No. 23-5409

# In the United States Court of Appeals for the Sixth Circuit

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
*Plaintiff-Appellant,*
BUSINESS ROUNDTABLE,
*Plaintiff-Appellant,*
TENNESSEE CHAMBER OF COMMERCE & INDUSTRY,
*Plaintiff-Appellant,*
*v.*
UNITED STATES SECURITIES AND EXCHANGE COMMISSION,
*Defendant-Appellee,*
GARY GENSLER IN HIS OFFICIAL CAPACITY AS CHAIR OF THE COMMISSION,
*Defendant-Appellee.*

On Appeal from the United States District Court
for the Middle District of Tennessee

## BRIEF OF AMICUS CURIAE THE BIOTECHNOLOGY INNOVATION ORGANIZATION SUPPORTING APPELLANTS

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## CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Amicus makes the following disclosure under Sixth Circuit Rule 26.1:

**1. Is amicus a subsidiary or affiliate of a publicly owned corporation?**

No. The Biotechnology Innovation Organization is a non-profit corporation organized under the laws of the District of Columbia.

**2. Is there a publicly owned corporation, not a party to the appeal or an amicus, that has a financial interest in the outcome?**

None known.

*/s/ Jonathan F. Cohn*
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## INTEREST OF AMICUS CURIAE

The Biotechnology Innovation Organization ("BIO") is the world's largest life sciences trade association representing nearly 1,000 biotechnology companies, academic institutions, state biotechnology centers, and related organizations across the United States and abroad.[1] BIO members are involved in the research and development of innovative biotechnology products that will help to solve some of society's most pressing challenges, such as managing the environmental and health risks of climate change, sustainably growing nutritious food, improving animal health and welfare, enabling manufacturing processes that reduce waste and minimize water use, and advancing the health and well-being of our families.

Small biotech companies face several challenges that are exacerbated by proxy advisory firms that are not accountable for their actions, are too big to challenge, often do not fully understand the nuances of the industry and may be incorrect in their assessments of small research and development organizations that have a broad investor base with high turnover. For example, many of BIO's members are small innovator companies that do not yet have a product on the market. Without the revenue stream from sales, they are

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[1] No counsel for any party authored this brief in whole or in part, and no entity or person, aside from amicus curiae, its members, or its counsel, made any monetary contribution intended to fund the preparation or submission of this brief. *See* Fed. R. App. P. 29(a)(4)(E). Counsel for Appellants and Appellees consent to the filing of this amicus brief. *See* Fed. R. App. P. 29(a)(2).

dependent on the investment community to continue their innovative work. Therefore, proxy recommendations are particularly disruptive—they demand the diversion of precious resources to respond to inaccuracies and can impact a company's investment prospects.

The SEC's rescission of the 2020 Rule that would have regulated proxy advisory firms directly affects BIO's members. First, the SEC's rescission denies BIO's members the necessary transparency and dialogue with proxy advisory firms that the 2020 Rule would have delivered. And second, BIO's members have been deprived of the stability and protections afforded by a faithful application of the Administrative Procedure Act ("APA"). In this case, the SEC disregarded a decade of collaboration and data gathering to essentially reach the opposite conclusion, thereby jettisoning the product of careful study and negotiation. The SEC fell far short of the "reasoned explanation" required for rulemaking under the APA, detailed in Appellant's Opening Brief and below. In its rushed withdrawal of the 2020 Rule, the SEC harmed BIO's members.

## INTRODUCTION

The 2020 Rule governing proxy advisory firms was designed to bring fairness to a game that is rigged. The volume of proxy ballot issues, the size of institutional investors combined with the number of stocks they own, and the concentration of power means just two major proxy advisory firms wield outsized influence on corporate governance. Their recommendations,

however, are often ill-suited for specialized industries with small companies like biotechnology, which depend heavily on a continuous stream of capital from investors. Because the "political winds have shifted," the SEC withdrew the 2020 Rule, guaranteeing a return to a rigged system where the outcome of hundreds of proxy ballot issues is preordained to align with the policy agenda of a mere two proxy voting advice businesses. *See* SEC Comm'r Hester M. Peirce, *Dissenting Statement on Proxy Voting Advice Proposal*, SEC (Nov. 17, 2021), https://bit.ly/42Z0ObZ [hereinafter, "Comm'r Peirce, *Dissenting Statement*"]. The losers are shareholders, as well as issuer companies, and in particular small biotech companies such as those represented by BIO.

This brief will first explain proxy advisory firms and the impact of the two largest firms in the market. Next, it will illustrate three persistent issues with proxy advisory firms that that the 2020 Rule sought to remedy: (1) that proxy advisory firms have little-to-no transparency, which is especially problematic given the outsized impact inaccuracies in recommendations have on small companies, (2) that proxy advisory firms enjoy a troubling conflict of interest that allows them to provide voting recommendations to institutional investors that may not be in the best interests of the businesses and then turn around and pursue and ultimately receive contracts to "consult" with those very businesses, and (3) that the recommendations from proxy advisory firms are one-size-fits-all and inadequate for small, distinct industries like biotech. Without providing the requisite "reasoned

explanation," the SEC has now rescinded the 2020 Rule. This Court should reverse the district court's judgment and set aside the 2022 rescission.

## BACKGROUND

Many things converged to lead to the rise in size and prominence of the two big proxy advisory firms over the last few decades. But to fully understand their impact, one must understand what they are and what they do. To begin, shareholders participate in the corporate governance of public companies through voting power in what's sometimes referred to as a "corporate democracy." *See Trinity Wall St. v. Wal-Mart Stores, Inc.*, 792 F.3d 323, 335 (3d Cir. 2015) (citation omitted). However, rather than appear for annual shareholder meetings in person to vote on these issues, many shareholders vote by proxy, i.e., having someone vote on their behalf. *Id*. at 334 (collecting authorities). Historically the subject matter contained on these proxy ballots included mergers and acquisitions, director elections, executive compensation, and policies related to corporate governance.

Over the years, the number of proxy ballot issues to be voted on has increased, and the subject matter has expanded. One early driver of increased proxy ballot issues was the 2010 Dodd-Frank Act, which introduced requirements like "say-on-pay" giving shareholders a vote over executive compensation and "say-on-frequency" requiring a vote for how often to approve executive pay. *See* SEC Comm'r Daniel M. Gallagher, *Outsized Power & Influence: The Role of Proxy Advisers* 7, Washington Legal Found. (Aug. 2014),

https://bit.ly/46qEuen [hereinafter, "Gallagher, *Outsized Power*"]. The increase has also been driven in part by activist groups who have been aided by the SEC's own legal interpretations. These groups take advantage of shareholder democracy to advance their preferred policies.

For example, the SEC has interpreted Rule 14a-8—a Rule defining which shareholder proxy proposals a company must carry on its own proxy statement—to now require companies to include shareholder proposals that "raise[] issues with a broad societal impact." SEC Div. of Corp. Fin., *SEC Staff Legal Bulletin No. 14L (CF)*, SEC (Nov. 3, 2021), https://bit.ly/3plbTGs (citation omitted); *see also* Substantial Implementation, Duplication, and Resubmission of Shareholder Proposals Under Exchange Act Rule 14a-8, 87 Fed. Reg. 45052, 45064-65 (July 27, 2022).[2] To illustrate, in 2022 the number of

[2] *See, e.g.*, SEC No-Action Letter: PayPal Holdings, Inc., 2023 WL 385338, at *1 (Apr. 10, 2023) (proposal requesting that the board "conduct an evaluation and issue a report within the next year evaluating how it oversees risks related to discrimination against individuals based on their race, color, religion (including religious views), sex, national origin, or political views"); SEC No-Action Letter: The Travelers Cos., 2023 WL 352627, at *1 (Mar. 30, 2023) (proposal to have the insurance company oversee an audit to "improv[e] the racial impacts of its policies, practices, products, and services"); SEC No-Action Letter: Paccar Inc, 2023 WL 2524422, at *1 (Mar. 9, 2023) (proposal requiring board to "annually conduct an evaluation and issue a report describing if, and how, the Company's lobbying and policy influence activities . . . align with the goal of the Paris Agreement, and how the Company plans to mitigate the risks presented by any misalignment"); SEC No-Action Letter: Lab. Corp. of Am. Holdings, 2023 WL 174011, at *1 (Mar. 22, 2023)

shareholder proposals voted on increased to over 550, up 25% from just the previous year alone. Brigid Rosati et al., *A Look Back at the 2022 Proxy Season*, Harvard Law School Forum on Corp. Governance (Oct. 23, 2022), https://bit.ly/44niPBX; PwC's Governance Insights Center, *Boardroom Recap: The 2022 Proxy Season* 2, PwC (Aug. 2022), https://pwc.to/3phF11z.

At the same time, there has also been a rise in the number of shares owned by institutional investors. More and more people now own stocks in the form of mutual funds and pension funds rather than "retail"[3] investing. Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 66518, 66519 (Dec. 4, 2019) (Proposed 2020 Rule). The result is that institutional investors own between 70 and 80% of the market value of all public companies in the U.S. *Id*. And in those cases, the fund, whether a mutual fund or pension fund, then votes on behalf of its clients. *See* SEC Comm'r Allison Herren Lee, *Every Vote Counts: The Importance of Fund Voting and Disclosure*, SEC (Mar. 17, 2021), https://bit.ly/3pfECwx.

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(proposal to reduce company's cooperation with law enforcement enforcing abortion laws).

[3] Retail investors (or "individual investor[s]") are "non-professional investor[s]." Adam Hayes, *Retail Investor: Definition, What They Do, and Market Impact*, Investopedia (Feb. 17, 2021), https://bit.ly/3r3578U. Retail investors may trade individual securities or funds containing a collection of securities and do so through brokerage firms of investment accounts. *Id*.

Every year, these institutional investors have thousands of proxy ballot issues to contend with for hundreds (or thousands) of different companies. *See* 84 Fed. Reg. at 66519. Because institutional investors have a fiduciary duty to vote proxies in the best interest of their clients, *id*. at 66547—which includes ensuring they have no conflict of interest—voting on this volume of proxy proposals would have become insurmountable. *See* Final Rule: In Re Proxy Voting by Inv. Advisors, 2003 WL 215467, at *2, *10 (Jan. 31, 2003).

But the SEC eased the burden on institutional investors in 2003 when it informed advisors that they may "demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of *an independent third party*." *Id*. at *4 (emphasis added).

This is where proxy advisory firms come in.

Proxy advisory firms provide institutional investors (or anyone willing to pay for their services) with recommendations on proxy-ballot proposals for thousands of companies. *See* 84 Fed. Reg. at 66519. These proxy advisory firms allow institutional investors to avoid the work required to decide how to vote on the thousands of proxy proposals each year and also give institutional investors the imprimatur of a purportedly conflict free vote. *In Re Proxy Voting by Inv. Advisors*, 2003 WL 215467, at *4. According to the American Council for Capital Formation, institutional investors typically vote in line with the proxy advisory firm's recommendation. Timothy M. Doyle, *The Realities of Robo-Voting* 5, Am. Council for Capital Formation (Nov. 2018),

https://bit.ly/3NOen9M [hereinafter, "Doyle, *Robo-Voting*"]. These firms even offer services where they submit votes for institutional investors or provide pre-populated voting forms for investors in line with their recommendations—a practice known as "robo-voting." *Id.*; *see also* 84 Fed. Reg. at 66519-20. Institutional investors, therefore, rely heavily on proxy advisory firms' recommendations, which means these firms' recommendations end up having outsized influence on the governance and ultimate direction of public companies.

The two companies—Institutional Shareholder Services ("ISS") and Glass Lewis & Co.—are a duopoly, controlling 97% of the proxy advisory market. 84 Fed. Reg. at 66543 n.215 (collecting authorities). They rule the game. One study analyzed 175 asset managers, which represented more than $5 trillion in assets under management, and found that they followed ISS's recommendations, for example, over 95% of the time. Doyle, *Robo-Voting* at 5. And of those 175 asset managers, more than half (managing $1.3 trillion in assets) voted with ISS more than 99% of the time. *Id*. at 8. In short, ISS and Glass Lewis wield enormous influence.

However, it's important to bear in mind that while proxy advisory firms constitute "independent third part[ies]" for the purpose of a proxy vote, they themselves do not owe a fiduciary duty to investors (unless they are registered investment advisers, which the SEC does not require them to do), nor do they owe a duty to the corporations or their shareholders. Final Rule: In Re Proxy Voting by Inv. Advisors, 2003 WL 215467, at *4; Am. Council for

Capital Formation, *Are Proxy Advisors Still a Problem?* 6 (July 2020), https://bit.ly/3PxydYi [hereinafter, "Am. Council for Capital Formation, *Proxy Advisors*"]. Therefore, proxy advisory firms' recommendations do not need to be (and may not necessarily be) in the investors' best interest. *Id*. And an investors' best interests are at particular risk when the recommendations are for specialized issuers, like biotech companies, where proxy advisory firms' recommendations often miss the mark.

## ARGUMENT

### I. The SEC's 2022 rescission marks an unjustified return to an opaque and costly status quo.

Despite their widespread influence and their participation in the highly regulated securities industry, proxy advisory firms have operated for decades with little to no regulatory oversight. Regulation of securities markets in the United States is premised on ensuring transparency so that investors can make informed choices about where they put their money. *See Pinter v. Dahl*, 486 U.S. 622, 638 (1988) ("The primary purpose of the Securities Act is to protect investors by requiring publication of material information thought necessary to allow them to make informed investment decisions concerning public offerings of securities in interstate commerce." (collecting cases)). But proxy advisory firms stand apart. They assess a company's proxy ballot issues, develop recommendations, provide those recommendations to institutional investors who then vote in almost perfect lockstep with their

recommendations—thereby creating an outsized influence on corporate governance, while remaining free from disclosure and transparency requirements.

It is critical to understand the significant effect that their recommendations have on public corporations. Often companies subject to ISS's and Glass Lewis's recommendations must divert resources to correct inaccuracies and supplement incomplete information. These efforts may nevertheless be for naught, given the cost and time involved in trying to correct errors, provide a competing recommendation, or convince the proxy advisory firm to reverse its recommendation.

The attention of key company personnel, particularly in smaller companies with lower headcount, is frequently diverted from day-to-day operations by efforts to anticipate, and head off, misguided recommendations from proxy advisory firms. Studies show that proxy advisory firms have "significant influence over corporate choices" on a range of critical issues that management cannot afford to ignore. James R. Copeland et al., *Proxy Advisory Firms: Empirical Evidence and the Case for Reform*, Manhattan Inst. (May 21, 2018), https://bit.ly/3Xsbu1t.

The 2020 Rule was designed to alleviate some of these issues. This Rule was the product of a decade of work, across administrations, that included multiple requests for public input, as well as meetings with stakeholders and careful agency consideration. *See* Appellants Br. 14, 34. The centerpiece was the "notice and awareness" requirement, which would have required proxy

advisory firms to provide companies with the same proxy ballot reports they provide to institutional investors *at the same time*. Exemptions From the Proxy Rules for Proxy Voting Advice, 85 Fed. Reg. 55082, 55109 (Sept. 3, 2020) (2020 Rule). The 2020 Rule also required proxy advisory firms to alert their clients if the companies subject to the recommendations provided any written responses. *Id*. This was a departure from proxy advisory firms' "existing voluntary forms of outreach to registrants and other market participants" that the SEC previously deemed "[in]sufficient." *Id*. at 55108. The purpose was to allow companies to review the firms' recommendations and give them an opportunity to respond. The 2020 Rule also required proxy advisory firms to disclose potential conflicts of interest in their recommendations. *See id*. at 55134. And while this disclosure provision of the 2020 Rule remains in force, its efficacy is reduced without the notice and awareness provisions, which would have allowed companies to paint a more complete picture.

The SEC's abrupt about-face stopped these developments before their benefits could be realized.

Without engaging in any additional fact-finding or data-gathering, the SEC reached the exact opposite conclusion it had reached in the 2020 Rule, determining that the transparency and dialogue afforded by the notice and awareness requirements were no longer necessary. *See* Comm'r Peirce, *Dissenting Statement* ("Nothing has changed since [the SEC] adopted the rule, and [the SEC has] not learned anything new."). Rather than providing

companies with opportunities to respond to proxy advisory firms' recommendations, the SEC embraced the status quo.

The status quo creates at least three significant issues, especially for emerging biotech companies like BIO's members. First, there is little-to-no transparency about a firm's recommendations, including, for example, the analysis or methodology used. Second, proxy advisory firms operate with a glaring conflict of interest—ISS and Glass Lewis provide consulting to assist companies in addressing proxy issues, and at the same time they provide proxy recommendations on proposals related to those same companies. Third, proxy recommendations are typically one-size-fits-all. Firms make recommendations based on their own standardized assessments of ballot issues, but these recommendations do not take into account differences in industries and markets, or even between companies in the same industry of vastly different sizes.

### A. Proxy recommendations lack transparency and often include factual or analytical inaccuracies.

The 2022 rescission did away with much-needed requirements that would have made proxy recommendations more "transparent, accurate, and complete." 85 Fed. Reg. at 55082. The 2020 rule would have enhanced the dialogue between proxy advisory firms and issuer companies, ensuring that investors have more complete and accurate information.

The recission flies in the face of the SEC's mission to protect investors by "provid[ing them] with full disclosure of material information" and

"promot[ing] ethical standards of honesty and fair dealing." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976) (citation omitted). The way proxy advisory firms obscure data and methodology is especially problematic because their recommendations are often based on factual or analytical errors.

In 2020, one study identified 42 examples of public companies filing supplemental proxy materials to correct the record regarding a proxy advisory firm vote recommendation. Am. Council for Capital Formation, *Proxy Advisors* at 4. And in 2021, there were at least 50. Kyle Isakower, *Proxy Advisors Are Still a Problem* 9, Am. Council for Capital Formation (Dec. 2021), https://bit.ly/3pqVmAM. These numbers capture only those instances where public companies filed supplemental proxy materials, and they almost certainly undercount the overall number of errors. *Id*. Even for those companies able to uncover the error, filing supplemental proxy materials requires time and resources and must be done within a limited window. *Id*. Understandably, many companies elect not to (or cannot) go through that process.

One BIO member reported what happened when it tried to engage with a proxy advisory firm. This year, Glass Lewis initially refused to recommend voting in favor of the company's proposals because it could not locate its proxy statement and notice of annual general meeting. Both documents are on the company's website and were filed with the SEC. But the company had to repeatedly and doggedly pursue Glass Lewis to correct the errors. Glass Lewis never responded to the company's communications and only

corrected the error at the last minute, arguably without enough time to remedy the impact on voting.

Another company reported a similar experience with Glass Lewis after it made a significant factual error in a proxy recommendation. Glass Lewis recommended a vote against the company's proposed executive compensation because an $800,000 stock grant to the chief financial officer was instead reported by Glass Lewis as $12 million. Even after the company contacted Glass Lewis multiple times, it refused to correct the error. Fortunately for the company, shareholders ultimately approved the executive compensation, but not without the company's time and effort to correct Glass Lewis's mistake.

And in the 2021 proxy season, another biotech company reported that a proxy advisory firm recommended a vote against the election of a board of directors due to concerns about the meeting attendance of the nominees in question. But the company had "released data on near perfect attendance for the board members." *See* Kyle Isakower, *Analysis of Proxy Advisors' Recommendations During the 2021 Proxy Season*, Harvard Law School Forum on Corp. Governance (Jan. 15, 2022), https://bit.ly/440fNDI.

Proxy advisory firms are extraordinarily influential, and their recommendations have a real impact on a company's direction—even its survival. The 2020 Rule was a badly needed mechanism to ensure that companies are aware of what is being said about them and have a meaningful opportunity to correct the record when errors and omissions are present.

### B. Proxy advisory firms' practice of providing consulting services to businesses while also providing proxy recommendations to the same businesses is a clear conflict of interest.

In addition to issuing misguided and often misleading recommendations, frequently with factual errors, proxy advisory firms offer paid consulting services to the companies they assess, creating a clear conflict of interest. The SEC allows ISS and Glass Lewis to both consult companies on shareholder issues, which will appear on the company's proxy ballot, *and* issue recommendations to investors about those same companies' proxy ballots. In other words, the consulting side of the house works with a company to develop a governance position and the advisory side of the house instructs investors to vote in favor of that position. *See* Gallagher, *Outsized Power* at 5-6.[4] While the 2020 Rule did not eliminate these conflicts, it was a critical step

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[4] Even when the firms are largely supportive of a company's direction, their recommendations often contain room-for-improvement type advice that, because of this conflict, tend to raise eyebrows. For example, one issuer reported that a proxy advisory firm supported a company's governance proposals while still giving that company a poor ESG rating. Dan Daskal, Note, *ISS and Other Proxy Advisory Firms' Conflicts of Interest: Analyzing the Insufficiency of New Securities and Exchange Commission Rules and Guidance*, 2021 Colum. Bus. L. Rev. 1487, 1506-07. This "lends credence to the claim that proxy advisory firms use ESG ratings [for example] to lure issuers into paying for consulting services." *Id.* at 1507. This type of influence might have also been alleviated by the 2020 Rule's notice and awareness provisions by helping companies ensure the accuracy of proxy recommendations, whether or not they consult with the proxy advisory firm.

in the right direction in that it at least required that they be disclosed. *See* 85 Fed. Reg. at 55134. The notice and awareness provisions of the 2020 Rule would have provided companies more protection against a proxy advisory firm's inaccurate representations.

It's actually even worse than just the appearance of a conflict of interest. In 2020, 54% of companies reported that they were approached by a representative of ISS Corporate Solutions during the same year in which they received recommendations *against* the company's proxy proposals from ISS. Center for Capital Markets Competitiveness & Nasdaq, *Proxy Season Survey 2020* 10, https://bit.ly/3PwvBtM. This was similar to the previous year when 58% of the companies reported they were contacted by ISS Corporate Solutions. *Id*. The clear implication of the contacts is that a company should hire ISS Corporate Solutions to avoid receiving a negative recommendation from ISS. But rather than step in and regulate proxy advisory firms, the SEC's 2022 rescission instead allows for proxy advisory firms to "self-regulate," leaving issues like these unresolved.

### C. Proxy advisory firms make one-size-fits-all recommendations that are particularly ill-suited to specialized industries like biotech.

One persistent problem, especially for biotech companies, is that proxy advisory firms issue one-size-fits-all recommendations, which do not take into account differing challenges and business models for emerging companies in specialized fields. Without the changes provided by the 2020 Rule,

these companies have no opportunity to respond, and investors must then make decisions with incomplete information.

### 1. Recommendations against board member "overcommitment"

For example, proxy advisory firms like Glass Lewis are especially concerned with directors of boards who are "overcommitted." Glass Lewis believes that "an overcommitted director can pose a material risk to a company's shareholders." Glass Lewis, *Glass Lewis 2023 Voting Guidelines* 31, https://bit.ly/3PsAbsH. As a result, Glass Lewis "generally recommend[s] that shareholders vote *against* a director who serves as an executive officer . . . of any public company" while also "serving on more than one external public company board." *Id*. (emphasis added).

Though well intentioned, such a strict standard does not serve small, innovator companies in the biotech sector and becomes problematic when rigidly applied. Biotech companies work in highly specialized areas, and they face fierce competition for talent that has *both* the necessary technical and management knowledge to lead these companies. Individuals with experience raising capital and managing the volatile biotech market cycle are in short supply. Small biotech companies would also prefer directors that serve on only one board—theirs—but are often forced to accept individuals with more than one directorship as a matter of necessity. There are only so many candidates with the appropriate business background and, say, expertise in gene therapy or pediatric oncology. These individuals are likely to have multiple opportunities and, given the choice between a board seat with a small

biotech start-up or an established Big Pharma player, are likely to choose the latter. A rigid bar on "overcommitment" that takes these candidates off the table deprives small biotechs of the leadership they need and, ironically, makes corporate governance less effective, not more.

These proxy advisory firms' recommendations matter. One study showed that directors who received negative recommendations received 19% fewer votes. Matthew Fagan, Note, *Third-Party Institutional Proxy Advisors: Conflicts of Interest and Roads to Reform*, 51 U. Mich. J. L. Reform 621, 622 (2018) (citation omitted). One-size-fits-all proxy recommendations against directors with multiple board seats only deprive biotech companies of good leadership.

**2. Assessment of total shareholder return**

Proxy recommendations are also inapt for biotech's distinct business models. For example, executive pay frequently appears on ballot issues. When issuing a recommendation, ISS analyzes a CEO's "pay for performance" by evaluating the alignment between executive pay and the company's performance. ISS, *United States: Pay-for-Performance Mechanics ISS' Quantitative and Qualitative Approach* 5 (Jan. 13, 2023), https://bit.ly/3PqLdPi. "Total Shareholder Return" is a "key measure for investors in the context of a long-term pay-for-performance evaluation." *Id*.

But biotech companies take a long time to succeed, and developing biotechnology necessarily entails perhaps even more ups and downs along the way. On average, it takes more than a decade and more than a billion dollars

to bring a new biopharmaceutical treatment from discovery to market. During that time, there may be scientific setbacks that impact stock price but are completely unrelated to the company's management. And on top of that, many biotech companies pursue a select number of development programs, making them especially sensitive to unexpected hurdles. So for biotech companies, the volatility of the stock price makes a short-sighted metric like total shareholder return a poor measure of the company's performance.

**3. Evergreen Provisions**

Proxy advisory firms also attempt to impose their one-size-fits-all recommendations on compensation structures. Some employee stock option plans contain "evergreen provisions" in which companies add shares to the company's plan reserves on an "automatic, formulaic" basis, usually at the start of each year. *Private Companies Redesign Their Employee Equity Plans as IPOs Near*, Aon (Sept. 2015), https://aon.io/3pnJAY0. One study showed that 70% of all technology and life sciences companies add evergreen plan provisions while they are still privately owned. *Id*. ISS, however, views evergreen provisions negatively across the board and typically recommends voting against them. *See Resurgence of Evergreen Features in IPO Equity Plans Restrict Investor Say*, ISS Insights (Mar. 15, 2021), https://bit.ly/3JsI5hR. The claim is that shareholders may only vote on these provisions every ten years, and they contribute to share "dilution." *Id*. But biotech companies use evergreen provisions with greater frequency than other companies because they rely more on equity compensation for employees than other companies. *See, e.g.*,

Matthew Mullery et al., *Trends on Equity Provisions in Biopharma de-SPAC Transactions*, WTW (Aug. 9, 2021), https://bit.ly/3r1OGcS. Evergreen provisions feature in long-term employee incentive structures to help biotech companies retain talent over the long development process of a product. This, in turn, contributes to the company's success and ultimately benefits investors and shareholders.

The point here is not that, as a policy matter, evergreen provisions are always a good thing or that they work in every situation. Evergreen provisions are an issue on which reasonable people can differ. The point is that the 2020 Rule's notice-and-awareness requirement would at least give affected companies the opportunity to raise, and discuss, the disagreement. The district court's approval of the SEC's abrupt and fact-free removal of that notice-and-awareness requirement returns small biotechs to the status quo, in which they are denied an opportunity to even tell their side of the story.

## II. The SEC's 2022 rescission did not provide a reasoned explanation for disregarding the facts described above and addressed in the 2020 Rule.

After a decade of collaboration, compromise, and fact-finding, the SEC made a "U-turn." SEC Comm'r Hester M. Peirce, *U-Turn: Comments on Proxy Voting Advice*, SEC (July 13, 2022), https://bit.ly/44kRgsG. In so doing, and contrary to both law and logic, it relied on the fact-finding used to develop the 2020 Rule and provided little explanation for its now opposite

conclusions. As a result, key components of the 2022 rescission simply contradict the SEC's previous reasoning.

The APA requires an agency to show its work, even when it changes its mind. *See Encino Motorcars, LLC v. Navarro*, 579 U.S. 211, 221 (2016) ("One of the basic procedural requirements of administrative rulemaking is that an agency must give adequate reasons for its decisions."). "[T]he agency must show that there are good reasons for the new policy." *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009). And in cases like this one, where an agency's "new policy rests upon factual findings that contradict those which underlay its prior policy," "a reasoned explanation is needed for disregarding" those facts and circumstances. *Id*. at 515-16.

The district court agreed that it would be "arbitrary and capricious" for an agency to disregard the fact that its new, different policy contradicted facts that supported its prior policy. Mem. Op. at 27 (citation omitted). The district court also acknowledged that the SEC contradicted its own earlier findings in the 2022 rulemaking. *Id*. at 28-29. The district court nevertheless concluded that the SEC's paltry justifications were sufficient for the 2022 rescission. *Id*. at 31-36. That conclusion was incorrect.

The 2020 Rule responded to the very tangible impacts of an unregulated market sector. As illustrated through the examples above, issues with proxy recommendations and a company's ability to respond to them are pervasive. Proxy advisory firms produce inaccurate recommendations (at an increasing rate), resulting in costly proxy battles and corporate governance decisions

that may not be in the best interest of the company or its shareholders. What's worse is that the SEC had previously identified systemic concerns with proxy advisory firms and had addressed them (or at least had begun to address them) with the 2020 Rule. Then, under new leadership, the SEC reversed course, pretending these fundamental concerns no longer exist, and putting issuers and their shareholders at the mercy of an activist-oriented, rent-seeking duopoly. In short, the SEC's factfinding well-supported the 2020 Rule. In issuing the 2022 rescission, the SEC did not provide the "reasoned explanation" necessary to justify abandoning that Rule. Without more—a change in circumstances, new evidence, or some other compelling justification—this abrupt about-face is arbitrary and capricious.

## CONCLUSION

This Court should reverse the district court's judgment and set aside the 2022 rescission.

Respectfully submitted,

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## Certificate of Service

On June 27, 2023, this brief was served via CM/ECF on all registered counsel and transmitted to the Clerk of the Court.

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## Certificate of Compliance

This brief complies with: (1) the type-volume limitation of Federal Rule of Appellate Procedure 29(a)(5) because it contains 5,207 words, excluding the parts of the brief exempted by Rule 32(f); and (2) the typeface and type style requirements of Rule 32(a)(5) and Rule 32(a)(6) because it has been prepared in a proportionally spaced typeface (14-point Palatino Linotype) using Microsoft Word (the same program used to calculate the word count).

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