Can Shareholder Proposals Hurt Shareholders? Evidence from Securities and Exchange Commission No-Action-Letter Decisions

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Abstract

This paper studies Securities and Exchange Commission (SEC) no-action-letter decisions that determine whether companies can exclude shareholder proposals from their proxy statements. During 2007–19, the market reacted positively when the SEC permitted exclusion, which suggests that investors viewed those proposals as value reducing on average. We also find that a company's stock price decreased over time while waiting for an SEC decision, which suggests that challenged proposals imposed distraction costs on companies. The SEC's decisions can be predicted by regulatory rules but are also related to a proposal's predicted votes—more popular types of proposals were less likely to be removed. We find no robust evidence that no-action-letter decisions differed when the SEC was controlled by Democrats versus Republicans. Taken together, the evidence suggests that managers may be serving shareholder interests in opposing some proposals and that the no-action-letter process may be helping shareholders by weeding out value-reducing proposals.

1. Introduction

Shareholder proposals are a growing part of the corporate governance landscape. We calculate that approximately 22,000 proposals have been submitted to corporations since 1997, with recent proposals pressing for the elimination of stag-

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gered boards; enhanced proxy access; adoption of environmental, social, and governance goals; and disclosure of political contributions, among other matters.[1] Activists view proposals as constraints on managerial agency problems, but skeptics worry that they waste managerial resources and allow special interests to advance narrow agendas.

The proposal process is shaped by the US Securities and Exchange Commission (SEC) to an extent that is not always recognized. The SEC regulates which issues can be brought to a vote and whether management is required to abide by the voting outcome. It establishes conditions for a proposal to be eligible for a vote, itemized in Rule 14-8, and authorizes companies to omit individual proposals on a case-by-case basis.

This paper brings the SEC's regulation of shareholder proposals out of the shadows to better understand the proposal process and investigate two substantive issues. First, we use the no-action-letter process by which the commission authorizes companies to exclude proposals to produce new estimates of the value of shareholder proposals that arguably are better identified than other estimates in the literature. Second, we study the determinants of the SEC's decisions with an eye toward assessing the impact of the regulatory process on corporate values.

Implicit in the SEC's aggressive regulation of the process is the idea that some proposals are harmful and should not be put to a vote and that the SEC is capable of identifying and screening out such proposals. This premise is contestable since evidence on the benefits and costs of proposals has proved elusive, and assessments of the regulatory process are scarce. One could argue that shareholder proposals are beneficial (or at least not harmful) almost by definition because shareholders would not vote to hurt themselves. However, it is possible that shareholders make mistakes when voting, managers are distracted or disrupted by having to respond to proposals, and sponsors use proposals as leverage to secure special treatment from managers.[2]

To assess whether proposals can hurt shareholders, we make use of unpredict-

[1] For example, in 2005, only nine of the Standard & Poor's (S&P) 100 companies used majority voting for director elections; by 2014, almost 90 percent of the S&P 500 had adopted majority voting (Choi et al. 2016). The number of S&P 500 companies with staggered boards declined from 300 in the year 2000 to 60 in 2013 (Bebchuk, Cohen, and Wang 2011).

[2] For example, Bebchuk (2005, p. 894) notes, "Given that it is their money that is on the line, shareholders naturally would have incentives to make the decision that would best serve their interests." Larcker and Tayan (2011) and Larcker, McCall, and Ormazabal (2015) argue that shareholders might make wrong decisions by following bad recommendations from proxy advisory firms. Matsusaka and Shu (2020) show theoretically that investors might follow proxy advice even if they know it is biased. The chief justice of the Delaware Supreme Court noted (Strine 2014, pp. 456) that shareholder proposals may "compromise the ability of corporations to pursue the most profitable courses of action . . . because managers will be distracted and disrupted by constant mini-referendums and continual election seasons initiated by activist investors." In its 2011 *Business Roundtable* decision vacating a new Securities and Exchange Commission (SEC) proxy access rule, the DC Circuit Court of Appeals expressed concern that "union and state pension funds . . . might use [proxy access] as leverage to gain concessions, such as additional benefits for unionized employees, unrelated to shareholder value" (*Business Roundtable v. SEC,* 647 F.3d 1144, 1151 (D.C. Cir. 2011). Matsusaka and Ozbas (2017) show theoretically how managers have an incentive to make value-reducing side payments to activists in exchange for having a proposal withdrawn.

ability in the SEC's no-action-letter decisions. If a company wishes to exclude a proposal from the proxy statement, it can submit a letter asking the SEC to confirm through a no-action letter that the commission will take no action against the company if it omits the proposal. The company's letter will allege that the proposal violates one or more conditions of SEC Rule 14a-8 such as the proponent failed to demonstrate minimum stock ownership, the proposal relates to redress of a personal grievance, the proposal is "vague or indefinite," or the proposal deals with "ordinary business operations." Because the commission's decision is not perfectly predictable, its announcement provides new information to the market about whether the proposal will go to a vote or be shut down. Our research strategy is to calculate event returns associated with the arrival of news from the SEC: a positive stock price reaction following a decision to exclude a proposal is evidence that investors expected the proposal to reduce value.

We study hand-collected data on all 3,903 proposals for which companies requested a no-action letter during the years 2007–19. The SEC granted a no-action letter in response to 55 percent of these requests, it declined in 28 percent of cases, and 14 percent were withdrawn before the SEC issued a decision. Our main finding is that the market responded positively to the issuance of a no-action letter, which means that investors viewed those proposals as harmful to shareholders on average. The mean cumulative abnormal return (CAR) ranges from .11 percent to .58 percent depending on the event window and is statistically different from 0. Using information in the company's request letter, we develop a predictive model of the SEC's decision and estimate the amount of surprise in each decision. This allows calculation of a probability-adjusted CAR, which can be interpreted as the market's implied value of the decision. The implied loss in value associated with proposals that the SEC allowed to be omitted ranges from .26 percent to 1.34 percent, with typical values around .7 percent. The positive return associated with omitting a proposal is robust to different event windows, expected return models, and deletion of concurrent events. We then explore three explanations of why the market apparently viewed these proposals as harmful.

First, the substance of the proposals would have reduced firms' value. Although the SEC explicitly does not condition its decisions on the value consequences of a proposal, Rule 14a-8 itself may screen out bad proposals. To gain perspective on this, we classify proposals into those predicted to have received 40 percent or more support had they gone to a vote and unpopular proposals predicted to attract less support. The market's reaction was more positive to the omission of unpopular than popular proposals (but not statistically different), which suggests that investors mainly favored removing unpopular proposals that might have distracted managers from more important matters. Related evidence comes from comparing returns across three broad types of proposals: corporate governance, compensation, and social issues. Several studies argue that corporate governance proposals increase value by mitigating managerial agency problems, reformers generally support such proposals, and they are most likely to be approved by shareholders, while there is more skepticism about the value of social issue pro-

posals. The evidence is too noisy to allow confident conclusions, but there is some evidence that returns were highest for omission of corporate governance proposals. This finding, if more than a statistical fluke, lacks an easy explanation.

Second, the proposals were nuisances that would have wasted managers' time. To pursue this idea, we use information about the reason that the SEC granted a no-action letter. Proposals that were omitted because they had already been substantially implemented, they duplicated another proposal already on the proxy statement, they would have caused the company to violate state or federal law, or the company lacked the power to implement them were nuisances. We do not detect a difference in the market's reaction to exclusion of nuisance proposals so defined compared with other proposals.

Third, the proposals were intended to provide private benefits to the sponsors. Recent court opinions and some scholarly evidence suggest that some shareholders bring proposals to advance their narrow interests rather than overall firm value. Labor unions and public pensions have been singled out (Romano 1993, 2001; Schwab and Thomas 1998; Matsusaka, Ozbas, and Yi 2019). We find some evidence that the market's reaction was more positive for the exclusion of proposals sponsored by unions and public pensions than proposals from other organizations or individuals, but the differences are not statistically significant.

Overall, the results of these explorations do not lend themselves to strong conclusions. However, none of the evidence points toward investors fearing approval of value-destroying policies, and some studies suggest that investors may have approved of omissions because the proposals were too unpopular to justify voting on them.

Although abnormal returns were positive on average when the SEC granted a no-action letter, we do not find the opposite pattern when it allowed a proposal to go to a vote. In fact, the mean return associated with a decision to decline a no-action-letter request is usually positive and often statistically different from 0. In an efficient market, the only way that both returns—granting and not granting a no-action letter—could be positive is if the event of neither occurring earned a negative return. There are two ways that neither occurring could have happened on a given day. First, the company could have withdrawn its request for a no-action letter. This happened often: we find that about 30 percent of all proposals were withdrawn by the sponsor before a vote, and 14 percent of proposals under review were withdrawn before an SEC decision. When a proposal is withdrawn, it often means that the company granted some concession to the proponent, who in exchange withdrew the proposal. Theory suggests that such agreements could be value reducing.[3] The other possibility is the nonevent of a day passing without an

[3] Matsusaka and Ozbas (2017) provide a theoretical treatment of the issue of negotiations in the proposal process. Bebchuk (2005, p. 878) argues that the main benefits of proposals come from concessions by management, not from the vote itself: "[I]t should be emphasized that the benefits of shareholder intervention power should not be measured solely, or even primarily, by the rate of actual shareholder intervention. Indeed, a large fraction of the benefits would be indirect. Introducing the power to intervene would induce management to act differently in order to avoid shareholder intervention." The same argument implies that the costs of proposals will largely be indirect as well, arising from managerial actions to preempt proposals.

SEC decision. The absence of news could be negative if waiting for an SEC decision is distracting or disruptive, as organizations representing corporate interests claim. To sort out these possibilities, we develop a simple model in which each day that a proposal remains on the table imposes a dissipative distraction cost on the firm. The model produces three implications that hold if and only if waiting is dissipative: the abnormal return on the day of an SEC decision is positive, a company's stock price drifts down as long as its request is under consideration by the SEC, and the amount of downward drift is larger the longer it takes the SEC to render a decision. We report evidence consistent with each of these implications, reinforcing the idea that investors may welcome the omission of proposals to avoid distracting and disrupting managers.

Under certain (strong) assumptions, the model also allows the mean value of proposals, conditional on characteristics, to be inferred by regressing abnormal returns on an indicator variable for the SEC's decision. A battery of regressions imply that proposals targeted at high-profit firms are expected to reduce their value by a statistically significant .42 percent to 1.06 percent depending on the event window, while proposals at low-profit firms were expected to increase value by .27 percent to .35 percent (with varying statistical significance by window). Investors may have disliked proposals targeted at high-profit firms because they threatened to disrupt operations that were performing well. The increase at low-profit firms squares with the idea that low performers benefit from external pressure to improve and with evidence that low-performing firms are most likely to be targeted by shareholder proposals (Denes, Karpoff, and McWilliams 2017).

Finally, we turn to the determinants of the SEC's decisions. The fact that prices increased on average when the SEC allowed omission suggests that the regulatory process may be improving capital markets when it screens out these proposals. Yet it is not clear how this sort of screening would happen since the SEC states that it does not consider a proposal's merits, only whether it meets the eligibility rules. One possibility is that the rules themselves screen out harmful proposals; alternatively, it is conceivable that the SEC exercises discretion in ambiguous cases in a way that correlates with a proposal's value. We explore these ideas by estimating regressions predicting the SEC's decisions. The most pronounced finding is that the SEC was about 20 percent more likely to grant a no-action letter for unpopular than popular proposals (where popularity is measured by predicted votes), a large effect that is statistically significant. This connection between SEC decisions and predicted votes appears even after controlling for the alleged rule violation, which implies that the rules are not inducing the connection. We also consider whether political factors influence no-action-letter decisions by conditioning on whether the commission had a Democratic or Republican majority. No robust evidence of political influence appears.

As mentioned, one purpose of our study is to bring the no-action-letter process into the foreground of discussions about shareholder proposals. This process may have huge ramifications for the effectiveness of shareholder proposals, as suggested by the intense public discussion that followed the SEC's proposal to

modify the no-action-letter rules in November 2019, but there is little evidence whether it helps shareholders by screening out disruptive or frivolous proposals or whether it hurts them by protecting underperforming managers. Our evidence paints a somewhat positive picture of the SEC's involvement, suggesting that it often screens out proposals that investors do not wish to see go to a vote. We provide a variety of descriptive evidence about the no-action-letter process that may be useful to other scholars interested in studying it. Descriptive evidence is also available in Soltes, Srinivasan, and Vijayaraghavan (2017), a complementary study that focuses on management's decision to seek a no-action letter and the voting outcomes associated with proposals that do not receive no-action letters. They find that some (17 percent) of the proposals that managers unsuccessfully sought to block subsequently attracted majority shareholder support, which could be instances of managers acting contrary to shareholder preferences.

At a broad level, our evidence provides perspective on the role of managers in the proposal process. Shareholder rights activists endorse the proposal process as a way to counteract managerial agency problems and failures to recognize valuable opportunities.[4] This view has a long pedigree, going back at least to Berle and Means (1932). It has been contested for just as long; corporate law is based on a presumption that managers act in the interest of shareholders (business judgment rule), and one tradition of economic thinking argues that competition in product, capital, and labor markets puts pressure on management to advance shareholder interests (Manne 1965; Fama 1980). Many of our findings are compatible with the view that managers are acting in the interest of shareholders when they oppose shareholder proposals, at least for the subset that the SEC allows them to omit. Managerial claims about the disruptive cost of proposals may be more than a self-serving rationalization. In the eyes of the market, a nontrivial set of shareholder proposals are value reducing.

2. No-Action Letters and the Proposal Process

Shareholder voting rights are rooted in state corporation law and corporate charter documents, but the proposal process is governed by the SEC. The SEC began regulating the process in 1935 on the basis of section 14 of the Securities Exchange Act of 1934, which charged the agency to develop proxy regulations "in the public interest and for the protection of investors." Over time, the SEC gradually developed a body of regulations that came to be collected in Rule 14a-8.[5] This rule has been amended many times over the years, most recently in 2011.[6] Under state law, shareholders have a right to make proposals in person at a company's

[4] The process could also be useful if managers are faithful agents but need a way to acquire information about shareholder preferences over alternative courses of action. This communication view appears to be how the SEC envisions the process (discussed more below).

[5] For histories of the development of the shareholder proposal rules, see Liebeler (1984) and Fisch (1993). For developments over the last 2 decades, see Bainbridge (2012).

[6] In September 2011, Rule 14a-8(i) was amended so that a company could no longer exclude proposals that would facilitate director nominations by shareholders (proxy access).

annual or special meetings. Because most shareholders do not attend, they cast their votes by proxy. The company is required to distribute a proxy statement to all shareholders prior to a meeting that in effect allows them to vote in absentia. Federal proxy access rules govern the conditions under which a company is required to list a proposal in its proxy statement.

The proposal process begins with a shareholder proponent drafting a proposal and sending it to the company. The proposal offers a resolution to be voted on and an argument in its favor. The resolution can take the form of an amendment to the company's bylaws, or it can be a request for the company to consider taking some action. The proposal must arrive at the company no later than 120 days before the proxy statement is to be mailed. If the company wishes to omit the proposal from the proxy statement, it can appeal to the SEC by submitting a letter no later than 80 days before the proxy statement is mailed. The letter states that the company intends to omit the proposal, indicates the grounds for doing so, and requests a no-action letter from the SEC staff confirming that it will not recommend an enforcement action against the company. If the company requests a no-action letter, the proponent is given an opportunity to respond, which may be followed by a series of rejoinders from both parties. The SEC renders a decision 40 days after the company's request on average. (The Online Appendix contains examples of SEC decision letters.) In most cases, if a no-action letter is issued, then the proposal is omitted from the proxy statement, while if the SEC declines to issue a no-action letter, the proposal appears in the proxy statement and goes to a vote. Both the company and the proponent have the option of taking their case to a federal court if they disagree with the SEC's decision, which happens occasionally. Sometimes the proponent agrees to withdraw the proposal before or after an SEC decision after negotiations with the company. The proxy statement containing the proposal must be mailed to shareholders within a window before the annual meeting that is stipulated by state law (for example, not more than 60 or fewer than 10 days in California and Delaware).

There are many possible grounds, or bases, for excluding a proposal under Rule 14a-8. Table 1 provides a summary of the procedural requirements for submitting a proposal (14a-8[b] through 14a-8[e] and 14a-8[h]) and substantive bases for exclusion (14a-8[i]). Procedural requirements include ownership of stock worth at least $2,000 or 1 percent of firm value for at least 1 year before the meeting, submission of no more than one proposal per meeting by a single proponent, and a 500-word limit on the proposal and supporting statement. The substantive bases for exclusion are wide ranging. At the most basic level, the proposal must be a proper subject for action under state law. A proposal can be excluded, among other reasons, if it would cause the company to violate a law, is false or misleading, relates to redress of a personal grievance, deals with ordinary business operations, conflicts with a management proposal, duplicates another proposal in the proxy statement, or relates to a specific amount of dividends. The SEC states that it does not judge the merits of a proposal when making a no-action-letter deci-

Table 1

Rule 14a-8 Bases for Exclusion of Shareholder Proposals

Rule	Description	All Claims	Granted Claims
Procedural requirement:			
14a-8(b)	Proponent must have held stock worth $2,000 or 1 percent of firm value continuously for at least 1 year before submitting proposal and must hold them through meeting date	718	375
14a-8(c)	Proponent may submit only one proposal per meeting	178	20
14a-8(d)	Proposal and supporting statement may not exceed 500 words	37	8
14a-8(e)	Proposal must be submitted no less than 120 days before proxy statement is mailed	231	145
14a-8(h)	Proponent or representative must be present at meeting	41	32
Total		1,205	580
Substantive basis for exclusion:			
14a-8(i)(1)	Improper subject for action under state law	214	1
14a-8(i)(2)	Will cause the company to violate state, federal, or foreign law	350	59
14a-8(i)(3)	Proposal and supporting statement are materially false or misleading	1,237	138
14a-8(i)(4)	Relates to redress of a personal claim or grievance or provides a benefit to proponent only	139	13
14a-8(i)(5)	Relates to operations that account for less than 5 percent of company assets or sales	95	3
14a-8(i)(6)	Company lacks the power to implement	374	36
14a-8(i)(7)	Deals with ordinary business operations	1,414	643
14a-8(i)(8)	Would disqualify a director candidate, remove a director from office, question competence of director or nominee, seek to include specific nominee, or otherwise affect the outcome of director election	128	30
14a-8(i)(9)	Conflicts with company's proposal	256	130
14a-8(i)(10)	Company has already substantially implemented proposal	1,081	384
14a-8(i)(11)	Substantially duplicates another proposal	217	96
14a-8(i)(12)	Deals with substantially the same subject as another proposal from previous years that received low shareholder support	105	65
14a-8(i)(13)	Relates to specific amounts of dividends	41	22
Total		5,651	1,620

Note. Values are for 2007–19. If the Securities and Exchange Commission allowed a proponent to modify the proposal to avoid a no-action letter, it is counted as a no-action letter not having been granted.

sion.[7] This means that investors should not make inferences about the merits of a proposal from the decision, except insofar as the proposal's merits are related to the conditions enumerated in Rule 14a-8.

Table 1 also reports the number of company requests that claim a given basis for exclusion and the number of SEC letters that grant no-action relief for that basis. The most popular claims for exclusion are that a proposal meddles with ordinary business (14a-8[i][7]), is false or misleading (14a-8[i][3]), or has been substantially implemented already (14a-8[i][10]) or that the proponent has not met the ownership conditions (14a-8[b]). These are also the most common grounds on which the SEC grants a no-action letter (as is late submission of proposals).[8]

The ability to exclude proposals that are improper under state law is important. Most states give the board the authority to run the company, in which case a proposal that mandates a course of action is improper under state law (except for bylaw amendments concerning decision and governance procedures). To avoid violating state law, then, most proposals are advisory or "precatory" in nature; they "request" or "urge" (or use similar language to ask) the company to take an action. In our sample, only 2.5 percent of proposals are binding.

It is also the case that few proposals manage to attract significant shareholder support. Figure 1 shows the distribution of votes for all proposals and for proposals that went to a vote after an unsuccessful no-action-letter request. Overall, only one in five proposals received majority approval, and the mean approval rate was 33.6 percent. Proposals that managers attempted to block were even less popular—only 17 percent received majority approval, and the mean approval rate was 30.5 percent. The fact that most proposals receive less than majority support—and are only advisory in any case—makes the process an ineffective tool for imposing outcomes on management. As a result, some observers believe that proposals are "mostly efforts by shareholders to bring public attention to potentially embarrassing corporate practices" and that management opposes them "not because they will actually interfere with its authority but because of the public pillorying that will often result" (Brown 2012, p. 512).[9] In contrast to these views of the proposal process as a way to mitigate agency problems, the SEC characterizes proposals as a way for shareholders to share information, "provid[ing] an avenue for communication between shareholders and companies, as well as among shareholders themselves" (SEC 2001, p. 2). All of this suggests that the impact of a proposal cannot be reduced to whether it received 50.1 percent of votes in favor.

Regardless of whether proposals are intended to put pressure on managers or merely communicate shareholder preferences, some of them appear to have an

[7] "Do we [SEC] judge the merits of proposals? No. We have no interest in the merits of a particular proposal. Our concern is that shareholders receive full and accurate information about all proposals that are, or should be, submitted to them under rule 14a-8" (SEC 2001, p. 8).

[8] Companies often claim several grounds for exclusion in letters to the SEC. If the SEC finds one reason to allow exclusion, it does not offer an opinion on the validity of the other grounds. Therefore, the values in Table 1 do not include all valid grounds for exclusion but only those that were flagged by the SEC staff.

[9] Proxy advisory firms and major institutional investors, however, have begun conditioning their support for reelection of directors on whether a company implemented shareholder proposals, which may be giving more force to voting outcomes.

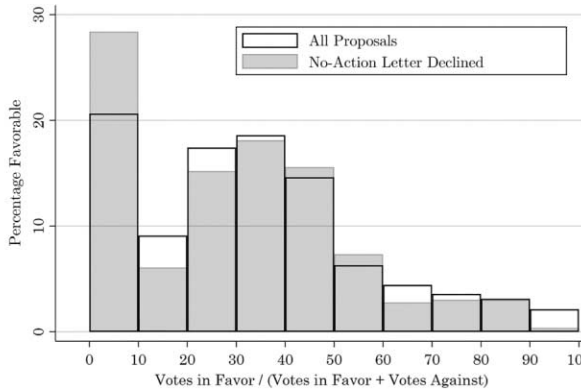

Figure 1. Distribution of favorable votes on proposals

effect. Gantchev and Giannetti (forthcoming) find that companies implemented 12 percent of proposals that received a majority vote in favor; Ertimur, Ferri, and Stubben (2010) find a 31 percent implementation rate for corporate governance proposals; and we find that companies were 7.3 percent more likely to adopt a governance provision within a year of it being proposed, not considering the voting outcome (Matsusaka, Ozbas, and Yi 2019).

The cost of initiating a proposal is small. A proponent need only draft a proposal and send it to the company along with proof of the requisite share ownership. However, the proponent is required to physically attend the company meeting or send a designated representative, which is a substantial cost that screens out casual proposals. For companies, the cost of including a proposal in the proxy statement is negligible, but the cost of filing a no-action-letter request is nontrivial. According to a 2009 Business Roundtable survey, submitting a no-action request costs a company on average 47 hours of time and associated direct costs of $47,784 (SEC 2010, p. 280 n. 817).

In general, the SEC plays a central role in shaping the shareholder proposal landscape through Rule 14a-8 and the no-action-letter process. The commission's decisions can eliminate an entire class of issues from going to a vote. The ordinary-business exclusion (14a-8[i][7]) has been especially important. Originally adopted in 1954 "to confine the resolution of ordinary business problems to management and the board of directors," the rule was modified in the 1970s to allow proposals focused on "policy issues that are sufficiently significant because they transcend ordinary business" (SEC 2017). The inherent subjectivity of the terms "ordinary business" and "sufficiently significant" has allowed the rule's coverage to stretch and contract over time, often suddenly, and often following a change in political control of the commission (Brown 2012).[10] Employment-

[10] The SEC has significant autonomy to regulate the no-action-letter process, largely untethered from democratic accountability. Rule 14a-8 is managed entirely by the commission; it is not prescribed by an act of Congress, and changes in staff guidance are not subject to the notice-and-comment requirements of the Administrative Procedure Act.

related matters concerning nonexecutive employees are considered ordinary business, but proposals on affirmative action and antidiscrimination policies were allowed (as significant policy issues) until 1991, when the commission reversed itself and permitted their exclusion. Proposals relating to employee discrimination based on sexual orientation were declared excludable in 1991 but were allowed to go to a vote beginning in 1998. Succession planning for a chief executive officer (CEO) was an excludable topic before 2008, when the commission reversed itself and began to allow such proposals. Executive compensation has followed a particularly tortuous path: in 1992 the commission permitted exclusion of proposals related to executive compensation plans, in 2002 it allowed such proposals to go to a vote, in 2006 it again excluded certain compensation proposals (limiting executive compensation), and in 2011 once again it permitted them to go to a vote. Most recently, in February 2018 the SEC issued a no-action letter that reversed long-standing practice and permitted exclusion of proposals calling for the company to set targets for reducing greenhouse gas emissions under the principle of micromanagement (EOG Resources, Inc., SEC no-action letter, 2017 WL 6551885 [February 26, 2018]).

3. Estimates of the Value of Proposals

We use stock price movements in the days surrounding the issuance of an SEC no-action-letter decision to make inferences about the value of proposals. By construction, this yields an unrepresentative sample of proposals because the SEC acts only in response to a company's request, which happens for about 37 percent of proposals during our time period. To put our sample into context with previous evidence, Table 2 summarizes the literature on the value consequences of shareholder proposals. According to Denes, Karpoff, and McWilliams (2017), this is the complete list of such papers.

One characteristic of the literature is that every published paper studies a sample that is restricted in some potentially important way. Of the 12 studies, seven consider only proposals related to corporate governance; one considers only proposals related to say on pay; and six consider only proposals from certain types of sponsors (four examine only public pension funds, one examines only labor unions, and one examines only proposals from the United Shareholders Association). Eight studies consider only proposals that went to a vote, which excludes approximately 20 percent of proposals that were omitted following a no-action letter and another approximately 20 percent that were withdrawn after negotiations.[11] Leaving out proposals that did not go to a vote might not seem like a material admission, but withdrawn proposals can have real consequences if, as many believe, they are used as bargaining chips that secure benefits for their proponents (see Anabtawi 2006; Bainbridge 2006; Bebchuk 2005; Larcker and Tayan 2012; Matsusaka and Ozbas 2017; Romano 2001; Schwab and Thomas 1998). Our

[11] Bauer, Moers, and Viehs (2015) report that 20.7 percent of proposals were withdrawn over the 1997–2009 period. This is almost certainly an underestimate given that some withdrawn proposals never appear in their data.

Table 2

Summary of Literature Measuring Returns to Shareholder Proposals

		Event Date (*N*)				Sample Restrictions			
Study	Period	News Story	No-Action Letter	Proxy Mailing	Annual Meeting	Topic	Sponsor	Voted	Other
Karpoff, Malatesta, and Walkling (1996)	1986–90	27		290	258	Corporate governance			
Smith (1996)	1987–93	39					California Public Employees' Retirement System		
Strickland, Wiles, and Zenner (1996)	1990–93			100	100	Corporate governance	United Shareholders Association	Yes	
Wahal (1996)	1987–93	96		211			Public pension		
Del Guercio and Hawkins (1999)	1987–93			224	224		Public pension		
Gillan and Starks (2000)	1987–94			1,239		Corporate governance		Yes	
Prevost and Rao (2000)	1988–94			32		Corporate governance	Public pension	Yes	
Thomas and Cotter (2007)	2002–4			1,454	1,454			Yes	
Cai and Walkling (2011)	2006–8			113		Say on pay		Yes	
Renneboog and Szilagyi (2011)	1996–2005			1,510		Corporate governance		Yes	
Prevost, Rao, and Williams (2012)	1988–2002			373		Corporate governance	Union	Yes	
Cuñat, Gine, and Guadalupe (2012)	1997–2007				450	Corporate governance		Yes	Majority approval
This paper	2007–19		3,903						No-action letter requested

Note. The list is drawn from Denes, Karpoff, and McWilliams (2017). The event dates are the date of a story in news media, the date of a no-action-letter decision, the date that the proxy statement was mailed (or the filing date of the definitive version in Del Guercio and Hawkins [1999] and Cai and Walkling [2011]), and the date of the annual meeting. For example, Karpoff, Malatesta, and Walkling (1996) use a sample of 27 observations when estimating returns associated with news stories. If the sponsor is listed as a public pension, the sample also includes proposals sponsored by the College Retirement Equities Fund. "Voted" includes only proposals that went to a vote (excluding proposals that were withdrawn or omitted). Cuñat, Gine, and Guadalupe (2012) consider only proposals that received votes in the vicinity of 50 percent.

sample is limited in that all proposals were challenged by managers but is not otherwise restricted in terms of topic, type of sponsor, or whether it went to a vote. As a fraction of the proposals in 2007–18, our coverage rate is 37 percent, lower than that of Thomas and Cotter (2007), which we estimate covers about 80 percent of all proposals during its time period, but higher than most other studies and covering a longer period.

Perhaps the most convincing study of effects on value to date is Cuñat, Gine, and Guadalupe (2012), which uses a regression discontinuity design that compares proposals that narrowly passed and narrowly failed. That paper's sample, which we estimate includes about 4 percent of the proposals during its time period, considers only proposals involving corporate governance topics for which (by construction) the approval rate was in the vicinity of 50 percent. Since most proposals receive far less than 50 percent support, the proposals in their sample were considerably more popular than the norm, which possibly overrepresents good proposals.[12] In comparison, our sample is restricted to proposals that were challenged by managers, which possibly overrepresents the population of bad proposals.

Our existing knowledge, therefore, is based on a collection of relatively small fragments of the overall picture, none of which captures its entirety. We believe our study fills in a sizeable and important missing piece of the picture by examining, among other issues, proposals that did not go to a vote. Our sample also includes many more non-corporate-governance proposals and non-public-pension-sponsored proposals than the existing literature. Having said that, it is worth restating that our sample is unlikely to be representative of all proposals.

Our research strategy focuses on the market reaction to no-action-letter decisions. Most studies examine event returns associated with the date that the proxy statement is mailed to shareholders. The problem with this approach is that to make a proposal, a shareholder must send a notice to the company at least 120 days before the proxy statement is mailed; companies must file a proxy with the SEC 10 days before mailing it; and SEC Rule 14a-6(e)(1) requires the preliminary statement to be made immediately available for public inspection. The proxy mailing date is thus at least 10 days after the date that the proxy statement's content has been provided to the market; consequently, it is not surprising that every study fails to find abnormal returns different from 0 on the mailing date.[13] Another limitation of the proxy mailing date is that companies often have multiple proposals on the same ballot (27 percent of proxy statements have multiple shareholder proposals in Karpoff, Malatesta, and Walkling [1996], not including management proposals). With multiple proposals on one event date, it is not possible to isolate effects for individual proposals by type of proponent or proposal

[12] In the Institutional Shareholder Services (ISS) Shareholder Proposal Database, we find that 80 percent of proposals receive less than 50 percent approval, and the mean approval rate is 26 percent.

[13] Two of the studies in Table 2 use the filing date rather than the mailing date (Del Guercio and Hawkins 1999; Cai and Walkling 2011). To the extent the filing date means the filing of the definitive proxy statement, this comes at least 10 days after the preliminary proxy statement is filed and becomes public.

topic, and interpretation of the net effect is cloudy: if there are four proposals and an abnormal return of 0 percent, it could mean that none of the proposals affect value, that half of them increase and half of them decrease value, and so on.

The no-action decision date, in contrast, involves the arrival of new information about a specific proposal. The existence of the proposal and company's request are known in advance of the decision because they are posted on the SEC's website immediately on being received.[14] However, the commission's decision is not fully predictable. The SEC grants a no-action letter in two-thirds of its decisions, and while some criteria appear to be black and white, such as the proposal not exceeding 500 words, whether a proposal violates other restrictions is not obvious to an outsider.[15] An outsider may be unsure if the proponent owns the required amount of stock, and the substantive bases—the proposal deals with ordinary business operations, has been substantially implemented, or is vague or indefinite—are inherently subjective. While precedent helps to interpret these phrases, there are still gray areas that are unresolved until the SEC decides. Our research strategy and inferences require that SEC decisions resolve some uncertainty about whether a proposal will be excluded, not that those decisions be random. If a decision was perfectly predictable, then the event return would be 0, which would bias our estimates toward 0.

4. Data

Our empirical analysis draws on five data sources. The primary data are hand collected from no-action-letter files compiled by the SEC. Since October 2007, the files have been published on the SEC's website in PDF format (the information is also available in LexisNexis). Each file contains a cover letter from the SEC that identifies the company, proponent(s), and decision date; a decision letter that explains the reason for the decision; and various letters from the company and its legal representatives and from the proponent and its legal representatives, including the proposal itself. Using these files, we hand collected the decision and decision date for each case and the company, proponents, and content of the proposal. A company's request can be resolved in one of several ways, the most common being a no-action letter granted, a no-action letter declined, and the proposal withdrawn.[16] Proposals were assigned topics, and proponents were grouped into types, as discussed in Section 5. Our data cover all no-action-letter decisions for 2007–19. Details of the data collection are reported in Appendix A.

Firm-level stock returns from the Center for Research in Security Prices are adjusted for the risk-adjusted expected return surrounding the event date, as usual

[14] The posting includes the proposal and the company's request letter. The SEC's procedures for processing requests and making them public are stated in SEC (2004) and updated for e-mail in SEC (2011).

[15] Even a request to omit a proposal because it exceeds 500 words may not be as obvious as it seems. One decision in our sample concerning the 500-word limit hinged on whether "CEO" was one word or three words.

[16] We exclude the small number of cases in which the company unilaterally withdrew its request and agreed to hold a vote on the proposal and in which the SEC did not render a decision.

in event studies. We calculate daily abnormal returns with the market-adjusted model and the Fama-French four-factor model. The length of the estimation period is 200 trading days, ending 10 days before the event date, and we require at least 150 days with returns. Event windows begin 1 trading day before the decision date and end from 1 to 10 trading days after the decision date.[17] We winsorize CARs at 1 percent in each tail. Longer event windows are called for if SEC decisions are posted with a delay, which does happen, or the news takes time to disseminate across the market. We drop an event if the window contained another no-action-letter decision for the same firm to avoid the inference problems discussed earlier with events involving multiple proposals at the same time. This screen reduces the sample size from 21 percent to 33 percent depending on the window length. There is seasonality in the no-action-letter process; 80 percent of no-action-letter decision dates are in January, February, or March. Finally, we use Compustat to obtain firms' financial information, Factset to obtain information on voting outcomes and aggregate proposal counts, and S&P Capital IQ's Key Developments database to identify concurrent events.

5. Descriptive Information

Because the no-action-letter process has not attracted much previous research, we present some descriptive evidence before proceeding to the main analysis. Table 3 reports the number of proposals received by companies and the number that companies challenged, centered on the year of the annual meeting for which a proposal was intended. The number of proposals received by companies varies by data source; we report numbers from Factset, which provides the most comprehensive coverage over time.[18] The number of proposals varied from a low of 473 in 2012 to a high of 1,202 in 2007. Requests for no-action letters also vary over time, from a low of 187 in 2013 to a high of 426 in 2008. Over 2007–18, companies requested no-action letters for 37 percent of proposals.

Table 3 also reports the outcome of the request.[19] Over the entire period, 14 percent of the proposals sent to the SEC were withdrawn by the proponent before a decision was issued. Of the proposals that were not withdrawn, nearly two-thirds were granted no-action letters and were allowed to be omitted from the proxy statement, while one-third were not granted no-action letters. The SEC was

[17] The findings are qualitatively similar if the event window begins on the day of the event rather than 1 day before, which implies that the patterns are not driven by day −1.

[18] Factset tracks a subset of companies, while our no-action-letter data cover all companies. To provide a meaningful estimate of the percentage of proposals referred to the SEC, we calculate the number of no-action-letter requests sent by companies in the Factset sample and use that to calculate the percentages in Table 3. Another popular data source is ISS. The numbers vary by source because companies are not required to report proposals that are received but then withdrawn, and the data providers have different approaches to capture the proposals. Factset coverage is incomplete for 2007, so we use ISS for that year.

[19] The columns do not sum to 100 percent because 3 percent of proposals do not fit any of the three outcomes. Most often this is because the company withdrew its request or the SEC declined to offer an opinion, which happened if the case was being litigated or the commission was reevaluating its reasoning.

Table 3
Shareholder Proposals and No-Action-Letter Decisions, 2007–19

		Sent to the SEC		Letter Granted		Request Declined		Proposal Withdrawn	
	Received	*N*	%	*N*	%	*N*	%	*N*	%
Annual meeting year:									
2007	1,202[a]	339	28	195	58	101	30	33	10
2008	1,009	426	42	274	64	94	22	49	12
2009	934	384	41	171	45	158	41	54	14
2010	946	363	38	225	62	94	26	37	10
2011	730	314	43	183	58	84	27	38	12
2012	473	231	49	149	65	46	20	31	13
2013	832	187	22	98	52	48	26	38	20
2014	784	290	37	150	52	78	27	55	19
2015	858	329	38	142	43	83	25	55	17
2016	798	255	32	150	59	76	30	28	11
2017	773	290	38	178	61	64	22	45	16
2018	638	258	40	125	48	82	32	46	18
2019	N.A.	237	N.A.	121	51	70	30	43	18
Total	9,977	3,903	37[b]	2,161	55	1,078	28	552	14
Proponent type:									
Non-SRI fund	285	46	16	26	57	16	35	4	9
SRI fund	913	341	37	178	52	80	23	79	23
Individual	3,997	1,892	47	1,257	66	498	26	100	5
Labor	1,445	422	29	176	42	141	33	90	21
Other	1,134	362	32	210	58	78	22	65	18
Public pension	1,107	239	22	74	31	76	32	57	24
Religious	592	364	61	119	33	119	33	114	31
Proposal type:									
Compensation	1,393	566	41	270	48	200	35	79	14
Corporate governance	3,760	1,403	37	809	58	397	28	124	9
Other	1,737	1,005	58	666	66	175	17	151	15
Social and politics	2,583	692	27	295	43	236	34	155	22

Note. The number of proposals received by companies is calculated using data from Factset. All other values are calculated using data from Securities and Exchange Commission (SEC) no-action letter filings. The data for proponent and proposal type are for 2007–18. N.A. = not available. SRI = socially responsible investment.

[a] Calculated using data from the Institutional Shareholder Services Shareholder Proposals Database.

[b] Calculated using data from 2007–18.

more likely than not to permit a company to exclude a proposal, but it did not always side with the company. The SEC's proclivity to agree with the company varied considerably over time, from a low of 52 percent in 2009 to a high of 76 percent in 2012.

Table 3 also shows similar information by the identity of the proponent. We classify proponents into six broad groups, corresponding to the major categories used in other studies. As other studies note, the preponderance of proposals come from individuals, especially a handful of activists sometimes called gadflies (a term they do not like) who submit dozens of proposals each year. The most active proponent in our no-action-letter sample was Los Angeles–based John Chevedden, a former aerospace employee who first filed a proposal in 1994, a few years after being laid off by Hughes (for background, see Kerber 2013). Chevedden, working with a network of family members, friends, and associates, was involved with 961 proposals in our no-action-letter sample. Recall that this count includes only his proposals that were challenged—he made other proposals that were not challenged. In terms of groups or organizations, the most active were labor unions and public pensions. The most prolific union proposers in our sample were the American Federation of Labor and Congress of Industrial Organizations Reserve Fund, International Brotherhood of Teamsters General Fund, and United Brotherhood of Carpenters Pension Fund. The most active public pension funds in our sample were the California Public Employees' Retirement System, the New York City funds, and the New York State Common Retirement Fund. Hedge funds, which play a prominent role in proxy fights and other activist activities (Brav, Jiang, and Kim 2015), are secondary players in the shareholder proposal process and almost entirely absent from our no-action-letter sample.

Companies are most likely to seek to omit proposals from religious groups, referring 61 percent of their proposals to the SEC. The challenge rate for proposals from individuals was also substantial at 47 percent. Companies were least likely to challenge proposals from non-SRI funds, with a 16 percent rate. Table 3 also reveals a sizeable difference in withdrawal rates between individuals (5 percent) and organized groups (24 percent). This reflects that organized groups often use the proposal process as a bargaining chip to gain concessions from the company instead of intending to take the proposal to a vote (Matsusaka, Ozbas, and Yi 2019). In terms of SEC decisions, the commission was most likely to allow omission of proposals from individuals, agreeing with companies in 72 percent of those cases that were decided. This may reflect a lack of sophistication among many individual investors, who do not understand Rule 14a-8 and lack advice from attorneys with expertise in the area. Public pensions and religious groups were the most effective at defending their proposals; the SEC allowed their omission only 50 percent of the time.

Table 3 also describes the subject matter of proposals. We focus on three broad topics that are common in the literature: compensation, corporate governance, and social issues (with everything else in a residual "other" category). Corporate governance proposals were by far the most common, constituting 40 percent of

all proposals. They called for declassification of boards, separation of the CEO and board chair position, proxy access, allowing shareholders to call special meetings, audits, and so forth. Social issues were the second most popular, constituting 27 percent of the total; they involved greenhouse gas emissions, renewable energy, human rights of employees, discrimination, pollution, and other issues; we also include political disclosure in this category. Compensation proposals include limits on executive compensation, tying executive pay to performance, requiring shareholder votes on compensation, requiring executives to hold equity, and claw backs. Companies were most likely to challenge compensation proposals (leaving aside those in the residual category), sending 41 percent of them to the SEC, followed by 37 percent of governance proposals and 27 percent of social proposals. In terms of decisions, the commission was most likely to allow omission of corporate governance proposals (leaving aside the residual category), granting no-action letters in 67 percent of the cases with a decision. No-action letters were granted in 58 percent of compensation proposals and 43 percent of social proposals. Corporate governance proposals were less likely to be withdrawn than all of the other types of proposals.

It is also interesting to examine the connection between SEC decisions and the bases claimed by companies in their no-action-letter requests. Our interpretation of the event return depends in part on the market's expectation of the decision. Figure 2 plots the percentage of the time (with 95 percent confidence intervals) that the SEC granted a no-action letter for each of the Rule14a-8 bases, conditional on the proposal not being withdrawn.[20] The withdrawal rate associated with each basis is also shown. Recall from Table 1 that the most common company claim was a violation of the ordinary business rule (14a-8[i][7]); the SEC agreed with such a claim 71 percent of the time. The SEC granted a no-action letter 53 percent of the time for claims that the proposal was false or misleading (14a-8[i][3]), 67 percent of the time for claims that the company had already implemented the proposal (14a-8[i][10]), and 77 percent of the time for claims that the proponent had not demonstrated sufficient stock ownership (14a-8[b]). Across all bases, the SEC was most likely (90 percent) to support a claim that a proposal was substantially the same as another proposal that voters had previously rejected by a large majority (14a-8[i][12]) and least likely (50 percent) to support a claim that the proponent had exceeded the one-proposal limit (14a-8[c]). Figure 2 also shows significant variation in withdrawal rates: at the upper end, proposals that duplicated another proposal (14a-8[i][11]) were withdrawn 21 percent of the time, while at the lower end, uncommon claims such as the proposal relating to specific amounts of dividends (14a-8[i][13]) or exceeding 500 words (14a-8[d]) were withdrawn about 2 percent of the time.

We also examined the number of claims that companies made in their letters to the SEC. Companies claimed a single rule violation in 55 percent of their requests. They claimed two violations in 26 percent of their letters, three violations

[20] If a company claimed more than one basis and the SEC granted a no-action letter, we classify the basis mentioned by the SEC as receiving the no-action letter and treat the other bases as missing observations (because the SEC did not approve or decline them).

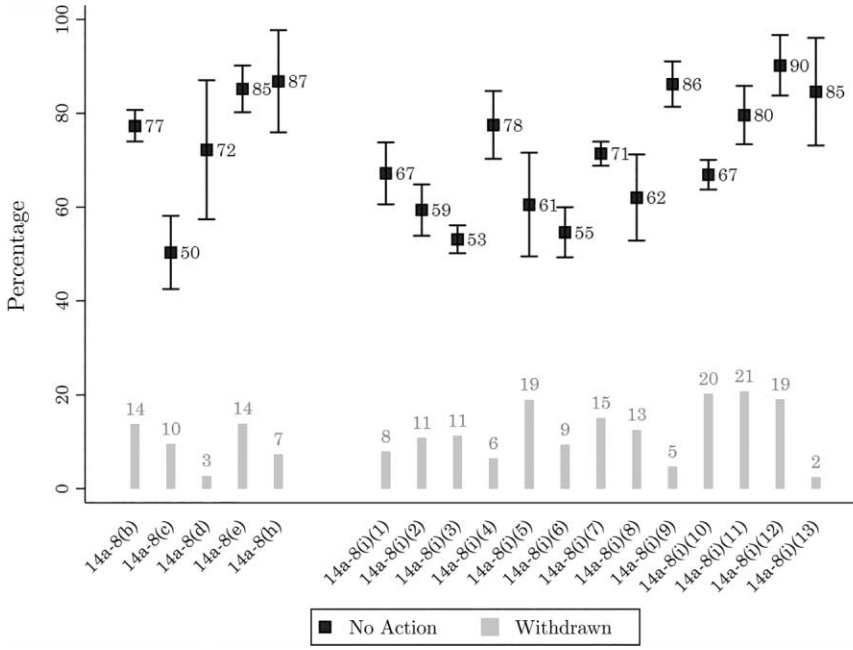

Figure 2. Outcomes by company-claimed bases for exclusion

in 11 percent, and four or more violations in 7 percent. The fact that companies asserted multiple violations in 45 percent of their requests underscores the uncertainty they face about the SEC's decisions. We explored but did not find a connection between the number of claims and the likelihood of receiving a no-action letter. Claiming a large number of violations, then, does not appear to be a signal of either strength or weakness in the company's case. Nor did we find a noticeable relation between the withdrawal rate and the number of bases claimed.

6. The Market's Reaction to Securities and Exchange Commission Decisions

We begin by establishing the basic facts. Table 4 reports the mean CARs associated with no-action-letter decisions. In the returns for the full sample when the SEC granted a no-action letter, effectively killing the proposal, the mean CAR ranges from .11 percent to .58 percent and is statistically different from 0 across all four windows and both abnormal return measures. This fact—one of our main findings—implies that investors were pleased when the SEC granted a no-action letter, which suggests that they did not value (on average) voting on those proposals.[21] The larger returns associated with longer windows likely reflect the fact that sometimes SEC decisions were publicized later than the cover-letter date that

[21] The finding is robust to winsorizing at the .5 percent, 2.5 percent, and 5 percent levels instead. It is also robust to beginning the event window on day 0 instead of day −1.

Table 4

Cumulative Abnormal Returns Associated with Securities and Exchange Commission Decisions

	Letter Granted			Request Declined			Proposal Withdrawn		
	CAR FF	CAR MA	*N*	CAR FF	CAR MA	*N*	CAR FF	CAR MA	*N*
All decisions:									
[−1, 1]	.11+	.15*	1,703	.15	.23+	757	−.27*	−.26+	477
	(.07)	(.07)		(.10)	(.12)		(.13)	(.14)	
[−1, 3]	.22*	.24*	1,626	.24+	.35*	711	−.06	.02	453
	(.09)	(.10)		(.14)	(.15)		(.17)	(.19)	
[−1, 5]	.26*	.26*	1,573	.21	.23	687	.17	.12	433
	(.11)	(.12)		(.17)	(.18)		(.22)	(.23)	
[−1, 10]	.40*	.58**	1,430	.16	.47+	636	.48	.33	388
	(.16)	(.17)		(.23)	(.25)		(.30)	(.30)	
Concurrent events excluded:									
[−1, 1]	.10	.15	806	.12	.25	367	−.36*	−.32+	218
	(.10)	(.11)		(.15)	(.17)		(.16)	(.18)	
[−1, 3]	.35*	.33*	638	.26	.53*	280	−.08	−.06	167
	(.15)	(.16)		(.23)	(.24)		(.25)	(.27)	
[−1, 5]	.69**	.68**	485	.27	.38	218	.69+	.51	135
	(.22)	(.23)		(.30)	(.32)		(.40)	(.41)	
[−1, 10]	1.01*	1.32**	251	.49	1.16*	121	1.75*	1.57+	67
	(.45)	(.46)		(.52)	(.55)		(.81)	(.79)	

Note. Mean cumulative abnormal returns (CARs) are expressed as percentages, with standard errors in parentheses. The CARs are calculated using the Fama-French four-factor model (FF) or by subtracting the market return (MA) and are winsorized at the 1 percent level. The sample includes all no-action-letter decisions issued during 2007–19, except observations for which there was another Securities and Exchange Commission decision in the event window.

+ Significant at the 10% level.

* Significant at the 5% level.

** Significant at the 1% level.

we use to center our event window; it may also be that the information took time to diffuse across the market.

Table 4 also reports the mean CARs for the full sample when the SEC declined to issue a no-action letter, in effect allowing the proposal to go to a vote. Given the findings when the SEC issued a no-action letter, we might expect negative mean CARs for declinations, but that is not what we find.[22] The mean CAR is always positive, ranging from .15 percent to .47 percent, and statistically significant at the 10 percent level for half of the windows and abnormal return measures. We postpone the interpretation of these returns for the moment.

If a company requests a no-action letter, there is a third potential outcome: the proposal may be withdrawn by the proponent.[23] The mean CARs associated with SEC announcements that it was closing a case because it had been notified that the sponsor withdrew the proposal are of a different nature than the others because we are less secure about the date that the market learned about the withdrawal—the SEC does not decide withdrawal; it merely records what it has been told by the company and proponents, sometimes many days after the withdrawal. The mean CARs associated with the SEC's acknowledgment of a withdrawn proposal are sizeable, −.26 or −.27 percent, and statistically significant over the [−1, 1] window but usually small and statistically insignificant over longer windows. A clear pattern is not apparent.

One important issue in event studies is the possibility of other news about the company reaching the market during the event window. In principle, such events do not require an explicit correction because they are independent noise terms that presumably contribute to the normal fluctuation in price.[24] According to this line of reasoning, retaining all observations (implicitly treating other news as part of the normal variance-generating process) is cleanest and least likely to induce accidental bias. While such an approach is defensible, it is also reasonable to wonder how robust any estimated return is to the exclusion of concurrent events. Our strategy is to present results both with and without concurrent events. The challenge is deciding which concurrent events to include—since many events are known to have predictable price effects, such as takeovers, excluding select concurrent events creates a risk of introducing bias.[25] Our solution is to use the S&P Capital IQ's Key Developments database, which tracks more than 100 such event types for each firm, and to delete all observations with one of those events in its announcement window. This neutral approach results in the loss of more than half of our observations but provides a demanding robustness test.

[22] At first glance, it might seem that we should expect the mean return for granted and declined requests to be equal and opposite, but this is not necessarily the case, as we discuss below.

[23] There are two other possibilities that occur rarely: the company may withdraw its request, and the SEC staff may decline to comment. We do not report the mean cumulative abnormal return (CAR) for these cases.

[24] It would be a problem if SEC decisions were contingent on company-specific news in the announcement window, but this seems unlikely.

[25] Another problem is that some firms, typically larger firms, experience a larger number of concurrent events, so excluding those observations biases the sample toward smaller firms (we find several such biases in our data).

Table 4 also includes estimates for the subsample that remains after deleting concurrent events. While there are differences between the two sets of results, the overall pictures are qualitatively similar. For cases in which the SEC granted a no-action letter, the CARs remain positive and are statistically significant for both measures of abnormal return except in the [−1, 1] window. In addition, except in the [−1, 1] window, the means are considerably larger when concurrent events are excluded. For cases in which the SEC declined to issue a no-action letter, the mean CARs remain positive but are statistically different from 0 in only two cases. For withdrawn proposals, the mean CARs remain somewhat contradictory, negative and sometimes statistically significant in the short windows and positive and sometimes statistically significant in the long windows.

Table 4 reports abnormal returns in the most direct way but does not take into account the amount of surprise in the SEC's decision. Since the SEC granted a no-action letter in two-thirds of the cases, a decision to decline was a bigger surprise than a decision to grant a no-action letter. To account for the amount of surprise, we use information in the company's letter to the SEC to estimate an empirical model of the ex ante probability of each outcome—no-action letter, declined, or withdrawn—and then adjusted each CAR by its model-based predicted probability. That is, we estimate a multinomial logit regression in which the explanatory variables are the Rule 14a-8 violations claimed by the company and use the estimated model to produce predicted probabilities.[26] We then adjust each CAR by its predicted probability to produce probability-adjusted CARs (PCARs).[27]

Table 5 reports PCARs. For the full sample, the mean PCARs associated with the SEC granting a no-action letter range from .26 to 1.34 percent and are statistically significant in all but one case. This again suggests that investors expected the omitted proposals to reduce the company's value if they were allowed to go to a vote. The patterns for declined requests and withdrawn proposals are qualitatively similar to those in Table 4. The mean PCARs are always positive for declined requests, ranging from .26 to 1.02 percent, and statistically different from 0 in half of the cases. The mean PCARs associated with withdrawn proposals are

[26] The logit model includes as explanatory variables dummies for each of the seven bases (or combinations of bases) that constituted individually at least 3 percent of all claims: 14a-8(i)(10), 14a-8(i)(7), 14a-8(b), 14a-8(i)(3), 14a-8(i)(3) and 14a-8(i)(7), 14a-8(i)(7) and 14a-8(i)(10), and 14a-8(e). These bases as a group represent over 50 percent of all company requests. The resulting model has an in-sample prediction accuracy of 61 percent (where the predicted outcome is the one with the highest predicted probability). It is possible to produce models with greater prediction accuracy by saturating them with explanatory variables, but this yields implied probabilities close to 0 or 1 for bases that seldom occur. When constructing the associated probability-adjusted CARs (PCARs), this leads to dramatic scaling of the estimates (for example, an outcome that is predicted to occur with a probability of .99 is scaled by 100 if it does occur), which creates implausibly high variance in the estimates. We view such extreme predicted probabilities as unrealistic—the result of overfitting the model.

[27] If Δ_i is the full return (as a percentage) associated with an outcome for observation i and $p_{\Omega i}$ is the ex ante probability of the outcome $\Omega \in \{N, D, W\}$ (where N is no action, D is decline, and W is withdrawn) for that observation, then the abnormal return is $CAR_i = (1 - p_{\Omega i})\Delta_i$. Inverting implies $\Delta_i = CAR_i/(1 - p_{\Omega i})$. We calculate $PCAR_i = CAR_i/(1 - p_{\Omega i})$.

Table 5

Probability-Adjusted Abnormal Returns Associated with Securities and Exchange Commission Decisions

	Letter Granted			Request Declined			Proposal Withdrawn		
	PCAR FF	PCAR MA	*N*	PCAR FF	PCAR MA	*N*	PCAR FF	PCAR MA	*N*
All decisions:									
[−1, 1]	.26	.35+	1,703	.26	.49*	757	−.44*	−.39*	477
	(.17)	(.18)		(.21)	(.24)		(.18)	(.20)	
[−1, 3]	.55*	.58*	1,626	.48*	.69*	711	−.12	−.01	453
	(.22)	(.24)		(.28)	(.30)		(.23)	(.24)	
[−1, 5]	.70*	.68*	1,573	.42	.51	687	.13	.10	433
	(.28)	(.28)		(.34)	(.36)		(.29)	(.30)	
[−1, 10]	.98*	1.34**	1,430	.46	1.02*	636	.62	.43	388
	(.40)	(.42)		(.49)	(.50)		(.40)	(.39)	
Concurrent events excluded:									
[−1, 1]	.25	.36	806	.07	.35	367	−.53*	−.44+	218
	(.25)	(.27)		(.29)	(.32)		(.23)	(.23)	
[−1, 3]	.94*	.91*	638	.19	.86+	280	−.17	−.12	167
	(.37)	(.39)		(.43)	(.46)		(.34)	(.35)	
[−1, 5]	1.81**	1.77**	485	−.08	.23	218	.80	.60	135
	(.55)	(.54)		(.55)	(.61)		(.52)	(.51)	
[−1, 10]	2.39*	2.99**	251	.09	1.71+	121	2.46*	2.24+	67
	(1.13)	(1.13)		(.94)	(1.03)		(1.21)	(1.21)	

Note. Mean probability-adjusted cumulative abnormal returns (PCARs) are expressed as percentages, with standard errors in parentheses. The PCARs are calculated by normalizing cumulative abnormal returns (CARs) using predicted probabilities from a multinomial logit regression. The CARs are estimated using the Fama-French four-factor model (FF) or by subtracting the market return (MA) and are winsorized at the 1 percent level. The sample includes all no-action-letter decisions issued during 2007–19, except observations for which there was another Securities and Exchange Commission decision in the event window.

+ Significant at the 10% level.

* Significant at the 5% level.

** Significant at the 1% level.

negative in the short windows (significantly so in the [−1, 1] window) and positive in the longer windows.

Table 5 also reports the mean PCARs after excluding concurrent events. The mean returns associated with issuance of a no-action letter remain positive in all cases and significantly different from 0 except in the [−1, 1] window. Interestingly, the estimates are about twice as large in the longer windows after excluding concurrent events, ranging from .91 to 2.99 percent. In contrast, the mean PCARs for declined requests typically fall in magnitude and statistical significance events. The mean PCARs for withdrawn proposals remain mixed as before.

Tables 4 and 5 point toward several conclusions. First, there was a robust positive market reaction when the SEC granted a no-action letter, removing a proposal from consideration. Taking into account expectations of the SEC's decision, we find that the market seems to have associated the deleted proposals with value destruction in the vicinity of 1 percent or more. Second, the market reaction to an SEC decision declining to issue a no-action letter was positive on average, albeit estimated with too much noise to reliably sign the mean. And third, the market reaction to the SEC's acknowledgment of a withdrawn proposal was mixed, depending on the length of the event window. Some of these patterns may seem puzzling or counterintuitive at first glance. We next consider alternative interpretations of the evidence and attempt to rationalize the findings theoretically and with additional evidence.

7. Why Did the Market Approve of Omissions?

We start by exploring the most robust pattern, the positive return when a no-action letter was granted. Perhaps the most natural explanation for the positive return is that the market considered the omitted proposals to be value reducing and was glad to have them taken off the table.

To gain perspective on this explanation, we examine the connection between a proposal's expected votes in favor and the CAR from the SEC's decision for proposals that the SEC allowed to be removed. We calculate expected votes by estimating a regression of votes in favor for the subset of proposals that went to a vote and then use the model's parameters to generate predicted approval rates for proposals that the SEC allowed to be omitted. The dependent variables are dummy variables for the proposal's subject matter and type of sponsor, both of which are known to be correlated with voting outcomes, as discussed below. We then divide proposals into those that were and were not predicted to receive 40 percent of votes in favor.[28]

[28] We estimated a linear probability model in which the dependent variable is votes in favor, defined as votes in favor/(votes in favor + votes against), and the explanatory variables are four subject-matter dummies (corporate governance, executive compensation, social issue, and other), seven sponsor types (individuals, public pensions, religious organizations, socially responsible investment [SRI] funds, non-SRI funds, labor unions, and other), and their interactions. We use 40 percent as the threshold because a 50 percent threshold would leave too few observations. Bach and Metzger (2017) find that implementation did not vary with approval rates in the 0 to (approximately) 40 percent range but increased with votes thereafter.

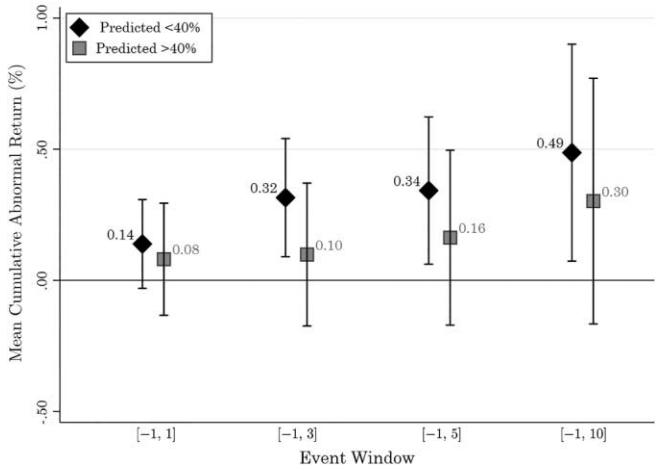

Figure 3. Cumulative abnormal returns for omitted proposals by predicted votes in favor

Figure 3 shows the mean CARs for the two groups. For all windows, the mean CAR is larger for proposals predicted to have weak support than for those predicted to have stronger support. The mean CARs for proposals with low predicated support range from .14 to .49 percent and are statistically different from 0 except in the [−1, 1] window. The mean CARs for proposals predicted to earn more than 40 percent support range from .08 to .30 percent and are never statistically different from 0. In no window are the mean CARs statistically different from each other, but it appears that much of the positive reaction to issuance of no-action letters comes from proposals predicted to fail. On the face of it, this is somewhat unexpected—it suggests that the market's reaction may not have stemmed from the prospect of passage as much as from costs imposed on managers from having to deal with frivolous proposals.

To pursue this idea, we examine a particular group of frivolous proposals, those that had already been implemented, duplicated another proposal, or by law could not be implemented. Using the Rule 14a-8 provision cited by the SEC in granting the no-action letter, we classify a proposal as a nuisance if the SEC determined that the company had already substantially implemented it (14a-8[i][10]), the proposal duplicated another proposal already on the proxy statement (14a-8[i][11]), the company lacked the power to implement the proposal (14a-8[i][6]), or the proposal would have caused the company to violate state or federal law (14a-8[i][1], 14a-8[i][2]). The market may dislike such proposals because they distract and disrupt managers from doing their jobs. If so, the market's reaction should be more pronounced on exclusion of those proposals than on exclusion of other proposals.

Figure 4 reports the mean CARs for nuisance proposals (so defined) and other excluded proposals.[29] Overall, nuisance proposals make up 25 percent of the pro-

[29] Figure 4 is qualitatively similar for PCARs.

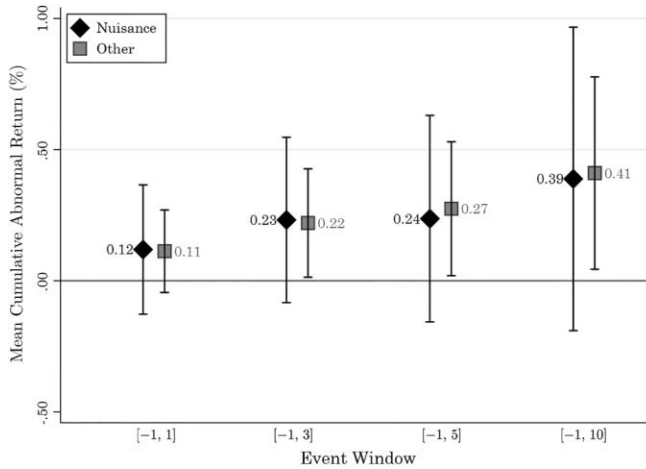

Figure 4. Cumulative abnormal returns for omitted proposals by classification

posals that were granted no-action letters. The mean CAR is not materially or statistically different for nuisance proposals than other excluded proposals in any window. The market's approval of the SEC granting no-action letters does not appear to have been related to the avoidance of nuisance proposals.

Another way to shed light on the reason for the market's approval of no-action letters is to compare returns by proposal topic. We classify proposals into three broad groups: corporate governance, compensation, and social issues, with all others omitted. Corporate governance proposals are those that would improve governance according to the E-index: board declassification, majority voting on bylaw amendments, majority voting for mergers, majority voting for charter amendments, limits on golden parachutes, and removal of poison pills. The E-index is intended as a summary measure of the quality of a company's governance provisions, and its elements are correlated with a variety of performance metrics and enjoy some popularity among reformers (Bebchuk, Cohen, and Ferrell 2009). Compensation proposals relate to the compensation of the company's top executives and directors, such as proposals to limit pay, tie pay to performance, limit golden parachutes, restrict vesting of stock, claw back pay, and hold shareholder votes on pay. Social issues are proposals related to the environment, sustainability, energy, animals, human rights, civil rights, health care, smoking, and political activity.

There are reasons to believe that corporate governance proposals are the most likely to affect a firm's value if implemented, and social proposals are least likely to increase value. For one thing, shareholders are most likely to support governance proposals and least likely to support social proposals: since 2007, the average vote in favor was 45 percent for governance proposals, 32 percent for compensation proposals, and 21 percent for social issues (and 25 percent for all other

proposals) for our data. We also know from Cuñat, Gine, and Guadalupe (2012) that value increased when shareholders approved corporate governance proposals during 1997–2007, which suggests that investors considered them to be value increasing on average (at least those that went to a vote). Assuming that this ordering in terms of value consequences is correct—corporate governance, then compensation, then social issues—we might expect investors to be most positive when social proposals are omitted and least positive when corporate governance proposals are omitted.

Figure 5 shows the mean CARs for each topic. Somewhat surprisingly, the returns are most positive for proposals that would have improved governance according to the E-index were excluded. The means range in a fairly narrow band from .41 to .56 percent. The mean CARs for compensation and social proposals are always lower. Management's decision to oppose proposals concerning its own compensation deserves scrutiny because of the inherent conflict of interest. However, the mean return is typically small, ranging from .10 percent to .47 percent, and never statistically significant. Similarly, for social issues, the mean return is usually positive but never statistically different from 0.[30] The means cannot be statistically distinguished from each other across topics. The difference between corporate governance proposals and the other proposal types is more pronounced when we use the market-adjusted return to calculate CARs.[31]

Yet another reason that investors might react positively to the issuance of no-action letters is that they fear that sponsors will use the proposals as bargaining chips to extract side payments. It might seem that managers will not bargain over a proposal that is likely to be rejected if it comes to a vote, but Matsusaka and Ozbas (2017) show theoretically that managers might make a side deal to avoid costs associated with contesting a risky vote. Documents in the SEC no-action-letter files for withdrawn proposals give reason to suspect that some activists use proposals as bargaining chips. For example, in 2016 the Humane Society of the United States, an animal rights group, filed a proposal with Ross Stores, a discount retailer, calling for separation of the CEO and board chair roles. In its submission letter, the Humane Society offered to withdraw the proposal if the company would "consider coming to the table with us instead" and agree to include a statement on its website that "Ross does not knowingly buy real animal fur" (Ross Stores, Inc., SEC no-action letter, 2016 WL 7487427 [January 31, 2017]).[32]

Labor unions and public pensions have been singled out by researchers and judges for potentially using the proposal process to advance private goals that do not maximize value, such as benefits for union workers or the preservation

[30] We also calculated but do not report mean CARs for proposals that asked companies to reveal their political contributions. Min and You (2019) show that such proposals are targeted at companies with a history of donating to Republican candidates, which suggests a political motivation rather than a value-enhancing goal. We do not find reliable evidence of positive or negative mean CARs.

[31] The gap between CARs for corporate-governance proposals and other types of proposals is much more pronounced using the market-adjusted return as the benchmark.

[32] The proposal was ultimately withdrawn; no reason was stated.

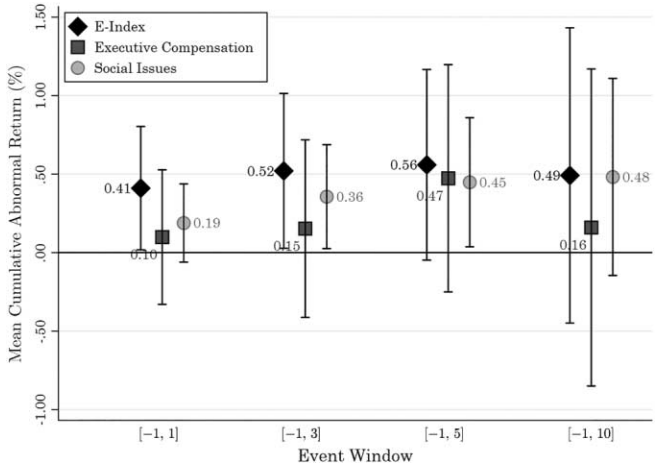

Figure 5. Cumulative abnormal returns for omitted proposals by topic

of jobs in local communities served by public pensions (Romano 1993, 2001; Schwab and Thomas 1998; Matsusaka, Ozbas, and Yi 2019; *Business Roundtable v. SEC,* 647 F.3d 1144, 1156 [D.C. Cir. 2011]). If the market's welcome of excluded proposals is related to concerns about value-reducing side deals, the decision-announcement return should be more pronounced for exclusion of proposals from unions and public pensions than from other proponents.

Figure 6 plots the mean CARs for excluded proposals by sponsor type. The mean CARs associated with proposals from unions and public pensions are larger than those for proposals from other groups over all windows, and noticeably so over the [−1, 5] and [−1, 10] windows, but the differences are not statistically significant. The market might have been concerned with the use of proposals as bargaining chips, but the sample is too small to be conclusive.[33]

Figures 3–6 do not provide a definitive explanation for the positive returns when the SEC allowed omission of a proposal. It is worth reiterating that none of the means that are compared can be distinguished from each other statistically, and while we have attempted to represent the most typical patterns, other patterns can appear with different classification methods. There are some signs, however, that investors might have favored the exclusion of proposals that were unlikely to gain majority approval. Since those proposals were headed for defeat, this suggests that the market was not so much concerned about the proposal's value consequences as the possibility that it would distract managers or lead them to make costly concessions to the sponsors. The tendency for the market to ap-

[33] In a preliminary version of this study, we reported some evidence that investors were more skeptical of proposals from individuals than organizations. After further investigation, we determined that the evidence was not sufficiently robust to support any conclusions.

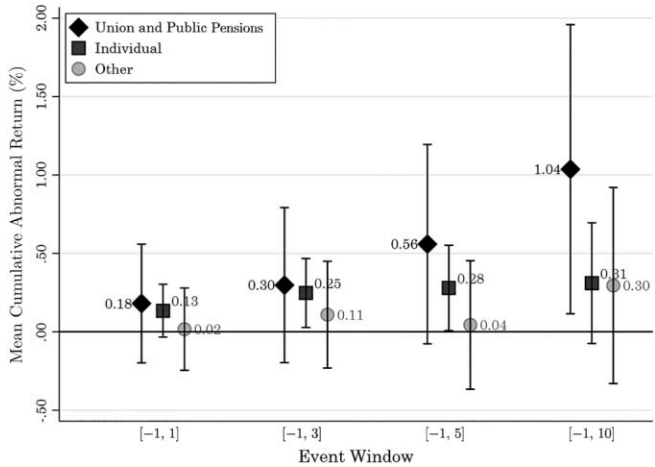

Figure 6. Cumulative abnormal returns for omitted proposals by sponsor type

prove of the removal of proposals sponsored by investors that might want to negotiate side deals points in the same direction.

8. Interpretation of Returns and Distraction Costs

The evidence to this point shows that investors approved when the SEC allowed the exclusion of shareholder proposals. There are hints that investors approved because allowing a vote would have distracted managers or led them to make costly concessions to proponents, not necessarily out of fear that voters would approve value-reducing proposals. However, other findings—such as the generally positive returns when the SEC allowed a proposal to go to a vote—seem puzzling.

This section explores how we might account for the evidence as a whole, asking what theory or story can account for what we observe. We start by sketching a simple model that can rationalize the findings. Central to understanding the findings is the presence of dissipative distraction costs. Business groups claim that proposals "divert management's and the board's attention away from creating long-term value for the company" by requiring extensive engagement with proponents and other shareholders and time spent crafting an opposition statement for the proxy.[34] The model produces additional implications that we then test.

The model is dynamic and runs from the company request date to the SEC decision date, with days indexed $t = 0, 1, \ldots, T$ and discount rate $\delta < 1$. On any day the SEC can render a decision $\Omega \in \{\text{N, D, W}\}$, where N is no action, D is decline, and W is withdrawn, with probabilities p_{N}, p_{D}, and p_{W}. Because the SEC may not

[34] Letter from Maria Ghazal, Senior Vice President and Counsel at Business Roundtable, to Vanessa Countryman, Acting Secretary at the SEC, June 3, 2019. The Business Roundtable emphasizes the prevalence of "immaterial proposals" that distract from "matters of true economic significance."

issue a decision on a given day, $p_N + p_D + p_W < 1$. The company's base value without the proposal is $X > 0$, the incremental value of holding a vote on the proposal is Z, and the incremental value of a withdrawn proposal is Y.[35] The value of holding a vote and the value of a withdrawn proposal can be positive or negative. Finally, to incorporate distraction costs, we allow for the possibility that a proportion of the company's value dissipates each day that the SEC does not issue a decision, that is, that the assets at time t are worth $X\lambda^t$, where $\lambda \leq 1$. As we show, there is an important empirical distinction between a case with a distraction cost ($\lambda < 1$) and a case without a distraction cost ($\lambda = 1$). This is not an optimizing model but rather a formal way to capture various factors determining a firm's value.

Because the only state variable is t, the firm's expected value at time t, $E[V_t]$, can be expressed recursively:

$$E[V_t] = p_N(X\lambda^t) + p_D(Z + X\lambda^t) + p_W(Y + X\lambda^t) + (1 - p_N - p_D - p_W)\delta E[V_{t+1}]. \quad (1)$$

Equation (1) can be solved by repeated substitution. In the limit, the solution takes the form

$$E[V_t] = \frac{p_D Z + p_W Y}{1 - B\delta} + \frac{(1 - B)X}{1 - B\delta\lambda}\lambda^t, \quad (2)$$

where $B = 1 - p_D - p_N - p_W$. This leads to proposition 1, proved in Appendix Section B1.

Proposition 1. If and only if the proposal process is dissipative ($\lambda < 1$),

i) the unconditional decision-date abnormal return is positive in expectation,

ii) the expected long-run return from the company's request date to the SEC's decision date is negative, and

iii) the expected long-run return is more negative the longer it takes for the SEC to render a decision.

The intuition is fairly straightforward. First, if there is no distraction cost, then the expected abnormal return on the decision date is 0. This is because the expected consequences of the decision are already capitalized into the price from the date of the company's request. However, if there is a distraction cost, the rendering of a decision is good news on average because it means no future dissipation due to waiting. Second, since each day without a decision is bad news, the company's price drifts down over time.[36] And third, the cumulative effect of the downward drift is larger in magnitude the longer it takes the SEC to decide. These three predictions can be taken as tests of the hypothesis that companies suffer a distraction cost from the process of dealing with proposals, something that was hinted at by earlier evidence.

[35] The value of holding a vote compounds the probability and the value of implementation, which means that Z is not the value of implementation.

[36] The idea that the absence of a decision conveys negative information is similar in spirit to evidence in Giglio and Shue (2014) that investors adjust the price of a firm engaged in a merger on days when no new information about the completion date arrives.

Table 6
Tests of the Distraction-Cost Hypothesis

	Fama-French		Market Adjusted		
	Mean	SE	Mean	SE	*N*
CAR on decision date:					
[−1, 1]	.06	.05	.10+	.06	2,937
[−1, 3]	.18**	.07	.23**	.07	2,790
[−1, 5]	.23**	.08	.23*	.09	2,693
[−1, 10]	.35**	.12	.51**	.13	2,454
LRCAR	−.40**	.15	−.45**	.16	3,627
β	−.03**	.01	−.03**	.01	3,627

Note. Cumulative abnormal returns (CARs) are expressed as percentages and are estimated using the Fama-French four-factor model or by subtracting the market return and are winsorized at the 1 percent level. The sample includes all no-action-letter decisions issued during 2007–19, except those for which there was another Securities and Exchange Commission (SEC) decision or withdrawn proposal at the company in the event window. Average CARs on the SEC decision date are unconditional on the nature of the decision. The long-run CARs (LRCARs) are calculated from 1 day after the company submits its request to 2 days before the SEC decision date. Values for the β coefficient are estimates from a regression of LRCAR on the number of days it took the SEC to render a decision.

+ Significant at the 10% level.

* Significant at the 5% level.

** Significant at the 1% level.

Table 6 reports estimates related to the three implications. The mean CARs on the SEC decision date are positive for all measures and windows, with a magnitude around .2 percent for the middle windows. All but one mean is statistically different from 0. The positive return associated with the SEC issuing a decision is consistent with the idea that waiting for the SEC incurs distraction costs.[37]

In Table 6 we also search for evidence of distraction costs by calculating the mean abnormal return over the period during which the company waits for the SEC's decision, which we call the long-run CAR (LRCAR) to distinguish it from the decision-date CAR. We start 1 day after the company files its request with the SEC and continue until 2 days before the SEC's decision date. The mean LRCAR during the waiting period is negative, −.40 percent or −.45 percent depending on the abnormal return measure, and statistically different from 0 in both cases. This pattern also supports the idea that companies suffer a distraction cost from having a proposal pending at the SEC.

The final implication is that distraction costs accumulate the longer the SEC takes to make its decision. To test this, we regress the LRCAR on the number of days that it took the SEC to decide (the mean was 40 days, with a range of 0 to 99). Both regression coefficients on the number of days are negative and statisti-

[37] The numbers are qualitatively similar—always positive and statistically different from 0 except in the [−1, 1] window—if observations with concurrent events are omitted.

cally significant at the 1 percent level. The coefficients imply that each day waiting for the SEC imposes a cost of .03 percent on the firm.

In short, all three implications that follow from the distraction-cost model find some empirical support. It is worth noting that no test is mechanically connected to another, so we have three independent sources of support for the hypothesis.

The model also helps to interpret the basic CARs. Theoretically, the returns associated with a decision to grant or decline a no-action letter at day t are $\mathrm{CAR_N} = (X\lambda^t - E[V_t])/E[V_t]$ and $\mathrm{CAR_D} = (Z + X\lambda^t - E[V_t])/E[V_t]$, respectively. Assume that $p_\mathrm{N} + p_\mathrm{D} + p_\mathrm{W} \approx 1$ and $\lambda \approx 1$, essentially ignoring distraction costs. Then

$$\mathrm{CAR_N} = -p_\mathrm{D}\left(\frac{Z}{E[V_t]}\right) - p_\mathrm{W}\left(\frac{Y}{E[V_t]}\right) \tag{3}$$

and

$$\mathrm{CAR_D} = (1 - p_\mathrm{D})\left(\frac{Z}{E[V_t]}\right) - p_\mathrm{W}\left(\frac{Y}{E[V_t]}\right). \tag{4}$$

This leads to several observations. First, the sign of the CARs does not indicate the sign of Z, the value of holding a vote on the proposal (nor, by extension, does it indicate the value of implementing the proposal). Although one might expect the sign of $\mathrm{CAR_D}$ to be the same as the sign of Z and the sign of $\mathrm{CAR_N}$ to be the reverse of the sign of Z, this is true only if withdrawals are not possible ($p_\mathrm{W} = 0$) or have no value consequences ($Y = 0$). When withdrawal is a material possibility, the market's reaction to an SEC decision depends in part on its view of withdrawal outcomes. If it views negotiated outcomes as value reducing ($Y < 0$), as some research suggests, then both CARs could be positive, as we observe, regardless of the sign of Z.

Second, $\mathrm{CAR_N}$ and $\mathrm{CAR_D}$ are not mirror images of each other, and they need not have opposite signs. Again, this is because they are influenced by a common component, the market's reaction to withdrawn proposals. If $Y < 0$, $\mathrm{CAR_N}$ and $\mathrm{CAR_D}$ are downward-biased estimates of the probability-weighted consequences for value of Z. In terms of Table 5, this would imply that the market's view of omitted proposals is even worse than our estimates suggest, and its view of proposals that go to a vote is less positive than we find. If we include the value of dissipation in the analysis, the preceding points apply with even more force.

Third, the announcement return associated with a company's decision to request a no-action letter from the SEC cannot be signed without additional assumptions. If we assume that the company's request is the first time that the market learns of a proposal, then the expected return is $\mathrm{CCAR} = (E[V_0] - X)/X$, the sign of which is ambiguous (see the proof in Section B2). The main source of the ambiguity is the expected value of the proposal and withdrawal: $p_\mathrm{D}Z + p_\mathrm{W}Y$. If this is negative, then the CCAR is negative, but if either Z or Y is sufficiently positive, that value can outweigh the distraction cost. If we assume that the market is aware of the proposal prior to the company's request and the news is only

that that company is challenging the proposal, the predicted sign of the CCAR is similarly ambiguous (see the proof in Section B2). This implies that even if the CAR associated with the SEC's omitting a proposal is positive, we cannot sign the CCAR. The upshot is that the sign of the CCAR does not reveal the sign of Z or Y or the presence or absence of a distraction cost, and it cannot be used as a robustness test on the main findings.[38]

9. Implied Value of Proposals

We would like to know the value of Z, but the model shows that it cannot be inferred from the CARs without stronger assumptions. One assumption that gives leverage would be that SEC decisions are independent of Z. In this case, the difference between the mean CAR_N and the mean CAR_D is the mean Z as a return: from equations (3) and (4), $E[\text{CAR}_\text{D}] - E[\text{CAR}_\text{N}] = E[Z]/E[V_t]$. Intuitively, the difference nets out the value consequence of a withdrawn proposal.

Unfortunately, although the SEC does not explicitly take into account the merits of the proposal when making a decision, the Rule 14a-8 criteria may be correlated with the effect on the firm's value. Proposals that violate the ordinary-business condition, for example, might be especially harmful because they take shareholders into domains that managers can handle better. Nevertheless, if the connection between the Rule 14a-8 criteria and proposals' effect on value is weak, the difference in returns may give an approximation of the average Z. In that spirit, we report regressions of abnormal returns on a dummy for the SEC decision that we label

$$\text{DEC} = \begin{cases} 1 & \text{if declined} \\ 0 & \text{if no-action letter granted} \end{cases}.$$

In this regression setup, the coefficient on the DEC dummy can be interpreted as an approximation (in the sense just discussed) of the average Z or, in other words, the average value of holding a vote. Interacting other variables with DEC reveals factors correlated with Z, which provides a sense of what might make some proposals value increasing and others value decreasing. By construction, withdrawn proposals are omitted.

Table 7 reports the regressions, with CARs calculated using the Fama-French four-factor model. The regressions first allow the market's response to vary between high-profit and low-profit firms, classified according to whether a company's income-to-sales ratio was above or below the annual median. The estimates show that the average value of holding a vote is negative for high-profit firms (statistically significant in all windows) and positive for low-profit firms (significant only in the $[-1, 1]$ window). The pattern suggests that proposals, on average,

[38] For completeness, we estimated CARs associated with requests for no-action letters and found means in the range of $-.17$ to .13 percent, negative in six of eight window by return measure cases, and statistically different from 0 ($p = .09$) only once.

were viewed as value reducing for high-profit firms and (according to the point estimates) value increasing for low-profit firms. The *F*-statistic indicates the two coefficients are statistically different from each other in all three regressions. This pattern is consistent with investors believing that proposals at high-performing firms will disrupt company policies that are working well, while proposals at struggling firms could push them in a productive direction. The finding is similar in spirit to evidence in Brochet, Ferri, and Miller (2018) that low-performing firms (but not high-performing firms) experience an increase in value in anticipation of contentious annual meetings with shareholder activists.

The regressions that include company fixed effects show the market's reaction conditional on good or bad performance relative to the company's history. The coefficients of interest tell a similar story: the market took a negative view of proposals at high-performing firms. The evidence is mixed for proposals at low-performing firms. The difference between the coefficients for high and low performers is statistically significant in two of three windows.

Table 7 also includes regressions with topic-specific and proponent-specific dummy variables and their interactions with the decision dummy (coefficients not reported). This specification allows the value of holding a vote to vary with the topic and proponent type. The coefficient on DEC × High-Profit Firm now indicates the mean for a high-profit firm compared with a low-profit firm. The coefficient ranges from −.74 to −1.28 percent, depending on the window, and is always statistically different from 0. We cannot reject the hypothesis that a proposal's effect on value is unrelated to topic or proponent.

For the regressions that add company-specific fixed effects, the implied value of *Z* is greater for high-profit than low-profit firms and has a magnitude similar to the regressions without fixed effects, although the level of statistical significance declines. In unreported regressions, we also explored how the value of holding a vote varies with the topic of the proposal, separately for high- and low-profit firms (essentially a triple interaction of decision, profit, and topic). The only pattern that appeared across alternative windows and specifications was a significantly negative association with compensation proposals at high-profit firms, which means that some of the negative reaction to proposals at high-profit firms comes from compensation proposals.

Table 7 suggests that investors viewed proposals targeted at high-profit firms as value destroying and (less robustly) that proposals at low-profit firms were seen as value increasing. To the extent that this is correct, it suggests that the no-action-letter process could add value if it removes proposals at high-profit but not low-profit firms. Conversely, the process could reduce value if it screens proposals in the other direction. We explore this in Section 10.

10. Explaining the Securities and Exchange Commission's Decisions

The purpose of the SEC's regulation of proposals and the no-action-letter process is to allow shareholders to exercise their voting rights while ensuring that proposals do not excessively or inappropriately draw on company resources. The

Table 7
Regressions of Cumulative Abnormal Returns on a Decision Dummy

	[−1, 1]	[−1, 5]	[−1, 10]
Firm profit:			
DEC × High-Profit Firm	−.42*	−.66*	−1.06*
	(.18)	(.29)	(.41)
DEC × Low-Profit Firm	.35*	.30	.27
	(.17)	(.28)	(.40)
DEC high profit = DEC low profit (*F*-statistic)	9.5**	5.8*	5.4**
R^2	.008	.011	.012
Firm profit with company fixed effects:			
DEC × High-Profit Firm	−.42*	−.67*	−1.13*
	(.19)	(.31)	(.45)
DEC × Low-Profit Firm	.33+	−.08	−.004
	(.20)	(.32)	(.46)
DEC high profit = DEC low profit (*F*-statistic)	7.7**	1.8	3.0+
R^2	.378	.421	.422
Firm profit with topic and proponent fixed effects:			
DEC × High-Profit Firm	−.74**	−.94*	−1.28*
	(.25)	(.40)	(.57)
DEC × topic (*F*-statistic)	.6	1.7	2.0+
DEC × proponent (*F*-statistic)	.4	1.0	1.4
R^2	.011	.018	.021
Firm profit with topic, proponent, and company fixed effects:			
DEC × High-Profit Firm	−.74**	−.58	−1.16+
	(.28)	(.44)	(.65)
DEC × topic (*F*-statistic)	.1	.9	1.2
DEC × proponent (*F*-statistic)	.6	.9	1.2
R^2	.379	.425	.429
N	2,386	2,188	1,998

Note. The dependent variable is the cumulative abnormal return (as a percentage). Each cell presents the results of a regression. Standard errors are in parentheses. Abnormal returns are calculated using the Fama-French four-factor model and are winsorized at the 1 percent level in each tail. The decision dummy (DEC) equals one if the Securities and Exchange Commission (SEC) declined the request and zero if it granted a no-action letter. Firms are classified into high- versus low-profit groups according to whether the income-to-sales ratio was above or below the annual median. Regressions for firm profit and firm profit with company fixed effects include dummies for high-profit and low-profit firms. Regressions for firm profit with topic and proponent fixed effects, with and without company fixed effects, include a dummy for high-profit firms. Topic dummies represent corporate governance, compensation, social, and other; proponent dummies represent unions and public pensions, religious and socially responsible investment funds, individuals, and other. Regressions with topic and proponent dummies include the logarithm of the market value of the firm as a control variable and one or more constant terms whose coefficients are not reported.

+ Significant at the 10% level.

* Significant at the 5% level.

** Significant at the 1% level.

SEC explicitly states that it does not screen proposals on their underlying merits, yet there is little evidence of whether this is in fact the case and, more generally, of how to explain the SEC's decisions. This section explores those issues with regressions predicting whether the SEC grants a no-action letter.

We are interested in whether the no-action-letter process screens out—intentionally or not—proposals that harm a company's performance. To that end, we consider several variables plausibly correlated with a proposal's impact on the firm's value. We are also interested in the possibility that political considerations influence the SEC's decisions, and therefore we compare the commission's decision criteria when it is controlled by Democrats versus Republicans.

Table 8 reports the estimates. The dependent variable is a dummy equal to one if the SEC granted a no-action letter and zero if it declined the request. The results are qualitatively similar with logit regressions. All regressions include (but do not report coefficients for) dummy variables for proposal topics, sponsor types, and the log of firm value.

Model 1 includes three variables related to a proposal's potential effect on value. The coefficient on the dummy for high-profit firms is negligible and statistically insignificant; the SEC did not appear to take into account the market's preference for proposals at low-profit compared with high-profit firms. Results for the dummy for proposals predicted to receive 40 percent or more votes in favor show some evidence of value screening: proposals that were expected to be popular with shareholders were 23.7 percent less likely to receive a no-action letter than other proposals, a substantively large coefficient that is statistically different from 0. Screening in this way has a normative appeal in the sense that the SEC appears to have allowed shareholders a say on issues with potential appeal while striking frivolous proposals. Although the CCAR does not reveal the value of a proposal, it provides a market assessment of the expected consequences of the review process overall. The coefficient on the dummy indicating a positive CCAR, too, is negligible and statistically insignificant.

To allow for political effects, model 1 includes a dummy for years in which a majority of SEC commissioners were Democratic appointees, with the omitted category being Republican control.[39] The SEC has five commissioners (not counting vacancies, which are common), appointed by the president for 5-year terms. By statute, not more than three commissioners can belong to the same party. The SEC's partisan orientation thus tracks that of the president with a lag. Partisan control could matter if one party was friendlier to management interests than the other party, and Cox and Thomas (2019) show that SEC interpretations can change suddenly when its leadership changes. The coefficient on the Democratic SEC dummy implies that the commission was 3.8 percent less likely to grant a no-action letter under Democrats than Republicans, a result that is statistically significant at the 5 percent level. However, not too much should be made of this because the coefficient is rather small in magnitude, and its statistical significance drops in the next regressions.

Model 2 in Table 8 explores whether the explanatory power of predicted votes revealed in model 1 is a mechanical consequence of Rule 14a-8 by including dum-

[39] Nominally independent members were classified according to the party of the president that nominated them. According to this classification, a majority of commissioners were Democrats during 2009–16, and a majority were Republicans in 2007–8 and 2017–19. We assign partisanship by calendar year even though some changes take place midyear.

Table 8
Linear Probability Regressions Predicting Securities and Exchange Commission Decisions

	(1)	(2)	(3)	(4)	(5)
High-Profit Firm	.2	−.6	−3.2		
	(1.7)	(1.7)	(3.2)		
Yes Votes > 40%	−23.7**	−21.6**	−25.1**		
	(6.0)	(5.7)	(7.8)		
CCAR > 0	2.4	1.9	.8		
	(1.7)	(1.6)	(1.9)		
Democratic SEC	−3.8*	−2.0	−2.1	.0	1.1
	(1.7)	(1.7)	(2.1)	(3.2)	(4.0)
High-Profit Firm × Democratic SEC				−2.1	−5.6
				(2.1)	(3.6)
High-Profit Firm × Republican SEC				1.9	−.1
				(2.7)	(4.0)
Yes Votes > 40% × Democratic SEC				−22.3**	−26.9**
				(5.8)	(7.8)
Yes Votes > 40% × Republican SEC				−20.9**	−22.0**
				(6.2)	(8.3)
CCAR > 0 × Democratic SEC				2.3	2.3
				(2.1)	(2.4)
CCAR > 0 × Republican SEC				1.3	−1.0
				(2.6)	(3.1)
Dummies for Rule 14a-8 claims	No	Yes	Yes	Yes	Yes
Firm fixed effects	No	No	Yes	No	Yes
R^2	.047	.123	.329	.124	.330
p-Values:					
High-Profit Firm × Democratic SEC = High-Profit Firm × Republican SEC				.231	.162
Yes Votes > 40% × Democratic SEC = Yes Votes > 40% × Republican SEC				.694	.219
CCAR > 0× Democratic SEC = CCAR > 0× Republican SEC				.756	.391

Note. Results are from linear probability regressions in which the dependent variable is one if the Securities and Exchange Commission (SEC) granted a no-action letter and zero if it declined. Each column is a regression; explanatory variables are dummies equal to one if the stated condition holds. Coefficients are scaled by 100 to be interpretable as percentages, with standard errors in parentheses. Yes votes are predicted values; CCAR is the abnormal return associated with a no-action-letter request in the [−1, 5] window. All regressions include dummies for proposal topics (four categories), dummies for sponsor types (three categories), and log of firm value (coefficients not reported). $N = 3{,}052$.

* Significant at the 5% level.

** Significant at the 1% level.

mies for the seven most commonly claimed bases for exclusion. If the tendency to grant fewer no-action letters to proposals predicted to receive more votes was induced by the rules, the Rule 14a-8 dummies should absorb the predicted-votes effect. Once the Rule 14a-8 controls are added, however, the coefficient on more predicted votes remains negative, large in magnitude, and statistically different from 0 (the rules strongly predict SEC decisions, as suggested in Table 1). It appears that the SEC's tendency to greenlight proposals that were popular with shareholders was discretionary, not baked into Rule 14a-8. Model 3 investigates robustness by including firm-specific fixed effects (retaining the Rule 14a-8 controls). The coefficients are similar in magnitude and statistical significance. Note that the negative coefficient on the partisan control variable shrinks in magnitude and statistical significance when these controls are added.

The models to this point, by including a simple dummy for partisan control of the commission, allow for Democrats and Republicans to differ in their overall propensity to grant no-action letters, which we do not see. It is possible, however, that they differ instead on the conditions under which they allow companies to remove proposals. For example, Democrats might for some reason favor requests from low-performing companies while Republicans favor high-performing companies. Models 4 and 5 in Table 8 allow the three performance-related variables to vary by partisan control of the commission. They include Rule 14a-8 controls, and model 5 includes firm fixed effects. The *p*-values are for the hypothesis that the effect of variables differs with partisan control of the commission.

The main conclusion from models 4 and 5 is that Democratic and Republican SECs appear to have used similar criteria to make decisions. The most pronounced pattern is for proposals with substantial voter appeal, which were more than 20 percent less likely to be struck down by both Democratic and Republican SECs. Firms' profitability and the sign of CCAR do not reliably predict the no-action-letter decision, regardless of which party controlled the commission. Comparing the two parties (bottom row), we find no statistically significant differences in the weighting of criteria appear. All of this suggests that discretionary decision criteria are being applied consistently even when partisan control of the commission changes.

To summarize, there does appear to have been some predictability in the SEC's decisions that was unrelated to Rule 14a-8: the commission was more likely to protect proposals that shareholders were likely to support. Whether this inclination to allow shareholders to have a say on issues with a real chance of passage stems from a desire to promote shareholder democracy, a desire to avoid angering the investment community, or something else cannot be determined from these estimates. Table 8 does not reveal much of a difference in behavior between Democratic and Republican control, which suggests that the no-action-letter process may be shielded from political influence to some degree.[40]

[40] We certainly do not want to take this too far. The rules change with political control of the commission. Our finding is only that, holding constant some aspects of the rules, we do not find that partisan factors predict decisions. We should also note that if the regressions are run separately by

These estimates should be viewed with some caution. The regressions are not convincingly causal. It is possible that our explanatory variables are correlated with unobserved factors that also drive the SEC's decision. It is possible that proponents and companies restrict the proposals they submit and challenge in response to the SEC's dispositions. Our results connecting decisions to the partisan composition of the commissioners depend on somewhat blunt annual classifications that do not vary much over time, starting Republican under President George W. Bush, becoming Democratic under President Barack Obama, and becoming Republican once again under President Donald Trump. We nevertheless believe it is useful to report these results because the findings are fairly robust (based on numerous alternative specifications that we do not report) and may suggest directions for future research.

11. Conclusion

This study uses the SEC's no-action-letter process to cast light on several aspects of the shareholder proposal process. We are particularly interested in how shareholder proposals affect firms' value and how the SEC's regulation of the process impacts corporate performance.

We estimate the effect of proposals on value on the basis of the observation that SEC no-action-letter decisions are not perfectly predictable and therefore provide new information to the market. The abnormal stock return associated with a decision can then be used to reveal how investors valued proposals. Over the period 2007–19, we find that the market's reaction to the omission of proposals was reliably positive on average, ranging from .26 percent in narrow event windows to 1.34 percent in longer windows, with .7 percent a plausible working number. It appears that investors expected these proposals to reduce value if they went to a vote. When managers sought to prevent votes on these proposals, they may have been acting as responsible agents of shareholders in many cases.

It is less clear why investors believed that omitting these proposals increased firms' value. Although some proposals would be harmful if implemented, why would it hurt to allow a vote on them? After all, rational shareholders should reject any value-reducing proposal, which would leave the firm no worse off. We conduct several tests in search of an answer; our findings are mainly suggestive and often statistically imprecise. It does not seem that the market was particularly worried that shareholders would approve value-destroying proposals because the abnormal return was higher for proposals predicted to fail than those predicted to pass. Rather, it seems that the market may have been concerned that dealing with frivolous proposals would distract and disrupt managers from other business, a common complaint of corporate lobbyists. We develop a model of the evolution of firms' value in the presence of distraction costs and find support for several of

party—allowing the coefficients on all control variables to vary by party—the coefficients on the predicted pass rate are statistically different with (but not without) fixed effects, which is to say that one can find partisan effects in some specifications but none that we feel are robust.

its implications. The market may also have been concerned that managers might negotiate with proponents to withdraw their proposals and make value-reducing concessions as part of a deal.[41]

Taken together, the evidence gives reason to believe that the market's assessment of a proposal is not based entirely on what would happen if it passed and was implemented but is also based on how resisting the proposal affects the performance of managers. Concerns about indirect costs of this nature are often raised by managers, regulators, and judges but seldom appear in empirical research, which tends to focus on passage and implementation. Our findings suggest that it may be useful for scholars to adopt a broader lens that also incorporates indirect consequences when thinking about proposals.

Our paper cannot provide an overall assessment of the shareholder proposal process; we doubt that our sample is representative of all proposals. The proposals in our sample were opposed by managers, who expended significant resources trying to prevent them from coming to a vote; proposals that management chose not to fight may well be different. Limited external validity is a characteristic feature of the literature on shareholder proposals; it has developed as an aggregation of narrowly focused studies. Our examination of proposals considered by the SEC fills an important gap in the literature, as approximately 40 percent of all proposals are omitted or withdrawn without going to a vote.

The discovery of a set of proposals that the market considered harmful complements the evidence in Cuñat, Gine, and Guadalupe (2012) that certain corporate governance proposals were value increasing in the eyes of investors. Taken together, these findings suggest that both reformers and critics of the process might have a point. Shareholders' proposals might have both a bright side and a dark side. If so, the challenge from a policy perspective would be to design rules and regulations that let in the good proposals and screen out the bad ones.

Thinking about policy design leads to the other central question of our analysis: how effective are the SEC's current regulations in protecting investors while shielding managers from disruptive proposals? The SEC plays an enormous role in determining what issues can be brought to a vote and the procedures for doing so. Among other things, its rules have effectively prevented shareholders from making binding proposals except on a small subset of issues. In terms of the SEC's no-action-letter process, we find that the codified conditions under which proposals are supposed to be permissible (Rule 14a-8) are strong predictors of the SEC's decisions. However, we also find that the SEC is much more likely (roughly 20 percent more likely) to allow omission of unpopular than popular proposals, holding constant other determinants of its decision. This suggests that the commission's decisions may depend on factors that go beyond the rules and that have the effect of removing frivolous issues from the proxy statement. To the extent that this protects managers from having to spend time on proposals with no

[41] Although we find it easiest to explain our findings in terms of distraction and disruption, we do not dismiss the possibility that uninformed shareholders might approve value-destroying proposals. Gantchev and Giannetti (forthcoming) provide an array of evidence related to this possibility.

chance of passage, it may be serving a valuable purpose. Here again we cannot offer an overall assessment of the SEC's impact on corporate performance, but we hope that providing some preliminary evidence will bring regulation more into the forefront of thinking about the shareholder proposal process.

Appendix A

The Data

A1. No-Action Letters

No-action-letter files pertaining to shareholder proposals are posted on the SEC's website for decisions beginning in October 2007.[42] The remaining no-action-letter files for 2007 were collected from LexisNexis.

The decision date is the date on the cover letter from the SEC to the company. If the decision was appealed, we did not consider the second decision.

Decisions were taken from the SEC's decision letter. Occasionally, the SEC grants a no-action letter but indicates a specific defect that the proponent may cure to make the proposal acceptable—such as formulating the proposal as precatory rather than mandatory. We classified these cases as the SEC having declined to issue a no-action letter since sponsors typically avail themselves of the opportunity to make the change. We also omitted a proposal if the company withdrew its request, if the SEC declined to issue an opinion, or if the proposal attempted to nominate a specific candidate for a director election (which is unambiguously not allowed).

The topic of each proposal was identified by reading the text supplied by the proponent and was assigned to one of three broad categories. Corporate governance includes proposals related to audits, board classification, board committees, board meetings, board structure, compensation committees, cumulative voting, director elections, director evaluation, director independence, director qualifications, independent board chairs, majority voting, proxy access, proxy voting, special meetings, shareholder meetings, succession policy, vote counting, and written consent. Compensation includes proposals related to executive compensation including claw backs, equity holding requirements, incentive pay, limits on pay, perks, say on pay, severance pay, and vesting. Social issues include proposals relating to animals, energy, the environment, foreign investments, health, human rights, and smoking. All other proposals were assigned to a residual "other" category. If a proposal touched on multiple topics, it was assigned to the latter category, unless all of the topics fit under one of the three broad categories.

Proponents were identified by reading the SEC letter, the company letter, and the proponent's documents and were assigned to six broad categories: non-SRI

[42] See U.S. Securities and Exchange Commission, Shareholder Proposal No-Action Responses Issued under Exchange Act Rule 14a-8 (https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8.shtml).

fund, SRI fund, individual, labor union, public pension, and religious. If the proponent was an individual usually associated with an organization, such as John Harrington, the president of Harrington Investments, we classified the sponsor as the organization. If a proposal was jointly sponsored by an organization and an individual, we designated the organization as the sponsor. If a proposal was sponsored by multiple organizations from more than one category, it was assigned to the residual category.

The SEC changed its procedures in November 2019 to rely primarily on verbal communication with the company. As a result, it will be much more difficult to collect this sort of information going forward.

A2. Other Information on Proposals

Information on voting outcomes and aggregate proposal counts come from the Factset SharkRepellent database. We hand matched our sample of proposals that were sent to the SEC with proposals in the Factset database on the basis of several criteria such as company name, year of the annual meeting, sponsor, and proposal topic during the period 2008–18. We do not use Factset for 2007 because it appears to be incomplete for that year. We obtained information on whether a proposal passed or not and votes in favor, defined as votes in favor/(votes in favor + votes against). We also used information on proponents and topics to match aggregate numbers to the categories in our sample. The voting outcome is not available for proposals sent to the SEC in 2018 and submitted for the annual meeting in 2019.

Appendix B

The Model

In each period, one of four things can happen: the SEC issues a no-action letter, the SEC declines to issue a no-action letter, the proposal is withdrawn, or nothing happens. The expected value can then be defined recursively:

$$E[V_t] = p_{\mathrm{D}}(Z + X\lambda^t) + p_{\mathrm{N}}(X\lambda^t) + p_{\mathrm{W}}(Y + X\lambda^t) + (1 - p_{\mathrm{D}} - p_{\mathrm{N}} - p_{\mathrm{W}})\delta E[V_{t+1}]. \quad \text{(A1)}$$

Equation (A1) can be expressed more compactly as

$$E[V_t] = A + (1 - B)X\lambda^t + B\delta E[V_{t+1}], \quad \text{(A2)}$$

where $A = p_{\mathrm{D}}Z + p_{\mathrm{W}}Y$ and $B = 1 - p_{\mathrm{D}} - p_{\mathrm{N}} - p_{\mathrm{W}}$. Repeatedly substituting V into equation (A2) gives

$$\begin{aligned} E[V_t] = {} & [1 + B\delta + (B\delta)^2 + (B\delta)^{T-1}]A \\ & + [1 + B\delta\lambda + (B\delta\lambda)^2 + \ldots + (B\delta\lambda)^{T-1}](1 - B)X\lambda^t + B^T\delta^T E[V_T]. \end{aligned}$$

If we assume a finite terminal value, the limit as $T \to \infty$ is

$$E[V_t] = \frac{A}{1 - B\delta} + \frac{(1 - B)}{1 - B\delta\lambda}X\lambda^t. \quad \text{(A3)}$$

The event return from an outcome Ω is $[V_t(\Omega) - E[V_t]]/E[V_t]$.

B1. Proof of Proposition 1

i) To show that the return from the SEC not making a decision in any period is negative if and only if $\lambda < 1$, note that $E[V_t]$ is decreasing in t from equation (A3). Then $\delta E[V_{t+1}] - E[V_t] < 0$.

ii) To show that the expected return from an SEC decision {N, D, W} is positive, note that the expected decision return has the same sign as $[p_D(Z + X\lambda^t) + p_N(X\lambda^t) + p_W(Y + X\lambda^t)]/(p_D + p_N + p_W) - E[V_t]$. This must be positive since $\delta E[V_{t+1}] < E[V_t]$, as shown in part i.

iii) The implication that value declines in t follows from equation (A3).

B2. Proof That the Return on the Company Request Date Can Be Positive or Negative

Suppose that the market is not aware of the proposal prior to the company's request. Note that the sign of the CCAR is the same as the sign of $E[V_0] - X = A/(1 - B\delta) + B(\delta\lambda - 1)X/(1 - B\delta\lambda)$. The first term can be positive or negative because the sign of A depends on the value of the proposal and the value of a withdrawal. The second term is negative because $\delta\lambda < 1$.

Suppose instead that the market is aware of the proposal prior to the company's request. We need to introduce additional terms: let q be the probability that the company will make a no-action request, and if the company does not make a no-action request, let $\hat{p}_W$ be the probability it negotiates a withdrawal and $\hat{Y}$ be the value consequence of a negotiated withdrawal. If we ignore distraction costs ($p_D + p_N + p_W \approx 1$), the value of the firm if it makes a request is

$$E[V_0] = p_D(Z + X) + p_N X + p_W(Y + X),$$

and the prerequest value is

$$E[V_{-1}] = (1 - q)[(1 - \hat{p}_W)(Z + X) + \hat{p}_W(\hat{Y} + X)] + qE[V_0].$$

The CCAR is $(E[V_0] - E[V_{-1}])/E[V_{-1}]$, which has the same sign as $[p_D - (1 - \hat{p}_W)]Z + p_W Y - \hat{p}_W \hat{Y}$. This cannot be signed without knowing the signs and magnitudes of Z, Y, and $\hat{Y}$ and how the probabilities change for a withdrawal (p_W, $\hat{p}_W$) and a proposal going to a vote $[p_D - (1 - \hat{p}_W)]$. Also note that it follows from the definitions of the abnormal returns that CCAR can be positive, negative, or 0 even if CAR is positive.

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