).

51. Indeed, there are signs that this may already be taking place. For instance, the Sustainable Endowments Institute, a project of public charity Rockefeller Philanthropy Advisors, has taken over the running of Proxy Democracy. PROXY DEMOCRACY, http://proxydemocracy.org/ (last visited Nov. 29, 2017).

52. This is a limited version of the argument further developed below in *infra* Part IV.B.

53. Mutual fund redemption fees are generally capped at 2%. 17 C.F.R. § 270.22c-2.

54. *See* Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q. J. ECON. 1149 (2001).

3. Switching Costs

Even if the costs associated with switching are not significant, they may dominate the interest of the investor in switching. The extent to which a rational investor cares about the way their mutual fund votes on a resolution at a particular corporation in which they hold a microscopic proportional interest is likely to be similarly tiny. Even when aggregated across all the issues at all the companies in which they are invested, the interests are likely to still be very small, and to be dominated by switching costs, unless the investor abides by very strong views on environmental and social matters. However, even for other investors that care just a very small amount, these preferences are not zero. When aggregated across the very large numbers of investors, the aggregate value of the preference may be substantial.

4. New Investors

Although this section has focused on reasons why the Main Street Walk may not be effective for existing investors in mutual funds, variations on the same arguments also apply to new investors. As discussed above, such investors may not have available to them a sufficiently variegated set of investment options to allow them to choose the right bundle. In addition, these investors will also be burdened by information costs in determining the mutual fund with the best bundle of policies. And, their preferences on the fund's social and environmental voting are likely to be dominated by the multiple other factors they are likely to consider in choosing a retirement-savings vehicle.

B. Voting According to Investor Preference

The alternative solution to investor sorting is for mutual funds to change their voting policies to reflect the preferences of their investors. How should a mutual fund ascertain the aggregate preferences of its large number of investors? It would not be realistic for the fund to conduct a vote of its ultimate investors each time a resolution is put forward at each of its many portfolio companies. Each poll would require costly preparation, distribution, and counting of ballots. And given the infinitesimal proportional interest of each individual investor in each portfolio company, and the even smaller likelihood of influencing the outcome of such votes, it would not be worth any individual investor's time to vote in such a poll.

However, since so many types of resolutions are similar, having individual votes is not necessary. Instead, mutual funds could ascertain the general preferences of their investors for each particular category of resolution, in the same way funds currently have voting guidelines for different categories of resolution. Funds would not need to poll all of their investors. Instead, they could use the kinds of sampling techniques employed by political polling and market research organizations to derive accurate estimates (within percentage points) of voter or consumer preferences from a relatively small number of respondents.[55] If this variation is randomly distributed across mutual funds, then the aggregate effect across all mutual fund investors in a corporation will be zero. If this kind of solution were to be adopted, economies of scale may lead to third parties collectively

55. For instance, the Bannon Communications and the SurveyUSA polls cited *Part III* claim sampling error of 3.8% and 2.5%, respectively. *See supra* notes 28 and 29.

polling for multiple mutual funds.[56] This is similar to the provision of proxy advisory services, and might be provided either by the same organizations, or by new entrants, such as firms with existing expertise in polling

As discussed in Part II, if a mutual fund votes its shares all-or-nothing, some distortion is inevitable, against the minority preferences of investors.[57] This could be alleviated by proportional voting: the mutual fund could split its vote, in the proportion that represents the fund's best estimate of the preferences of their investors. That is, if a fund's polling led it to believe that 70% of its investors, weighted by value of investment, would prefer the fund to vote in favor of a particular resolution and 30% would prefer the fund to vote against the resolution, then it would vote 70% of its shares in favor of the resolution, and 30% of its shares against the resolution. Such proportional voting is explicitly contemplated by the Department of Labor's 1994 Interpretive Bulletin.[58] A very small number of mutual funds already split votes—0.04% of funds reporting on Form N-PX in 2014 recorded split votes, making clear that such vote splitting is possible.[59] Conversations with the representative of an investment adviser responsible for implementing the votes of a large mutual fund family confirmed that it would be relatively straightforward for that mutual fund family to split their vote on shareholder resolutions.[60]

If voting in accordance with investor preferences—either all-or-nothing or proportionally—were considered a desirable solution, how might it be achieved? A regulatory solution, through the SEC (applicable to all mutual funds) or the Department of Labor (applicable to investment advisers and other fiduciaries of ERISA pension plans), could require consideration of investor preferences in voting. A judicial reinterpretation of fiduciary duties of mutual funds or investment advisers could also require mutual fund directors or investment advisers to consider what investors consider to be in their own best interests. However, some kind of regulatory or judicial *deus ex machina* solution may not be necessary. Instead, it is possible that voting in accordance with investor preferences may come about without regulatory or judicial intervention (or that regulation might instead follow a market trend towards proportional voting).

Mutual funds might adopt proportional voting as a defense to pressure from public

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56. It is possible that a fund might attempt to bias a survey in the direction the fund considers optimal. This presupposes that a fund has a strong enough reason to influence the outcome of the survey to outweigh the risk of trying to do so; it is not clear that this would be the case. However, if this were seen as a likely possibility it would increase the importance of having surveys conducted by a reputable third party. If there were a significant concern about biased surveys, having a third party conduct the survey could become a differentiating factor among funds implementing proportional voting.

57. *See, e.g.*, Leo E. Strine, Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 373–74 (2015) (suggesting that "mutual funds feel poorly positioned to vote on specific social proposals, about which their diverse investors likely disagree").

58. *See* Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Policy or Guidelines, 59 Fed. Reg. 38,863, 29 § C.F.R. 2509.94–2 (July 29, 1994), at 366 ("An investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan may be subject to a proxy voting policy of one plan that conflicts with the proxy voting policy of another plan. Compliance with ERISA § 404(a)(1)(D) would require such investment manager to reconcile, insofar as possible, the conflicting policies . . . and, if necessary and to the extent permitted by applicable law, vote the relevant proxies to reflect such policies in proportion to each plan's interest in the pooled investment vehicle.").

59. Only 0.04% of fund-votes in 2014 were split votes. *See supra* note 18.

60. Email correspondence with a representative of a large mutual fund, (May 5, 2016) (on file with *The Journal of Corporation Law*).

advocacy organization to vote in a particular way. If the information problem discussed in Part IV.A.1. were to be solved, non-profit groups that advocate the implementation of certain environmental and social policies by corporations, including those that regularly submit shareholder resolutions on such topics, could use the data to identify mutual funds that vote against their investors' likely preferences. Such advocacy organizations could make the distortion clear to that mutual fund's investors within the organizations' own networks, and to other investors or potential investors in that fund with similar views, and suggest that investors consider switching to a fund that votes in the manner the advocacy organization prefers. Indeed, some precursors of this kind of campaign are already being undertaken by certain advocacy organizations. For instance, a group of advocacy organizations have recently begun a campaign to pressure Vanguard to change its policy of voting against or abstaining on resolutions relating to disclosure of political spending.[61] If these campaigns were to become more common and more successful, a fund may start voting in the manner advocated by the organizations.[62] However, to the extent the fund votes all-or-nothing, there will still be a minority of investors whose preferences the fund is voting against. To avoid this, a fund could adopt a proportional voting policy. Adopting proportional voting could be done preemptively, to prevent or deter such campaigns by advocacy organizations, or defensively, in response to an explicit request by advocacy organizations for the fund to vote in a particular way. Either way, the explanation that the fund was voting in the interests of all of its investors would provide an irreproachable answer to such advocacy.

If one mutual fund were to adopt proportional voting, whether in response to outside pressure or of its own volition, it could then market itself as better aligned with the preferences of investors than its competitors.[63] As discussed in Part III.A. there are various reasons why many investors may be unlikely to switch between mutual funds. However, there are likely to be some marginal investors who have particularly strong preferences about issues in which there may be sufficient distortion that they might consider switching. Pension funds that employ investment advisers could also use their purchasing power to pressure investment advisers to adopt proportional voting, not just for those pension funds' investments, but for all of the adviser's mutual fund products. At that point, proportional voting could become an effective defensive measure for investment advisers and mutual fund families. Because proportional voting would largely involve fixed costs (establishing a polling infrastructure or paying an outside advisor to undertake polling), for large mutual funds the per-investor cost of implementing proportional voting would be very small. Given the breadth of their investors, and the likely divergence of views amongst them, large mutual funds may also benefit more from being able to represent the views of all of

61. *See, e.g.*, Eleanor Bloxham, *Corporate Political Donations and Lobbying Are Still Trapped in a Murky, Dark Cloud*, FORTUNE (Mar. 7, 2016, 1:54 PM), http://fortune.com/2016/03/07/corporate-political-spending-lobbying/ ("[o]ver 65,000 members of Public Citizen, U.S. PIRG, and Common Cause, among others, sent emails to Vanguard asking it to change its voting policy guidelines to vote in favor of political spending disclosure."). *Id.*

62. In 2017, Vanguard broke with its traditional practice to vote for a greenhouse gas emission disclosure proposal at Exxon Mobil. *See, e.g.*, Tom Buehrle, *Vanguard Speaks Softly but Carries a Big Stick*, N. Y. TIMES (Sept. 1, 2017), https://www.nytimes.com/2017/09/01/business/dealbook/vanguard-speaks-softly-but-carries-a-big-stick.html.

63. For instance, SRI funds could easily start adopting a proportional voting mechanism and marketing it to potential investors—most likely ultimate investors with strong social preferences, but possibly a broader group.

their investors compared to smaller, more homogeneous funds. Their votes would be defensible to all of their investors since they would no longer be taking voting positions that diverged from the majority preferences of their investors or even the minority preferences.

Long-term demographic changes may strengthen the likelihood of a move towards voting according to investor preferences. Younger investors entering the market for mutual fund products as they find employment and start saving for retirement are likely to be more socially engaged than older investors, and may be more likely to weigh their preferences on social and environmental matters in making investment decisions, and the proportion of the market represented by such investors represent will only increase.

C. The Impact of Undistorted Social Responsibility Resolutions

If steps were taken to reduce distortion in mutual fund voting, this may have significant flow-on effects. As described in Part II, because many mutual funds currently vote against or abstain on shareholder resolutions that a majority of their investors are likely to support, many resolutions receive aggregate support substantially less than a majority of votes cast, even though a majority of the ultimate investors of those corporations would prefer that those resolutions pass. Were mutual funds to vote consistently with the majority preferences of their investors, or proportionately with the preferences of all of their investors, aggregate levels of support would increase substantially, and many resolutions that currently receive less than 50% support would pass. Empirical evidence suggests that moves by certain mutual funds to change their voting policy on certain shareholder resolutions may influence their peer mutual funds to similarly change their own policies.[64]

Increased passage of shareholder resolutions is likely to result in increased implementation of the measures requested. Shareholder resolutions are generally precatory, so directors of companies where a resolution passes may choose whether or not to implement the resolution. However, as discussed above, if a resolution passes, the company is more likely to implement the action requested.[65] In the same way that mutual funds may choose to consider the views of their investors in determining their voting policy, directors may be influenced to follow the preferences of shareholders expressed through the vote. Because of other mutual fund voting policies, and the policies of proxy advisory firms, directors that do not implement shareholder resolutions that receive majority support may have votes withheld from their own elections in subsequent years, which may impact directors' decisions to implement resolutions.[66] A corporation may be more likely to implement a requested action even if the resolution did not pass, but received strong minority support, e.g., more than 40% of votes cast. Many social responsibility resolutions that corporations believe are likely to receive strong support result in negotiated

64. *See* Matvos & Ostrovsky, *supra* note 22, at 91 (finding that a fund is more likely to oppose management when other funds are more likely to oppose it as well).

65. *See* Thomas & Cotter, *supra* note 39; Ganor, *supra* note 39; Ertimur et al., *supra* note 39; Renneboog & Szilagi, *supra* note 39.

66. *See, e.g.*, Laurent Bach & Daniel Metzger, *How Do Shareholder Proposals Create Value* 3 (Working Paper, 2017), http://ssrn.com/abstract=2247084 ("[i]f support for a proposal barely passes 50% of votes cast "for" and "against" (the "Simple majority threshold") and yet management does not implement the proposal, then the number of votes against incumbent directors in the next election increases significantly.").

agreements to implement some measures requested in the resolution.[67] Increasing the level of voting support for these resolutions would mean that they are more likely to result in negotiated agreements.

Reducing distortion and increasing the level of support for resolutions is likely to have a dynamic effect on the number and type of resolutions submitted. Proponents are more likely to submit resolutions that are likely to receive greater support. Proponents that are currently seeking change through other forms of action may devote more resources to submitting shareholder resolutions if those resolutions become more effective as a way to persuade corporations to make desired changes. This is likely to result not only in more of the types of resolutions that start to receive greater support, but also the submission of new types of resolutions, on topics which—even though they reflect the preferences of investors—may not receive much support based on the current voting policies of mutual funds. One potential limitation on submitting new types of resolutions may be SEC rules allowing exclusion of shareholder proposals submitted pursuant to Rule 14a-8 that relate to the ordinary business of the corporation.[68] However, since 1970, the SEC has allowed shareholder proposals on environmental and social matters that it considered of sufficient social importance.[69] That resolutions are likely to receive greater support may be evidence that investors consider them to be important.

The above scenario represents private ordering by corporations on issues of social and environmental importance, initiated by shareholder resolutions and supported by mutual funds and other institutional investors voting in a manner guided by investor preferences. On many social and environmental matters that are put to shareholders for a vote, it may be preferable for rules to be set for the industry or economy as a whole, by legislation, regulation, or judicial action. For instance, on political spending, legislation or regulation requiring disclosure of political spending may be preferable to policies that apply at individual companies. It is clearly the case that, with respect to many problems, company private ordering will be inferior to mandatory rules.[70] Where a policy should apply across a large group of companies, implementing it one company at a time will be duplicative and expensive. There may be "first-mover" disadvantages whereby particular companies that adopt the rule before other companies suffer disproportional costs. There may also be distortions from public corporations becoming subject to rules through private ordering that privately held corporations and other types of business entities are not subject to. In addition, because the distribution of popular ownership of corporations over-represents wealthier and higher income households, decisions made through shareholder voting may be less reflective of social welfare than decisions made through more broadly democratic bodies, and therefore likely to be only a second-best solution. However, corporate private ordering would not be necessary if there were legislative or regulatory action on these

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67. For a discussion of settlements of resolutions relating to political spending, *see* Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 272 (2016).

68. 17 C.F.R. § 240.14a-8(i)(7) (2008). *See also* Reilly S. Steel, *The Underground Rulification of the Ordinary Business Operations Exclusion*, 116 COLUM. L. REV. 1547, 1551 (2016) (providing a comprehensive discussion of the SEC's ordinary business exclusion).

69. Med. Comm. for Human Rights v. SEC, 432 F.2d 659, 681 (1970).

70. *See* Michal Barzuza, *The Private Ordering Paradox in Corporate Law*, 8 HARV. BUS. L. REV. (forthcoming 2018); Scott Hirst, *The Case for Investor Ordering*, 8 HARV. BUS. L. REV. (forthcoming June 2018); Lucian Bebchuk & Scott Hirst, *Private Ordering and the Proxy Access Debate*, 65 BUS. LAW. 329, 342 (2010) (describing problems with private ordering of majority voting and staggered boards).

matters. Where there is no such action, the second-best solution may be the best available solution.

The greater submission and success of shareholder resolutions, and the implementation of shareholder-proposed changes by corporations, may also inform the views of regulators, legislators, and jurists on those matters. That more resolutions succeed makes clear that investors prefer the changes proposed, and the implementation of proposed changes makes clear that directors of corporations may also agree that those actions are in the best interests of the corporation. Implementation also allows other corporations and commentators to see that proposed actions can be made without certain potential negative effects that they might fear. As a result, successful resolutions can lead to broader adoption and, in some cases, to regulation. To a significant extent, the strong support for shareholder resolutions requesting 'say-on-pay' votes, and the success of those resolutions in persuading corporations to adopt say-on-pay votes, paved the way for the mandatory say-on-pay rules included in the Dodd-Frank Act.[71]

V. CONCLUSION

This article began by considering the relationship between voting by institutional investors on social responsibility resolutions, and the interests and preferences of their own investors on social and environmental matters. Evidence from mutual fund voting on social responsibility resolutions raises several questions.

First, why do mutual funds with similar investors, and identical fiduciary duties, vote very differently on social responsibility resolutions? This suggests that some mutual funds are not voting in the best interests of their investors.

Second, is there a distortion between how mutual funds vote and what their investors would prefer? The data this article uses for investor preferences is necessarily limited and imperfect; as an initial step to examining some of these questions, mutual funds—with the encouragement of the SEC—should undertake their own analyses to determine the preferences of their investors, and whether there is indeed a distortion between those preferences and their own voting policies.

Third, is distortion between mutual fund votes and investors preferences undesirable? Indeed, should mutual funds consider the preferences of their investors at all? The article considers both sides of this question, and does not attempt to reach a conclusion, although it suggests some reasons why considering investor preferences is more consistent with the existing proxy voting system.

Finally, if distortions in mutual fund voting are undesirable, how might they be eliminated? A prerequisite for eliminating a distortion is information about mutual fund voting that would allow investors, potential investors, mutual funds, and third parties to compare the voting records of different mutual fund families. Having such information available may increase the possibility of investor selection based on preferences, but this is, at best, a partial solution. More effective would be changes in mutual fund voting to reflect investor preferences, such as proportional voting.

71. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78n-1).

Appendix

Mutual Family Fund Voting on Political Spending Resolutions, 2014

Fund Families, by For / Against (Fund Votes)	*% For / Against*
1.Deutsche (278)	100 / 0
2. MFS (238)	95 / 5
3. SEI (392)	86 / 14
4. Mainstay (126)	85 / 15
5.MorganStanley (114)	83 / 17
6. Wells Fargo (225)	83 / 17
7. Columbia Funds (318)	58 / 42
8. John Hancock (401)	56 / 42
9. Charles Schwab (438)	55 / 45
10. Legg Mason (136)	51 / 49
11. Janus (194)	44 / 6
12. State Street (396)	39 / 32
13. Allianz (306)	38 / 62
14. AXA (727)	37 / 60
15. TIAA (494)	36 / 62
16. Invesco Funds (547)	36 / 61
17. Prudential (525)	19 / 50
18. Goldman Sachs (165)	18 / 75
19. Northern Trust (108)	15 / 85
20. Federated Investors (102)	15 / 85
21. Fidelity (1,075)	6 / 11
22. Jackson National (235)	5 / 95
23. Capital Group (175)	3 / 97
24. JPMorgan (392)	3 / 97
25. T Rowe Price (457)	2 / 98
26. BlackRock (1,257)	1 / 98
27. Vanguard (1,028)	0 / 36
28. Dimensional (368)	0 /100
28. Dreyfus (170)	0 /100
28. Putnam (331)	0 /100

Fund Families, by Size (Fund Votes)	*% For / Against*
1. Vanguard (1,028)	0 / 36
2. Fidelity (1,075)	6 / 11
3. Capital Group (175)	3 / 97
4. BlackRock (1,257)	1 / 98
5. T Rowe Price (457)	2 / 98
6. JPMorgan (392)	3 / 97
7. State Street (396)	39 / 32
8. Allianz (306)	38 / 62
9. Columbia Funds (318)	58 / 42
10. Dimensional (368)	0 /100
11. Goldman Sachs (165)	18 / 75
12. Federated Investors (102)	15 / 85
13. Dreyfus (170)	0 /100
14. Wells Fargo (225)	83 / 17
15. Invesco Funds (547)	36 / 61
16. MFS (238)	95 / 5
17. Charles Schwab (438)	55 / 45
18. John Hancock (401)	56 / 42
19. Prudential (525)	19 / 50
20. Jackson National (235)	5 / 95
21. Morgan Stanley (114)	83 / 17
22. Legg Mason (136)	51 / 4
23. Northern Trust (108)	15 / 85
24. AXA (727)	37 / 60
25. TIAA (494)	36 / 62
26. Mainstay (126)	85 / 15
27. SEI (392)	86 / 14
28. Deutsche (278)	100 / 0
29. Putnam (331)	0 /100
30. Janus (194)	44 / 6